A WORLD BANK STUDY

Ill-gotten Money and the Economy

EXPERIENCES FROM MALAWI AND NAMIBIA

Stuart Yikona, Brigitte Slot, Michael Geller,
Bjarne Hansen, Fatima el Kadiri

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Foreword

This study is a bold attempt to quantify the economic magnitude of ill-gotten money generated by different kinds of criminal, illegal, and unethical activities. It is also a timely contribution to the financial sector literature on financial integrity. With the ever growing concerns about ill-gotten money in the world today, work that strengthens our views on the effects of these criminal activities on the integrity and functioning of financial systems, good governance, financial stability, and economic development is especially relevant. The World Bank contribution to this debate is also to bring to bear the economic perspective, in addition to the developmental one. The *2011 World Development Report* on conflict, security, and development provides us with a critical framework to think through the link between organized crime and development, with an economic lens.

While similar studies have been conducted in advanced economies like Australia, the Netherlands, and the United States, none has been done for developing economies. This study on Malawi and Namibia affords us a unique insight into the challenges that developing countries face as they attempt to address this economic menace of ill-gotten money that is generated by different kinds of criminal, illegal, and unethical activities. The importance of addressing these challenges cannot be overemphasized. An enabling domestic environment is necessary for sustainable financial and private sector growth and overall economic development that contributes to lifting people out of poverty. Efficient, effective, and proportionate laws, regulations, and rules, and a government's capacity to enforce such legal instruments in an equitable and transparent manner, are all key ingredients for such an environment. Only with these ingredients in place can we collectively begin to effectively deter or thwart the effects of ill-gotten money in our economies.

This study challenges us to think differently about criminal activities in our economies.

First, it demonstrates that it is possible to measure the magnitude of activities that generate ill-gotten money and in doing so be able to estimate the impact on economic development. It does so through a methodological framework that is simple, flexible, and adaptable to low-income and middle-income countries alike.

Second, the findings encourage practitioners and policy makers to think the unthinkable—that is, that there are some illicit activities that have no macro relevance to the economy. As such, it may not be economically optimal to spend already scarce resources on combating these activities. The opposite is equally true, namely, the money spent on fighting corruption and tax evasion can only have a positive impact, and is economically relevant.

Finally, the study confirms that there are many tools available to the authorities to enable them to trace ill-gotten money. One such tool is the anti-money laundering system that many countries around the world are strengthening. Programs on anti-money laundering are essential elements of the World Bank's development mandate in the financial sector. They relate to, and reinforce, the Bank's complementary work on governance and legal framework issues. A better understanding of the orders of magnitude and how ill-gotten money affects economic development and poverty reduction is also

essential to tailor, prioritize, target, and allocate scarce resources where they really make a difference.

Above all, this study reaffirms our belief that criminal, illegal, and unethical activities can and do have an impact on economic development. Having an appreciation of this fact—as established in this study—will make a difference in helping governments optimize the use of resources in a manner that contributes to the reduction of poverty.

Admittedly, a study of this nature cannot be definitive. Criminals do not respond to surveys. But it can serve as a reference for a policy debate on not only the effects of illicit proceeds generating activities on an economy, but also on the appropriate remedies. It is a debate that the World Bank welcomes, and one that we personally look forward to.

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The stellar work of our editor, Diane Stamm, is greatly appreciated.

We would also like to thank Sanjay Seth for the cover design.

The findings, interpretations, and conclusions expressed in this report are entirely those of the authors. They do not necessarily reflect the views of the World Bank, its Executive Directors, or the governments they represent.

Stuart Makanka Yikona
Task Team Leader
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Acronyms and Abbreviations

ABSA	South African Bank
ACB	Anti-Corruption Bureau
ACC	Anti-Corruption Commission
AgriBank	Agricultural Bank of Namibia
AML	anti-money-laundering
AMLAC	Anti-Money Laundering Advisory Council
BAT	British American Tobacco
BEE	Black Economic Empowerment
BoN	Bank of Namibia
CFT	Combating the Financing of Terrorism
DBN	Development Bank of Namibia
EU	European Union
FATF	Financial Action Task Force
FBI	Federal Bureau of Investigation (United States)
FIA	Financial Intelligence Act, 2007 (Namibia)
FIC	Financial Intelligence Centre (Namibia)
FIU	Financial Intelligence Unit
Forex	Foreign exchange
GDP	gross domestic product
GIPF	Government Institutions Pension Fund
IFMIS	Integrated Financial Management Information System
ISS	Institute for Security Studies
LCC	Low Capacity Countries
MEJN	Malawi Economic Justice Network
MWK	Malawi Kwacha
NAD	Namibian dollar
Namfisa	Namibia Financial Institutions Supervisory Authority
NamPost	Namibia Post Office Savings Bank
NGO	nongovernmental organization
NHAG	Namibia Housing Action Group
NLF	Namibia Liquid Fuel
NLFS	Namibia Labor Force Survey
OC	organized crime
ODC	Offshore Development Company
OECD	Organisation for Economic Co-operation and Development
SARPCCO	Southern African Police Chiefs Cooperation Organization

SSC	Social Security Commission
STR	suspicious transaction report
SWAPO	South West Africa People's Organization
UDF	United Democratic Front
UNODC	United Nations Office on Drugs and Crime

Currency Equivalents
(Exchange Rate Effective as of March 3, 2011)

Malawi Kwacha	Currency Unit	Nambian Dollar
MK 150.84	US$1.00	N$6.96

Weights and Measures: Metric System

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Executive Summary

Over the last 20 years, the international community has significantly stepped up its efforts to prevent, detect, and deter money flows related to criminal activities and terrorism financing. Since the early 2000s, this drive has extended to developing countries, with most of them introducing anti-money laundering (AML) policies.

The primary driver behind this is law enforcement; these policies are aimed at detecting and tracing flows of ill-gotten money, which would enable authorities to fight and prevent crime and recover assets of crime, corruption, and tax evasion.

Insufficient attention has been paid to the economic side of ill-gotten money and the efforts to combat such flows, particularly in developing countries. Why is it critical for them, and what is the case for combating the flows of ill-gotten money in countries severely constrained by a lack of resources and limited technical capacity to implement a full AML-framework? Moreover, why are ill-gotten proceeds relevant to the issue of economic development? What is the magnitude of the ill-gotten money flows from activities that generate such flows? Added to this are concerns that anti-money laundering policies may at times actually jeopardize certain development objectives, such as access to finance for poor people.

The core objective of this study is to introduce economics into the international debate about anti-money laundering, and to introduce the idea of the usefulness and effectiveness of such policies. We also hope that we might be able to bridge the gap between the law enforcement and economist communities. Indeed, the *2011 World Development Report* (WDR) on conflict, security, and development provides us with a critical framework to think through the link between organized crime and development from an economic perspective.

The study focuses on two developing countries: Malawi, a low-income country, and Namibia, a middle-income country. The central questions asked are:

- Why are "proceeds of crime" relevant for economic development?
- Do "proceeds of crime" and related policy responses help or harm economic development?

One critical step in such analysis is to obtain a better understanding of the magnitude of the domestic or cross-border sources of ill-gotten money in a country: how it is recycled through the economy and across its borders or spent and invested. Only then is it possible to discuss the economic effects of the circulation and allocation of ill-gotten money in developing countries and the economic impact of the underlying activities. While not intended to be exhaustive or definitive, this study is meant to contribute to a better understanding and quantification of the issues relevant to the proceeds of crime and economic development.

For practical and operational purposes, and to be grounded in country specifics, this study only focuses on Malawi and Namibia. However, it is hoped that the approach developed in this study will be useful to other developing-country governments in identifying the main sources and magnitude of the flows of ill-gotten money, and the main recycling patterns and their effects on the economy. Such a framework will help govern-

ments in developing countries to systematically analyze the potential impact of AML and design and prioritize AML policies.

The findings presented in this study are based on an extensive literature research; World Bank discussions with numerous public- and private-sector officials and representatives of the Governments of Malawi and Namibia during a Bank mission in November 2010; and workshops conducted in both countries in February 2011 to obtain feedback on the preliminary findings. In conducting this study, the team adopted an interactive approach. This was critical because mobilization of local expertise is essential not only in establishing a complete picture of current and future AML challenges, but also in designing policy considerations that subsequently are widely supported.

The literature reveals consensus on the negative impact of crime on economic development and poverty.[1] The United Nations Office on Drugs and Crime (UNODC), for example, conducted a study on crime and development in Africa. The study states that crime should "be prominent in the minds of development planners, and crime prevention thinking should influence all aspects of development projects" (UNODC 2005, xvi). This is consistent with the argument made in the 2011 WDR, cited above.

When considering the full economic effects of crime and its proceeds, a clear distinction must be made between the economic effects of:

- The underlying criminal and illegal activities themselves
- The effects of the circulation and recycling of ill-gotten money.

Corruption is a telling example of how criminal activities can have potentially tremendous negative effects on economic development. Corruption brings about a diversion ("leakages") of financial resources from the national budget to private spending purposes, and even more so in the case of the embezzlement of state funds. In general, these private expenses or expenditures have much lower "multiplier effects" than expenditures on, for example, agricultural fertilizers, education, health, and infrastructure.[2] Wealth and money that are derived from crime (including corruption) will mostly be spent on direct consumption (small volumes) or invested in valuable assets (in the case of large volumes) such as art, gold and diamonds, luxury vehicles, and real estate. This is the case in developing countries, as our study reveals. The impact of one dollar invested in, for example, an imported luxury vehicle, on output, income, or employment will in the long run be smaller than the impact of the same amount spent on, for example, education.

Specific effects of the circulation of ill-gotten money

One of the basic premises behind the global AML framework is that the abuse of the financial system for money-laundering purposes ("making dirty money white") is harmful to the financial sector, its reputation, and the people's confidence in it. A reputation for integrity is the one of the most valuable assets of a financial institution and of the financial sector as a whole.[3] Consequently, money laundering is harmful to the welfare of entire economies, since trust in financial institutions is generally seen as a basic requirement for long-term economic growth.

Bartlett (2002) argues that this is especially relevant for developing countries, which have immature or developing financial systems and a reputation of being highly corrupt. Strong developing-country financial institutions are critical to economic growth.

Bartlett emphasizes that trust in the financial sector is not only a domestic necessity but that it is also essential to attracting foreign capital and investments. However, there is no empirical proof of these assumptions. Further research is needed on this issue.

Financial inclusion and combating financial crime

An often mentioned negative effect of AML policy is that it limits financial inclusion by creating significant barriers to the financial sector for some people. Our study finds, however, that AML is generally perceived as not having a negative impact on financial inclusion strategies. Banking sector inefficiencies, high costs, negative real interest rates, and lack of confidence or trust are considered major barriers to an increased role of the financial sector in the day-to-day economic relations of individuals and business firms in Malawi and Namibia. With respect to lack of trust, it is the perception (justified or not) that the banks are not there to meet their client's needs but are self-serving, and there is also fear of bank failure and the loss of one's hard-earned savings.

But money laundering is about more than the financial sector; it is also about the recycling of ill-gotten gains into the real economy (which is not always intermediated by the financial sector, in particular in cash-based and informal economies). A significant majority of all transactions are in cash; at one point or another, lawyers, real estate agents, and car dealers will have dealings with individuals and businesses that want to spend their ill-gotten money. For that reason, the authorities should consider focusing most of their attention on ensuring that these gatekeepers undertake appropriate due diligence when engaging in large transactions. Heretofore, most attention has been paid to the financial sector (primarily banks), but as observed in this study, in Malawi and Namibia, most financial activities take place outside the formal financial system.

An analysis of the full economic impact of illegitimate activities and the circulation of ill-gotten money cannot be done without assessing its magnitude vis-à-vis the overall economy or specific segments within the economy, such as regions, economic sectors, and populations. This is a major challenge in developed countries, but it is an even greater challenge in developing countries, where reliable data on crime and flows of ill-gotten money are even more difficult to find.

The magnitude of flows of ill-gotten money is usually considered as unknown and impossible to estimate. Our fieldwork in Malawi and Namibia confirms the difficulty of gathering definitive quantitative data. More important, however, it shows that it is possible to reach reasonable conclusions on orders of magnitude—that is, a range of amounts—which can be a critical contribution to policy making.

Malawi has implemented an AML framework in recent years. The main sources of ill-gotten money there are corruption and tax evasion (including trade mispricing). Other prevalent forms of crime for profit in Malawi are smuggling of (counterfeit) goods, the production and export of cannabis, organized motor vehicle theft, violent housebreakings, human trafficking, and labor exploitation.

According to our estimates, income derived from corruption amounts to about 5 percent of GDP in Malawi. We show that one-fourth of the government budget is used for wages and salaries, interest payments, and net lending. Consequently, if 20 percent of the remaining government expenditures (goods and services, subsidies, transfers, development expenditures) are reallocated by corrupt practices, then 5 percent of GDP is involved in corruption (see table A.1 in appendix A). Tax evasion is about 8 to 12 percent

of GDP. We estimate that the tax gap is about one-third of the Malawi government budget or 12 percent of GDP (see table A.1 in appendix A). An alternative estimate could be based on the estimated size of the informal economy. Based on the Cobham approach (see table B3.1 in box 3.5), the Malawi domestic tax gap is about 9 percent of GDP. However, these estimates should be treated with caution.[4]

The authorities have, in a focused and concerted manner, used financial intelligence to go after tax evaders. The Malawi Revenue Authority has recovered millions of Kwacha by using the AML tools available to it.

Namibia began implementing its AML system in May 2009. Crime and public corruption, and their effect on the economy, are a concern. Illicit diamond dealing is one of the oldest organized crimes in Namibia, followed by drug trafficking and car smuggling. Based on data on reported cases by the police or in the press, it can be concluded that, in terms of financial magnitude, government corruption is a larger problem than other forms of organized crime and fraud.

Tax evasion and tax avoidance are generally considered a critical problem for domestic resource mobilization in developing countries. Namibia is no exception. Forms of tax evasion prevalent in Namibia include evasion of value-added taxes (VATs), evasion of customs duties (smuggling and trade mispricing), forms of corporate income tax evasion, such as the misuse of the special zero-percent VAT rate, tax evasion related to the gambling industry, and tax evasion by nonprofit organizations. The problem is exacerbated by a general lack of awareness of tax obligations by sole proprietors and small- to medium-size business owners.

Tax evasion—at an estimated 9 percent of GDP—is by far the largest source of ill-gotten money in Namibia and is clearly a challenge for the authorities. Namibia is also an example of how the AML regime and tools are already being used to go after tax crime; the largest referrals of intelligence reports from the Namibian Financial Intelligence Unit are to the Inland Revenue authority.[5] It is evident, therefore, that the AML system is a useful instrument in tackling the tax evasion problem.

One key finding in both countries is that the majority of the proceeds of crime or corruption will be spent on daily consumption (family expenses). If and when daily needs are met, money from crime and corruption is spent on luxury and lifestyle items. As a Malawi official said in relation to medium-level government corruption in the country: "It is spent on posh cars and first class beautiful houses."

The findings in Malawi and Namibia cannot be generalized. However, the methodology and approach developed in this study could be used in other countries and could prove useful to check whether, as assumed, corruption is the second-largest source of ill-gotten money (after tax evasion) in many developing countries.

Conducting similar studies in other developing countries will be a next step in testing the existence of such patterns and effects of the circulation of ill-gotten money in developing economies. In conducting these studies, special attention should be given to:

- Development of data and information management
- Flows of ill-gotten money in a cash-based economy
- Corruption typologies (spending and investment patterns)
- Cross-border transfers of ill-gotten money
- In-depth analysis of money laundering cases (proven or under investigation).

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Notes

1. For an overview of the literature on the direct and indirect economic costs of crime, see, for example, Brand and Price 2000; Cohen 2005; Mayhew 2003; and Shapiro 1999.
2. In economics parlance, the "multiplier effect" refers to the exchange of money and its circulation within the economy. The multiplier operates on the principle that one individual's expenditure is another individual's income.
3. "Money Laundering FAQ"; www.fatf-gafi.org.
4. The corruption survey by the Centre for Social Research revealed that a mean estimate of 9 percent of the procurement contracts involve some kind of gratification, while the mean estimate of the contract value that must be offered in gratification in order to secure contracts is 7 percent. Firms seeking to do business with the state sector must pay an average gratification of 14 percent (Centre for Social Research, University of Malawi 2010, 43–4).
5. A total of 37 tax-related referrals.

CHAPTER 1

Introduction

Most developing countries have introduced anti-money laundering (AML) policies over the past five to 10 years. These policies are primarily aimed at tracing criminal money flows, which would enable authorities to fight and prevent crime and recover assets of ill-gotten money. However, developing countries are severely constrained by a lack of resources and limited technical capacity to implement a full AML framework. There are also concerns that AML will jeopardize development objectives such as the access to finance for poor people.

The central question of this study is whether and how AML polices contribute to economic development and poverty reduction. In this study, we provide an initial answer to this question by focusing on two developing countries: Malawi, a low-income country, and Namibia, a middle-income country.

Before discussing the research objectives of the study, the motivation for focusing on Malawi and Namibia, and the methodological background, three basic issues must be addressed:

- What is money laundering?
- What is AML?
- What are the specific challenges for developing countries in pursuing AML policies?

Concepts of Money Laundering

Money laundering is an elusive concept although it is widely used in both common vocabulary and economic analysis. Figure 1.1 provides an overview of the various definitions of money laundering that are often used interchangeably. The narrowest and most colloquial use of the term is what we call the "bags-full-of-cash" definition. Most international organizations have adopted a broader definition of money laundering, which

Figure 1.1. Concepts of Money Laundering

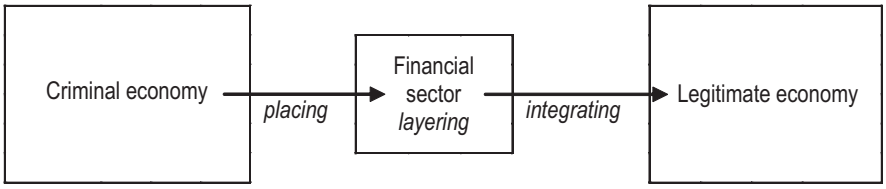
Narrow		
↓	Bags-full-of-cash definition	Turning illicit cash into a licit bank account[a]
	Concealment definition	Obscuring or concealing the link with crime[b]
	Legal definition	Use or possession of illegally obtained money[c]
Broad		

Sources: a. Colloquial use. b. FATF. b. World Bank. b. IMF. c. Palermo Convention.

we will call the "concealment definition." Official legal definitions are often even broader and include even the possession of illegally acquired money as "money laundering." All three definitions are difficult to use from an economic standpoint.

According to the colloquial "bags-full-of-cash definition," money laundering basically is the act of turning illicit cash into a licit bank account in the name of a legal or natural person. Many descriptions of the process of money laundering still reflect this narrow definition of money laundering.[1] Money laundering is also often described as a three-stage process of "placing" (introducing illegal profits into the financial system), "layering" (engaging in a series of conversions and movements to distance the funds from the source), and "integrating" (reentering the funds in the legitimate economy). In its most basic definition, money laundering can be represented by a simple throughput model, consisting of a transfer of cash from the criminal economy, through the banking sector, into the legitimate economy (figure 1.2).

Figure 1.2. Basic Representation of Money Laundering



Source: Author's formulation.

However, in most definitions that are officially used by international organizations, money laundering will not only happen *through* the financial system but with money that is already *within* the financial system. The International Monetary Fund (IMF) and the World Bank define money laundering as "the process in which assets obtained or generated by criminal activity, are moved or concealed to obscure their link with crime." The FATF has described money laundering as "the processing of criminal proceeds to disguise their illegal origin" in order to "legitimatize" the ill-gotten gains of crime.

The two central notions in these definitions are that (a) the money is derived from crime, and (b) there is concealment of the criminal source.

Money laundering does not have to involve cash (and very often does not), which is especially relevant for most forms of fraud, tax evasion, and corruption. In addition, money laundering can also involve sophisticated activities such as blending illegal with legal businesses, creating legal facades, or externalizing proceeds of crime to foreign tax havens in "no questions asked" banking systems.

Legal definitions of money laundering that many jurisdictions have adopted are even wider. Most countries subscribe to the definition adopted by the United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (1988) (the Vienna Convention) and the United Nations Convention Against Transnational Organized Crime (2000) (the Palermo Convention). According to this definition, even the *possession*, and *all use*, of illegally obtained money is labeled as money laundering, regardless of whether people are trying to hide the source.[2] Having illegally obtained money in a bank safe or hidden it under a mattress is also money laundering, including using it for consumption or other spending purposes.

"Economification" of Money Laundering

To conduct an economic analysis of "proceeds of crime," these various definitions must be translated into economically relevant acts.

The first two definitions are too narrow, since not all illegally obtained money has to flow through the financial system in order to be spent in the legitimate economy. Illegally obtained cash can be used to purchase goods and services directly. Even the acquisition of real estate and business investments might be done in cash—depending on the payment habits that are in place in individual jurisdictions or among specific ethnic or cultural populations. For small amounts of money, hiding the illegitimate source is not necessary. The direct expenses of illegally obtained money in the legitimate economy might be small on an individual basis, but can be substantial on a macroeconomic scale.

The legal definition of money laundering is too broad, however, from an economic perspective. If even the possession of money from an illegitimate source is called "money laundering," then money laundering is no longer an *act* but simply a *label* for money that is of illicit origin. By definition, there is no "unlaundered money" derived from crime. In addition, the legal definition includes both *assets* ("possession of…") and *transfers* ("use of…") of illegally obtained money.

However, to understand what happens in the economy and how money laundering affects economic development, assets (such as cash hoarding, savings in a bank account, or investments in the legitimate economy) must be separated from transfers (transfers within the national economy and across borders).

For the purpose of this study, and given its economic angle and the confusion behind money laundering in this context, we will avoid the term "money laundering" as much as possible. If we use it, we will refer to the broad definition (legal definition) unless explicitly stated otherwise.

We will "economify" the legal concept of money laundering as much as possible into "assets of ill-gotten money" and "transfers of ill-gotten money" (table 1.3). This distinction between assets and transfers is relevant from an economic and an AML point of view, as we will explain later.

Table 1.1. Economic Definitions of Money Laundering

Legal definition	Economic definition	Patterns
"Use of…"	Transfers of ill-gotten money (flows)	Transfers in the legitimate, informal, or criminal economy, and cross-border transfers
"Possession of…"	Assets of ill-gotten money (stocks)	Cash, bank accounts, portfolio investments, real estate, cars, other possessions, business investments, and so forth

Source: Author's formulation.

We introduce in this report the term "ill-gotten money" to avoid misunderstanding about the sources. In our definition, "ill-gotten money" includes the proceeds of crime, fraud and corruption, and tax evasion—even when not criminalized in a given jurisdiction. Crime covers all activities that are defined by law as "criminal." This can differ to some degree from jurisdiction to jurisdiction and might change over time.

From an AML point of view, so-called "crimes for profit" are most relevant. This encompasses property crimes (stealing money), operating illegal markets, and so-called "economic crimes." The last category includes fraud, corruption, and (most forms of) tax evasion. In some cases, tax evasion is not criminal but merely illegal. Illegal activities

are against the law but not defined as a crime under criminal law. Box 1.1 provides an overview of the terms as we will use them in this report.

Box 1.1. Terminology

Ill-gotten money: Money derived (illegally acquired) from crime and tax evasion.

Crime: All activities that are defined by law as "criminal." This includes corruption and fraud.

Crime for profit: Crimes that are perpetuated for the purpose of obtaining financial gain.

Illegal activities: Activities that are against the law but generally not considered as "crime."

Money laundering: Any use, including the mere possession, of illegally acquired assets (legal definition).

Source: Author's formulation.

What is AML?

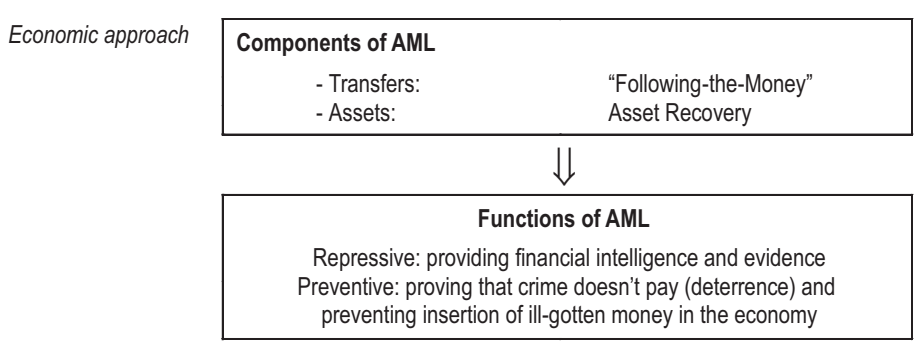
Most countries have adopted anti-money laundering (AML) legislation based on the 40 + 9 recommendations of the Financial Action Task Force (FATF)—the world's leading anti-money laundering body. These recommendations provide an extensive and detailed list of measures that countries should have in place to combat money laundering and terrorist financing. According to the FATF recommendations, countries must criminalize "money laundering," establish a Financial Intelligence Unit (FIU), and have the widest possible range of tools and procedures that enable law enforcement agencies to follow the money trail and recover assets of illegitimate activities on one hand, and preventive measures in a given set of financial activities and other professions on the other hand.

The FATF uses 20 predicate offenses to "money laundering." Because of the standards that have been created, it is widely assumed that "AML = FATF 40 + 9 recommendations."

AML is about following the trail of ill-gotten money and ultimately recovering assets derived from illegitimate activities.

Both components of AML (see figure 1.3) serve two purposes:

Figure 1.3. What is AML?



Source: Author's formulation.

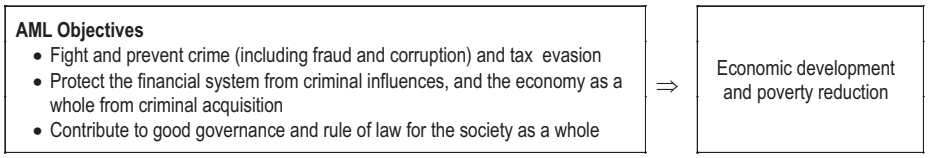
- *A repressive purpose.* AML should provide financial intelligence and evidence that can be used by institutions such as the police, anticorruption bureaus, and tax authorities.
- *A preventive purpose.* If authorities are able to track and trace ill-gotten money and recover assets derived from illegitimate activities, this will act as a deterrent for crime-for-profit and other illegal activities, since criminals won't be able to enjoy the fruits of their activities.

AML and Economic Development

Why is AML relevant for economic development? To answer this central question we must consider the three primary goals of the global AML regime (figure 1.4). These are to:

- Serve as an additional tool in fighting and preventing crime and tax evasion[3]
- Protect the financial system from criminal influences,[4] and more generally the insertion of "tainted" money into the economy as a whole
- Contribute to good governance and promote the rule of law for the society as whole.[5]

Figure 1.4. AML and Economic Development



Source: Author's formulation.

With respect to the first goal, it is generally acknowledged that crime, corruption, and tax evasion are harmful to economic development. For example, corruption brings about diversion of financial resources from the national budget to private spending purposes. Financial transaction records are a useful instrument in discovering criminal activities, and identifying criminals or criminal organizations, and are an essential ingredient in taking the ill-gotten money back from the offender(s).

One of the basic assumptions of the global AML framework is that money laundering threatens the integrity of the financial system.[6] Protection of the financial system from criminal influences, the second goal, ensures that there is confidence in the financial system. More generally, it also aims at preventing key sectors of the economy from being controlled by criminals. This is especially important for developing countries that are seeking to make the financial sector (and other strategic economic sectors) one of the main drivers of economic development. The first two issues will be discussed further in chapter 2.

Finally, contribution to good governance and rule of law is beneficial for society as a whole because it promotes security and a culture of compliance, enhances transparency, and fosters international cooperation. These long-term goals of AML are preconditions to sustainable economic development and poverty reduction. Obviously, like any policy initiative, the AML system must be properly designed and effectively implemented.

In this context, as we will see later in this report, developing countries face the following specific challenges that can potentially impact the effectiveness of some of the standard AML tools:

- A widespread use of cash
- A large informal sector
- Low capacity (financial resources, AML skills, and legal institutions), with significant and critical tradeoffs to address.

Consequently, the AML system must take these challenges into consideration. We will discuss these issues extensively in the following chapters and propose some ways in which developing countries can adapt some of the AML measures to specific circumstances.

It has been argued, however, that AML is harmful to economic development. There are three main areas of concern.

First, implementation of AML measures generates costs for both the government and the private sector. From the government side, major costs involve creating an FIU, training AML stakeholders, and recruitment of AML specialists. For the private sector, it involves compliance costs for the financial sector (setting up compliance departments, setting up IT systems, training of all staff), and other reporting entities. As such, there is an "opportunity cost" for spending scarce government resources on AML. The money spent on AML cannot be spent on other pressing development objectives such as agriculture, education, health, and infrastructure, and so forth.

Second, AML impedes access to financial services by low-income people. The concern is that AML measures may conflict or make less effective policies that are aimed at promoting greater access to finance in developing countries.[7] Identification requirements can discourage poor or undocumented people from making use of the formal financial system. The costs to banks of compliance with AML requirements might increase the prices of financial products and services, including those targeting poor people.

Third, it is even argued that countries with strict AML regulations will be punished by a negative "externality effect," that is, the inability to attract foreign capital, including money of illicit origin. From this perspective, nonadoption of AML could be economically beneficial in attracting foreign capital. Bagella, Becchetti, and Lo Cicero (2004) provided in this context an econometric analysis of the impact of AML policies in five Andean countries (Bolivia, Colombia, Ecuador, Peru, and Venezuela) on neighboring countries. The authors stressed the need for a cooperative approach in order to reduce negative externality effects of isolated AML efforts.

Research Objectives

How valid are the above-mentioned concerns? Does AML help or harm economic development? What are the main sources of ill-gotten money in developing countries? How is ill-gotten money recycled through the economy and across its borders? How is ill-gotten money spent? Where is it invested? And what are the economic effects of the circulation and allocation of ill-gotten money in developing countries? This report explores these questions.

What this Study Does

- The central question of this study is: Does AML contribute to economic development? This report, while not intended to be exhaustive or definitive, is meant to contribute to a better understanding and quantification of the issues that are relevant to AML and economic development.
- The second objective of this study is to develop a framework that enables governments in developing countries to systematically analyze the main sources of ill-gotten money, the magnitude of the flows of ill-gotten money, and the main recycling patterns and its effects on the economy. Such a framework will help governments in developing countries to systematically analyze the potential impact of AML and design and prioritize AML policies. This is also about making a domestic case for AML policies for developing countries.

As mentioned, the study focuses on two sub-Saharan African countries, Malawi and Namibia. We believe that the findings in these two countries can be used as a starting point for developing a methodology that is applicable to other developing countries.

Why Malawi and Namibia?

First, both countries, over the last few years, have made considerable progress in introducing and implementing their AML framework. Second, the countries differ considerably in their level of economic development; Malawi is a very poor low-income country, whereas Namibia is an upper-middle-income country. Corruption is a major problem in both countries, however, as it is in many developing countries. But neither Malawi nor Namibia is (yet) affected by a large organized crime problem, although crime is on the increase, as it is in the entire Southern African region. According to the South-African-based Institute for Security Studies (ISS), "it is widely accepted that organized crime has expanded significantly, even though the actual extent and impact of organized crime in the Southern Africa sub-region and across Africa as a whole has not yet been documented" (Hübschle 2009).

In this study, a crime-specific approach is chosen, because different crimes have different economic effects, affecting different segments of the population, and channeling the proceeds differently through the economy. For example, some crimes are merely cash based (such as the trade in illicit drugs) whereas others are mainly bank based (such as various forms of fraud) or a combination of the two (which can be the case with some forms of corruption).

To be able to answer the two central questions, four sub-questions were formulated:

- **Sources:** What are the main sources of ill-gotten money in Malawi and Namibia?
- **Magnitude:** What is the estimated magnitude of flows of ill-gotten money vis-à-vis the overall economy?
- **Recycling patterns:** What are the main recycling patterns of the ill-gotten money?
- **Economic effects:** How do the underlying criminal and illegal activities and the recycling patterns affect the economy?

We will explain the methodology of this study in more detail in chapter 2.

What this Study Does Not Do

The study does not analyze the *effectiveness* of AML policies. That is a major topic that needs to be studied separately.

Having established their AML frameworks in the last five to 10 years, it is now an opportune time for developing countries to review what has been achieved, what has not worked, and what needs to be changed. Even advanced economies with mature AML systems have barely begun to explore this issue.

The FATF started a discussion on effectiveness in 2009. The European Commission funded in 2010 a long-term research project on the effectiveness of AML in its 27 member countries. The study is being carried out by Unger (2010). While we believe that addressing the specific effectiveness challenges in developing countries is critical—and we hope this study will contribute to that work—it does not address "effectiveness" issues as such.

Research Approach

The findings of this report are based on an extensive literature research; World Bank discussions with numerous public- and private-sector officials and representatives of the Governments of Malawi and Namibia during a Bank mission in November 2010; and workshops conducted in both countries in February 2011 to obtain feedback on the preliminary findings.

In conducting this study, the project team adopted an interactive rather than an interrogative approach. This was critical because mobilization of local expertise is essential not only in establishing a full picture of current and future AML-challenges, but also in designing policy considerations that subsequently are widely supported.

Limited data on crime is a common problem in many developing countries. During numerous discussions with interviewees in Malawi and Namibia, an initial common recurring response was that the magnitude of flows of ill-gotten money was unknown and impossible to estimate. In response to these challenges, we were compelled—in collaboration with our partners in Malawi and Namibia—to collect as much data and as many facts as possible, and to gather anecdotal evidence and perceptions of experts.

Our approach turned out to be an invitation to policy makers and experts in both countries to be open and to come forward with facts, figures, cases, perceptions, and opinions—even if these turn out to be provocative. As will be explained in chapters 3 and 4, the analysis indicates that the magnitudes of the proceeds generated from some forms of crime for profit are macro-relevant (meaning that they are of significant importance as a percentage of GDP) and need to be addressed from the perspective of economic development and poverty reduction.

Outline of the Report

Chapter 2 presents the methodological framework of the study. It explores the economic debate on money laundering and its economic effects and magnitude, explains the approach used in the report to analyze the economic effects of money laundering, and offers a detailed rationale for focusing on Malawi and Namibia. Chapters 3 and 4 present the findings of the study in Malawi and Namibia. Chapter 5 offers conclusions and recommendations for AML policy makers in Malawi and Namibia and in developing countries in general.

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Notes

1. See, for example, FATF, "Money Laundering FAQ"; http://www.fincen.gov/news_room/rp/files/fatf.pdf.
2. Most countries subscribe to the definition adopted by the Vienna and Palermo Conventions, which is (a) the conversion or transfer of property, knowing that such property is derived from any [drug-trafficking] offense or offenses or from an act of participation in such offense or offenses, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such an offense or offenses to evade the legal consequences of his actions; (b) the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from an offense or offenses or from an act of participation in such an offense or offenses; and (c) the acquisition, possession or use of property, knowing at the time of receipt that such property was derived from an offense or offenses or from an act of participation in such offense or offenses.
3. http://www.fatf-gafi.org/document/29/0,3746,en_32250379_32235720_33659613_1_1_1_1,00.html.
4. Reuter and Truman (2004, 129–38).
5. Chaikin and Sharman (2009); see also, Jayasuriya (2009).
6. Reuter and Truman (2004).
7. For an overview of this discussion see Genesis (2008).

CHAPTER 2

Methodological Framework

"Money laundering" is an emerging niche within the academic field of economics. The creation of the FATF in 1989 and the subsequent criminalization of money laundering in most countries have drawn the attention of a small circle of economists to financial crime and the relation between ill-gotten money and the overall economy.[1]

Economic research in this field focuses on two aspects: (a) the economic effects of money laundering, and (b) the amounts of ill-gotten money that circulate within economies or across borders. These two aspects will be reviewed in this chapter. In addition, the chapter discusses our methodological approach and presents a short introduction on the economies of Malawi and Namibia.

Economic Effects

It is generally believed that the circulation of ill-gotten money has a negative impact on the economy. According to the FATF, "Successful money laundering damages the integrity of the entire society and undermines democracy and the rule of the law." As for developing countries, it is argued that not having an AML system is economically dangerous. "The more it [having an AML framework] is deferred, the more entrenched organised crime can become." This could have a "damping effect on foreign direct investment, [and] undermines the creation of a business friendly environment," which might be considered as a "precondition for lasting economic development" (FATF).[2]

Economic research in this field has yielded a long list of theoretically possible economic consequences of the circulation of ill-gotten money, as can be seen from the overview provided by Unger et al. (2006). This overview (table 2.1) is based on extensive research of the economic effects of "money laundering" over the 10-year period, 1995–2005. It includes various allocation effects (such as distortions of consumption, savings, investment, and government expenditures) and a wide variety of direct and indirect growth effects. Growth effects can be both negative and positive in the short run, but seem to be always negative in the long run, according to Unger.

However, these initial attempts to study the effects of money laundering from an economic angle are in some respects still immature and sometimes even confusing. In many studies, the term "money laundering" is still being used without clarification of what is covered (see chapter 1). In addition, the economic impact of "money laundering" is not always clearly separated from the impact of the underlying predicate offenses.

Further, studies on the impact of ill-gotten money on countries in the lower ranges of the income ladder are virtually nonexistent. Economic research has almost exclusively focused on developed economies—which are generally characterized by a sophisticated financial sector and established AML regimes. Little analysis has been done on economic

issues of ill-gotten money in developing countries. In this context, the only study that extensively and explicitly focuses on developing economies was commissioned by the Asian Development Bank and conducted by Bartlett (2002). Bartlett's analysis is, however, purely theoretical, illustrated with some anecdotal cases and examples.

Table 2.1. 25 Economic Effects of Money Laundering

1.	Losses to the victims and gains to the perpetrator	13.	Greater availability of credit
2.	Distortion of consumption	14.	Higher capital inflows
3.	Distortion of investment and savings	15.	Changes in foreign direct investment
4.	Artificial increase in prices	16.	Risk for the financial sector, solvency, liquidity
5.	Unfair competition	17.	Profits for the financial sector
6.	Changes in imports and exports	18.	Reputation of the financial sector
7.	Negative (or positive) effect on growth rates	19.	Illegal business contaminate legal business
8.	Effect on output, income, and employment	20.	Distorting of the economic statistics
9.	Lower revenues for the public sector	21.	Corruption and bribe
10.	Threatens privatization	22.	Increases crime
11.	Changes in the demand for money, exchange rates, and interest rates	23.	Undermines political institutions
		24.	Undermines foreign policy goals
12.	Increase in the volatility of interest and exchange rates	25.	Increase in terrorism.

Source: Unger et al. 2006.

To more systematically analyze the full economic effects that are relevant to AML, a clear distinction must be made between the economic effects of:

- The underlying criminal and illegal activities
- The specific effects of the circulation of ill-gotten money
- The economic effects of AML *policies.*

This third category is not an explicit subject of this study, as has been stated in chapter 1. However, a brief overview of the discussion on AML and financial inclusion will be provided in chapter 5. Some of the supposed most important effects are given in table 2.2.

Table 2.2. Economic Effects

Categorization of effects that are relevant from an AML perspective:	
I. Underlying criminal and illegal activities	Unfair competition
II. Circulation of ill-gotten money (not exhaustive)	"Corruptive penetration of the upperworld"
Reputation of the financial sector	"Corruptive penetration of the AML system"
Capital flight	Distortion of the foreign exchange market
Stimulation of financial and legal services	Distortions of economic statistics and erosion of the tax base
"Spill-over effect" into crime	*III. AML policies*
Preference for "sterile assets"	

Source: Author's formulation.

Economic Effects of the Underlying Criminal and Illegal Activities

As numerous studies have demonstrated, crime is bad for economic development.[3] The United Nations Office on Drugs and Crime (UNODC) has, for example, conducted a study on crime and development in Africa (UNODC 2005). It states that Africa has a serious crime problem that is undermining development efforts. The study explores three broad impacts of crime in Africa: (a) that crime erodes Africa's social and human capital,

(b) that it drives business away from Africa, and (c) that it undermines the ability of the state to promote development. Crime should, therefore, "be prominent in the minds of development planners, and crime prevention thinking should influence all aspects of development projects" (UNODC 2005, xvi).

Another study by UNDOC (2010) focuses on the internationalization of crime. Again, the UNODC stresses the economic relevance of anticrime efforts for developing countries: "Crime is fuelling corruption, infiltrating business and politics, and hindering development." It is also "undermining governance by empowering those who operate outside the law" (UNODC 2010, ii). In its report, UNODC highlights the globalization of crime and the need for a transnational anticrime approach. To resolve global issues, global thinking is required. UNODC also advocates for better data. While quantitative estimates are necessarily imprecise and will give only a relative order of magnitude of the problems, collection and sharing of better data is essential for future policies.

Corruption can have potentially tremendous negative effects on economic development. Our research suggests that this is also the case in Malawi and Namibia. Corruption brings about a diversion ("leakages") of financial resources from the national budget to private spending purposes. These private expenses or expenditures have much lower "multiplier effects" than expenditures on, for example, agricultural fertilizers, education, health, and infrastructure. Money derived from crime (including corruption) will mostly be spent on direct consumption (small volumes) or invested in valuable assets (in the case of large volumes) such as art, gold and diamonds, luxury vehicles, real estate, and so forth. This is the case in both developing counties (see, for example, Walker 2004 and various studies by Van Duyne) and developed countries, as our study reveals.

The impact of one dollar invested in, for example, an imported luxury vehicle on output, income, or employment will, in the long run, be smaller than the impact of the same amount spent on, for example, education.

Most economic effects of crime and corruption are negative, but there are also positive effects. Engagement in illicit activities can, for example, be a source of income when there are no possibilities of earning sufficient income through licit activities. This is especially relevant in the context of developing countries. As one interviewee in Malawi explained, some families have used proceeds from the sale of "chamba," or Indian hemp, to send their children to school. Or, as another interviewee said, "stealing money from wealthy citizens can be considered as a redistribution of wealth from the rich to the poor." It has also been said that corruption in some cases greases the wheels of growth; there is, however, little evidence to support this thesis (Campos and Dimova 2010).[4]

Economic Effects of the Circulation of Ill-gotten Money

Reputation of the Financial Sector

One of the basic assumptions behind the global AML framework is that the use of the financial system for money-laundering purposes (making dirty money white) is harmful for the reputation of, and will erode confidence in, the financial system. A reputation for integrity is the one of the most valuable assets of a financial institution.[5] Consequently, money laundering is harmful to the welfare of entire economies, since trust in financial institutions is generally seen as a basic requirement for long-term economic growth.

Bartlett (2002) argues that this is especially relevant for developing countries, with immature or developing financial systems and a reputation for being highly corrupt.

Strong developing-country financial institutions are critical to economic growth. Bartlett emphasizes that trust in the financial sector is not only a domestic necessity but that it is also essential to attracting foreign capital and investments. There is no empirical proof of these assumptions, however, and further research is needed on this issue.

Capital Flight

The internationalization of crime (UNODC 2010) and the internationalization of money laundering are two sides of the same coin. It is often stated that ill-gotten money tends to flow to jurisdictions that are economically more advanced, financially more sophisticated, fiscally attractive, or that have a more permissive environment toward money laundering. Walker and Unger (2009), for example, assume that ill-gotten money seeks countries with attractive banking regimes (that is, advanced banking systems, tax havens, and "no questions asked" banking) and countries with stable economies and low political risks.

This is especially relevant for developing countries where corruption in recent decades has led to massive capital flight to financial centers elsewhere.[6] The well-recognized problem of illicit capital flight from developing countries is typically facilitated by either domestic financial institutions or by foreign financial institutions in foreign offshore centers or major financial centers such as London, New York, Singapore, and Tokyo. We will return to this issue in chapters 4 and 5. Baker (2005) argues that the outflow of "dirty money" from developing countries to advanced economies is 10 times larger than the inflows of foreign aid.

Stimulation of Financial and Legal Services

Money laundering can also have positive economic effects. Unger (2006) points out that a net inflow of criminal money could lead, at least in the short term, to an increased demand for financial and legal services, without having to bear the costs of the predicate crime. Masciandaro (2007) argues that governments might deliberately choose to adopt lax financial regulations in order to attract money and benefit from short-term gains that can be generated.

"Spill-over Effect" into Crime and Corruption

Money laundering can also facilitate and even stimulate criminal activity. It provides criminals with apparently legitimate money, which they can use to subsidize, continue, diversify, and expand their criminal activities (Levi 2002).

Money laundering can be a link between crime and even more crime, because ample money-laundering opportunities will make crime and corruption easier and more profitable. In addition, ample money-laundering opportunities within a jurisdiction can attract foreign criminals. Masciandaro (1999) has labeled this the "spill-over effect."

Preference for "Sterile" Assets

Criminological studies and asset forfeiture policies have shown that proceeds of crime and corruption are often placed in so-called "sterile assets" (Bartlett 2002), that is, assets that generate limited productivity for the broader economy, such as antiques, art, automobiles, luxury goods, and real estate. This is the case in high-income countries, but also in developing countries such as Malawi and Namibia, as our study will show.

The preference for sterile assets is especially problematic for developing countries, since this might divert valuable foreign reserves to the importation of luxury goods in-

stead of basic necessities. Financial leakages from the national budget might also result in price distortions in the real estate market, as seems to be the case in both Malawi and Namibia.

Unfair Competition

Ill-gotten money might undermine fair competition. Walker (1995), for example, has argued that criminals might be able to outbid honest buyers because of the availability to criminals of large amounts of funds and their primal interest in finding a "safe haven" or money-laundering opportunity for their ill-gotten money instead of profit making. Licit enterprises might, for the same reasons, be kept growing by means of ill-gotten money although they are structurally loss making (Van Duyne and Soudijn 2010).

The "unfair competition" effect of ill-gotten money could also influence the outcomes of privatization or tendering processes. This "bad money drives out good money effect" is especially relevant for Namibia with respect to tendering for government concessions.

"Corruptive Penetration of the Upperworld"

Business and even government decisions might be affected by ill-gotten money. Van Duyne and Soudijn (2010, p. 260) call this "corruptive penetration in the upperworld decision chambers"—criminals buying their way into the government, the financial sector, and other public and private businesses. Corruptive penetration in the upperworld economy and criminal upperworld subsidy can occur on a national scale, but also on regional levels in specific markets or sectors of the economy.

"Corruptive Penetration of the AML System"

Chaikin and Sharman (2009) have discussed the symbiotic relationship between corruption and money laundering. They argue that corruption and money laundering tend to co-occur, but, more important, the presence of one tends to create and reciprocally reinforce the incidence of the other. Corruption produces income that has to be laundered. At the same time, bribery, trading in influence, and embezzlement can compromise the working of the AML system itself. We call this effect the "corruptive penetration of the AML system."

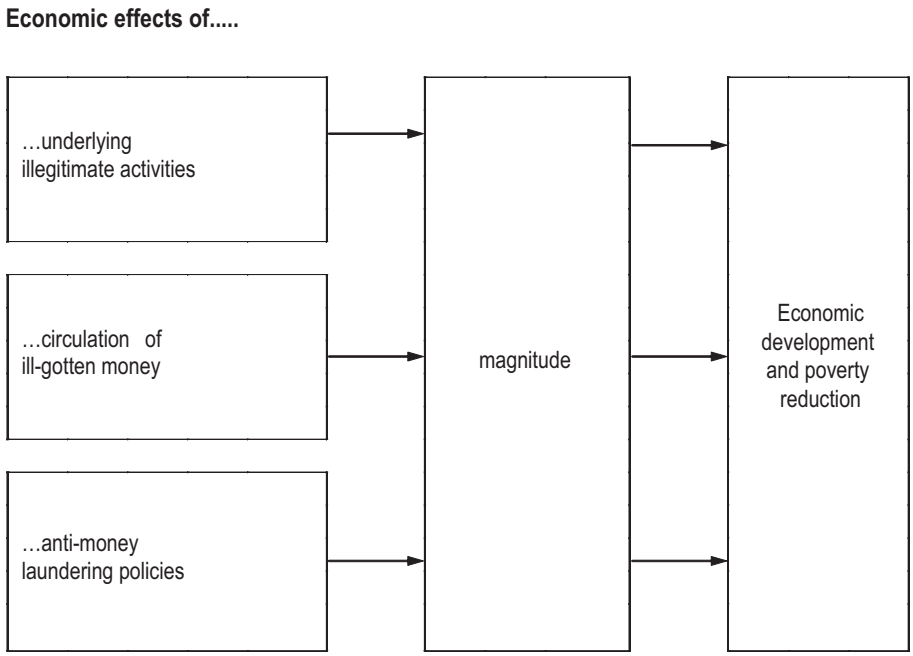
Distortion of the Foreign Exchange Market

Ill-gotten money might flow unrecorded over national borders—either because of the transnational nature of many illicit markets (involving cross-border financial transactions) or with the aim of laundering or spending the proceeds of crime or corruption in another jurisdiction. These cross-border flows could give way to distortions in the foreign exchange market (Alldridge 2002; Keh 1996; McDowell 2001) and, more specifically, fuel the existence of a black market for foreign exchange (demand and supply). This seems to a certain extent to be the case in Malawi and to a lesser extent Namibia, as we will see.

Distortion of Economic Statistics and Erosion of the Tax Base

A basic concern related to the circulation of unlaundered ill-gotten money is that there is money in circulation that is officially not known (Bartlett 2002; Tanzi 1996). This could result in distortions of the national accounts and lower tax incomes. The concern is, however, not unique for ill-gotten money. Criminal activity can be considered a subset of

Figure 2.1. The Impact of Illegitimate Activities, Ill-gotten Money Circulation, and AML Policies on Economic Development



Source: Author's formulation.

the informal economy, which is particularly large in low- and middle-income countries (Schneider 2006). Both illegal and informal (that is, legal but unrecorded) activities will distort economic statistics, or at least make the official statistics less reliable.

Magnitude

An analysis of the full economic impact of illegitimate activities and the circulation of ill-gotten money cannot be done without assessing its magnitude vis-à-vis the overall economy—or specific segments within the economy, such as regions, economic sectors, and populations. This is a major challenge in developed countries, due to the lack of reliable data on crime, but even more so in developing countries, where reliable data on crime and money laundering are even more difficult to find.

Measuring money laundering has long been considered a niche topic for economists and other quantification enthusiasts who firmly believe that these criminal activities can be meaningfully quantified. It was generally accepted that money laundering cannot be measured in a meaningful way. The FATF, for example, states that "it is absolutely impossible to produce a reliable estimate of the amount of money laundered."[7] However, that attitude is changing. Several other international organizations (the European Union [EU], the IMF, the United Nations, and UNODC) have initiated studies aimed at quantifying criminal money flows and money laundering, both within specific jurisdictions and across jurisdictions.

There are basically four approaches on measuring the magnitude of ill-gotten money flows: (a) bottom-up, based on a detailed assessment of crime statistics; (b) macroeconomic, based on statistical discrepancies; (c) estimates derived from extrapolations of suspicious transaction reports and asset recovery data; and (d) perception surveys. None of these approaches has proven satisfactory on its own. We will, therefore, use a combination of the four methods.

Crime Statistics Approach

The FATF Working Group on Statistics and Methods noted the lack of data on money laundering in 1989, when the FATF started. The Australian Financial Intelligence Unit, the Australian Transaction Reporting and Analysis Center (AUSTRAC), was among the first to take up the challenge, by commissioning a study on the extent of money laundering in Australia. This study was carried out by Walker (1995) and was presented to the FATF in 1996. The Walker model has subsequently been refined and applied by Walker (1999, 2007) and by Unger (2006) in a study commissioned by the Netherlands Treasury Department. The Walker analysis is based on crime statistics, expert perception surveys on perceived crime, or both.

The Walker approach has been widely criticized as too data hungry, too complex, and too speculative (for recent criticism, see Fleming 2009 and Van Duyne and Soudijn 2010). The lack of sound crime data and the complexity of the calculation will make application of the pure Walker model in many developing countries difficult.

The Walker model is, however, explicitly aimed at quantification—contributing to the efforts of how to measure money laundering. It is the first and, until now, most comprehensive and systematic, bottom-up analysis of crime data and translates these into money-laundering figures. In addition, Walker's model is explicitly global. Walker stresses that the volume of money laundering in a country depends not only on the volume of crime within its borders, but will to a large extent be determined by cross-border inflows and outflows of criminal money. This notion is relevant with respect to the (increasingly) transnational character of many forms of crime and the discussion on capital flight from developing countries.

Macroeconomic Approach

The overall amount of money laundering in a country could also be approached by analyzing macroeconomic proxy variables. These estimates are, however, too "macro" for day-to-day policy considerations, they are highly speculative, and they depend to a large extent on the availability and accuracy of national account statistics, which makes its application in developing countries problematic. Tanzi (1997), for example, calculated the difference between money printed and money circulating in the United States to demonstrate that US$5 billion per year was appropriated in cash through the illegal drug trade. Quirk (1997) attempted to find a correlation between money laundering and the macroeconomic demand for money, including the effects of money laundering on interest rates and exchange rates.

Schneider (2000, 2006), a leading expert on estimates of the size of shadow economies, applied his dynamic multiplier-indicators multiple causes (DYMIMIC) analysis to 162 countries, which are used in this report, as well. A weakness of Schneider's approach is that it cannot distinguish between informal economic activities (legal but unreported and untaxed activities) and criminal activities such as corruption, fraud, drug trafficking, and so forth.

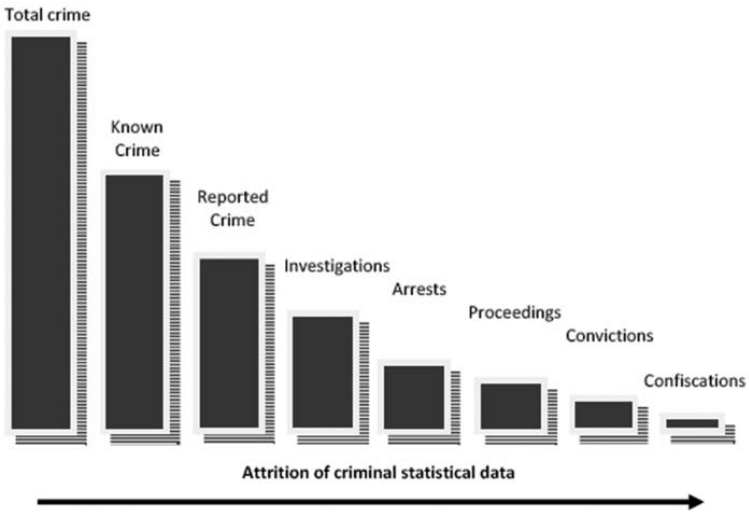
Suspicious Transaction Reports Approach

A different method was followed by Levi and Gold (1994), who analyzed financial data, including suspicious transaction reports (STRs), in order to identify the overall extent of money laundering in a country. Counting these STRs will, however, include large errors in both directions: STRs that are actually legitimate (overreporting) and illegitimate transactions that are not reported (underreporting). This methodological drawback makes the STR approach unsuitable for countries like Malawi and Namibia that are in a pioneering phase of their AML regime.

Meloen (2003) and Van Duyne (1993, 1999, 2005) presented an analysis of STRs and asset recovery databases in the Netherlands. Similar studies have been carried out in the U.K. (see, for example, Dubourg and Prichard 2007; Fleming 2007; and Prichard 2007). But, again, STRs and asset recovery programs reveal only part of the overall picture.

A similar approach has been adopted by Eurostat (2010) as part of the EU action plan to develop a coherent EU strategy to measure crime. Money laundering and trafficking of human beings were identified as priority projects within this action plan. The ultimate goal of the money-laundering project is to establish a cost-benefit analysis of AML policies in the EU and its member countries. The first step toward this long-term goal is the accumulation of a systematic and coherent collection of known figures such as STRs, cash control declarations, numbers of law enforcement investigations, and number of convictions and sentences (see box 2.1). The EU approach could be applied to, or serve as an example for, developing countries.

Box 2.1. Attrition of Criminal Data (indicative scale only)



The diagram applies to all types of crime, from domestic violence, drug trafficking, and counterfeiting to money laundering and cyber crime. With regard to the figures for unrecorded money laundering, the difference between the real and known figures can only be approximated and indirectly estimated. The weaker the correlation, the cruder the estimate. The Eurostat project initially focuses on the systematic collection of current statistical information. This first step should be a base for drawing up a cost-benefit analysis.

Source: Eurostat 2010.

Perception Approach

The most subjective but in the short run most practical approach is a perceptions approach in which experts are questioned about their perceptions of crime and money laundering and the perceived (relative) magnitude of the problem. This method has been explored in a systematic way by Walker (2007).

Methodology

As stated in chapter 1, the purpose of this study is to (a) provide an initial answer to the question of whether and how AML contributes to economic development, and (b) develop a framework that enables governments in developing countries to analyze the main sources of ill-gotten money.

Four sub-questions were formulated:

- **Sources:** What are the main sources of ill-gotten money in Malawi and Namibia?
- **Magnitude:** What is the estimated magnitude of flows of ill-gotten money vis-à-vis the overall economy?
- **Recycling patterns:** What are the main recycling patterns of the ill-gotten money?
- **Economic effects:** How do the underlying criminal and illegal activities and the recycling patterns affect the economy?

Due to a lack of reliable data, a pragmatic approach was followed. We based our findings on a combination of available crime statistics and other relevant data, STR information, a literature research, anecdotal information and perceptions of various experts in Malawi and Namibia, and basic macroeconomic research. This pragmatic approach is, of course, methodologically disputable, but it is "good enough" for the purpose of this study.

The starting point of our research is individual crimes, since spending patterns, money-laundering methods, and economic effects can differ from crime to crime. The findings are mainly based on a literature research, interviews with experts in Malawi and Namibia in November 2010, and workshops in both countries in February 2011.

In pursuing our research, the following five-step analysis has been followed:

1. The main crimes or sources of ill-gotten money are identified based on interviews with relevant stakeholders, available literature, the Internet, government reports, and other open and closed sources.
2. A rough estimate (guesstimate) is made of the magnitude of the flows of money involved. This is an ambitious undertaking given the large informal sector in both Malawi and Namibia and the limited availability of proper crime statistics. However, an indication of a probable range based on an intuitive assessment of relevant specialists and officials involved in dealing with the activities might give some idea of the absolute or relative magnitudes.
3. A narrative description is given on how the money is spent or recycled within the economy or across its borders.
4. The economic effects are analyzed in a narrative way. The effects as they are described in table 2.1 will be used as a point of reference and to enrich our findings in Malawi and Namibia.
5. Finally, we analyze the initial results of AML policies in Malawi and Namibia in conjunction with the observed magnitude and effects of money laundering.

This flexible methodology can be applied to other countries, at various levels of sophistication, and can be based on crime statistics, perceptions, econometric modeling, STRs, anecdotes, or a combination of these sources.

The study must be regarded as an initial exploration of the field and a starting point for further empirical research, in-depth analysis of relevant individual cases, and a more systematic collection and development of proper crime and money-laundering data. Educated guesses and intuitive estimates, including estimates represented in ranges, could serve this purpose, at least for the time being. In the long run, a systematic collection and development of proper crime statistics is essential for developing countries to be able to target and evaluate anticrime and anti-money laundering policies.

Collaboration with experts in Malawi and Namibia has proven to be crucial. They not only have the required information, but they also have to deal with the issues on a day-to-day basis and are the focal point in developing and implementing new AML policies. This interactive approach required mutual trust, optimal transparency from the World Bank research team, openness on the side of the experts in both countries, and willingness to express provocative opinions and explore creative solutions and new ways of looking at the issues. The outcome might not be perfect but it is a starting point for further research and new policy initiatives.

Our pragmatic research approach has proven to be valuable in providing the necessary input for policy considerations. The information gathered in Malawi and Namibia indicates, for example, that corruption and tax evasion are macro-relevant and need to be prioritized in the AML policies in both countries. In addition, experts in both countries have indicated sources of ill-gotten money that are not criminal or even illegal, but are generally considered unethical or abusive and harmful to economic development. We will briefly discuss two main issues in this category—improper transfer-pricing policies by multinational corporations and certain forms of high-level "legalized corruption"—which are very macro-relevant but cannot be addressed by AML measures.

The analysis will lay the foundation for identifying major AML challenges, prioritizing AML efforts, and adapting AML policies to circumstances that are specific or unique to both individual countries.

Countries of Focus: Malawi and Namibia

Malawi is a dynamic, low-income country. Namibia, on the other hand, is an upper-middle-income country whose GDP per capita is more than 10 times higher than Malawi's. The main features of both economies are summed up in table 2.3 and will be discussed below. Despite these differences, Malawi and Namibia share some important similarities with respect to their AML environment and AML policies, which will make a comparison of the two countries worthwhile.

Both Malawi and Namibia have demonstrated a strong commitment to establishing an AML framework. Malawi enacted its *Money Laundering Proceeds of Serious Crime and Terrorist Financing Act in August 2006* and subsequently implemented a full AML program. Namibia enacted a *Prevention of Organized Crime Act in 2004* and its *Financial Intelligence Act in 2007*.

The criminalization of money laundering broadly meets international standards in both countries. Authorities in both countries have set up an operational Financial Intelligence Unit and created a National AML Committee to enhance domestic cooperation,

and adopted a phased approach to implementing their respective statutes, beginning with the banking sector. In the last two years, the authorities have stepped up efforts to strengthen the capacity of the relevant stakeholders, such as prosecutors, the judiciary, investigators, and the central bank, to combat financial crimes.

Both Malawi and Namibia fit the description of what the FATF has labeled "Low Capacity Countries." Implementation of the AML framework is constrained by competing priorities for scarce government resources. Both economies are characterized by a relatively large and vibrant informal sector. Crime and money laundering largely take place within the context of, and facilitated by, these large informal sectors.

Cash is still widely used in both countries. Fifty-five percent of Malawi's adult population does not use any form of financial service. Fifty-one percent of Namibia's adult population is "financially excluded." These remarkably high levels of financial exclusion are the result of a combination of poverty, banking sector inefficiencies, and a general distrust of formal financial institutions. The widespread use of cash makes the tracing of ill-gotten money difficult in both countries.

Both Malawi and Namibia are politically stable, conflict-free countries. Malawi ranks 51st on the Global Peace Index and Namibia ranks 59th, making these countries the third (Malawi) and eighth (Namibia) most-peaceful countries on the African continent. Malawi gained independence from the U.K. in 1964 and has enjoyed relative political stability since then. Its first democratic elections were held in May 1994. President Bingu wa Mutharika has been in office since 2004 and is serving his second term.

Table 2.3. Malawi and Namibia At-A-Glance, 2009

	Malawi	Namibia
Independent since	1964	1990
Surface area (square kilometers)	118,480	824,268
Population (million)	15.3	2.2
Urban population (% total population)	18.8	36.8
GDP (US$1 million)	4,727	9,265
GDP per capita (US$)	310	4,267
Gini coefficient (2004)	39.0	70.7
GDP growth (% annual average, 2006-09)	7.4	4.0
Unemployment (% adult population)	n.a.	51.2
Shadow Economy (% GDP 2006)	38.7	33.9
Number of ATMs (per 1,000 inhabitants)	1.1	5.9
Financial inclusion (% adult population)	45	49
Global Peace Index 2010	51/149	59/149
Ibrahim Index of African Governance 2010	22/53	6/53
Corruption score 2010	3.4	4.4
Corruption Perception Index 2010	85/178	56/178
Press Freedom Index 2010	79/178	22/178

Sources: World Development Indicators; Development Economics LDB database; Schneider, Buehn, and Montenegro 2010 (shadow economy), Transparency International, Vision of Humanity, Reporters Without Borders, CIA (Gini coefficient), Finscope 2007, 2008.
Note: ATMs = automated teller machines.

Namibia gained independence from South Africa in 1990 following a long liberation war by the South-West Africa People's Organization (SWAPO). Former SWAPO leader Sam Nujoma governed the country from 1990 to 2004. The current president is Hifikepunye Pohamba.

While the overall level of corruption in Malawi is similar to its surrounding countries, and Namibia is one of the least corrupt countries in Sub-Saharan Africa, corruption is nevertheless an issue of concern in both countries.

Trade in Malawi is conducted by business people from surrounding African countries, Malawians of Asian descent and increasingly from West Africa (mainly Nigeria). Namibia hosts an international business community with strong historical ties with Angola, Europe, and South Africa. Both countries host a rapidly growing Chinese business community. These foreign business relations in combination with the easy accessibility of both countries over land (long and porous borders, limited capacity for effective control of cross-border movements of citizens and goods), also make both countries vulnerable to illicit businesses, which move in and out along the same routes.

In the next two chapters we will turn to a detailed discussion of crime and economic development issues in Malawi and Namibia. We will explore crimes that are the main source of ill-gotten money in the two countries, how ill-gotten money flows through the respective economies, and how this affects economic development and poverty reduction.

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Notes

1. See, for example, Alldridge (2002); Baker (2005); Keh (1996); Levi (2002); Mackrell (1997); Masciandaro (1999); McDonell (1998); Quirck (1997); and Walker (1995).
2. "Money Laundering FAQ"; www.fatf-gafi.org.
3. For an overview of the literature on the direct and indirect economic costs of crime see, for example, Brand and Price 2000; Cohen 2005; Mayhew 2003; and Shapiro 1999.
4. Campos, Dimova, and Saleh 2010.
5. "Money Laundering FAQ", www.fatf-gafi.org.
6. See, for example, Baker (2005); Kar and Cartwright-Smith (2008); and Le and Rishi (2006).
7. "Money Laundering FAQ"; www.fatf-gafr.org.

CHAPTER 3

Country of Focus: Malawi

Malawi has implemented an AML framework in recent years to combat its two main sources of ill-gotten money: corruption and tax evasion (including trade mispricing). Other main crimes for profit (with a mixed perception of the magnitude and importance) are theft, motor-vehicle theft, fraud, cannabis production, smuggling of goods, and human trafficking. In this chapter we discuss the forms, causes, magnitude, and economic impact of these sources of ill-gotten money.

Interviews with Malawian experts on the subject revealed that improper transfer pricing by multinational corporations is also generally considered to be a source of ill-gotten money. It is, however, not illegal, although the Malawi government recently adopted transfer pricing regulations.

The analysis is based on open-source literature, magazines, newspaper articles, and interviews with government officials, the private sector, academia, and civil society organization representatives, conducted by a team of World Bank and Malawi Financial Intelligence Unit (FIU) staff in November 2010 and a workshop in February 2011.

Main sources of information on crime in Malawi are publications by the Institute for Security Studies (ISS) and the country's two most prominent newspapers, *The Daily Times* and *The Nation*. Verifiable information from the media was used as additional anecdotal data to corroborate information gathered through interviews with both the journalists met and the officials the team interacted with. From 2007-2010, the ISS conducted, in cooperation with the Southern African Police Chiefs Cooperation Organization (SARPCCO), a three-year research project on organized crime in the Southern African region (Hübschle 2009; ISS 2010).[1] Closed-source information was provided by the FIU, the Anti-Corruption Bureau, the Malawi Police Service, and researcher and prominent lawyer Jai Banda.

The Malawi Economy

Malawi is a landlocked country that is surrounded by Tanzania on the north, Zambia on the west, and Mozambique on the south. Malawi is among the world's least developed and most densely populated countries. Urbanization is low and agriculture is the main source of income.[2]

The latest *Human Development Report* indicates that Malawians are wealthier, healthier, and more educated than they were 10 years ago (UNDP 2010). Malawi's annual GDP growth has averaged about 7 percent over the last decade, a result of improved macroeconomic management, good weather, increasing agricultural output, favorable economic conditions in the surrounding countries, and a supportive donor environment. Overall poverty has declined and life expectancy has increased considerably.

About half of the Malawi population lives below the official poverty line. Dependency on agricultural exports (mainly tobacco) makes the country vulnerable to external shocks in food prices. The economy suffers from critical shortages of foreign currency, which has led to scarcities of essential imports, such as temporary fuel shortages. One-third of the government budget is financed by foreign donor money. Economic inequality is high and corruption remains a fact of everyday life in Malawi.

The Financial Sector

The financial sector in Malawi is relatively small and bank dominated.[3] The system comprises 11 commercial banks, eight nonlife and four life insurance companies, a microfinance sector,[4] and a small capital market. Seventy-five percent of total gross financial sector assets of US$1.5 billion are held by the banking system. The banking system is largely privately owned, of which a significant part is foreign-owned banks. The five-largest banks hold 89 percent of total banking assets. The intermediation rate in Malawi is one of the lowest in Sub-Saharan Africa, with a 6 percent private-credit-to-GDP ratio.

Malawi is a predominantly cash-based economy. Approximately three-quarters of all business transactions are conducted through cash payments.[5] Fifty-five percent of the adult population does not use any form of financial service. In 2010, the Malawi government launched a four-year national strategy for financial inclusion, which is broadly targeted at low-income people. The strategy is aimed at increasing financial access through the expansion of microfinance institutions and the promotion of technological solutions such as mobile phone banking. These actions have been launched with the support of the World Bank.

The widespread use of cash is an important obstacle to an effective AML system in Malawi. As our research revealed, it is not only the poor who do not use bank accounts. Medium-to-large businesses and middle- and upper-class members of society also make no or limited use of the banking system. The preference for cash payments is a result of both supply-side obstacles within the banking sector and a deeply rooted "culture of using cash." Inefficiencies (delays), transaction costs, and deficiencies in the contractual and information frameworks contribute to the marginal role of banks in Malawi's economy.

The Anti-Money Laundering (AML) System

In 2006, the Government of Malawi enacted the *Money Laundering Proceeds and Serious Crime and Terrorist Financing Act*, which criminalized money laundering. This Act broadly meets international standards. The Malawi FIU, which began operations in 2007, is a centralized and independent authority that receives and processes information from the financial sector and transmits disclosures to judicial or law enforcement authorities for prosecution (the so called "administrative model"). It functions as a "buffer" between the financial and the law enforcement communities.

The Malawi AML framework includes a National Anti-Money Laundering and Combating the Financing of Terrorism Committee, which started meeting in September 2007 and is chaired by the Ministry of Finance. Its current membership comprises (a) the FIU, (b) the Reserve Bank of Malawi, (c) the Malawi Police Service (represented by the Fiscal and Fraud Unit), (d) the Anti-Corruption Bureau, (e) the Director of Public

Prosecutions, (f) the Malawi Revenue Authority, (g) the Ministry of Foreign Affairs, (h) the National Intelligence Service, (i) the Malawi Gaming Board, and (j) the Ministry of Justice. Its current role is to coordinate the efforts of its members in the development of Malawi's AML framework.

Banks, lawyers, notaries, and other independent legal professionals, accountants, casinos, dealers in precious metals and stones, and real estate agents, among others, are obliged to file suspicious transaction reports (STRs). During January 2008 to October 2010, the Malawi FIU received 47 STRs. All reports were delivered by banks—except two STRs from independent foreign exchange (forex) bureaus (table 3.1).

Table 3.1. Breakdown of Suspicious Transaction Reports by Reporting Agency, Malawi, January 2008–October 2010

Entity	Number
Banks	45
Forex bureaus	2
Other	0
Total	47

Source: Malawi FIU.

The majority of the STRs were found to be related to fraud (18) and tax fraud (14) (table 3.2). Five STRs were related to illegal foreign exchange dealing and 4 to human trafficking. Only two STRs had a connection with corruption. There were no STRs related to drug trafficking. Four STRs have various or unknown sources. Forty-four reports have been disseminated to law enforcement and other government agencies. The recipients of the reports were (a) the Anti-Corruption Bureau, (b) the Fiscal Police, (c) Immigration, (d) the Malawi Revenue Authority, (e) the National Intelligence Service, and (f) the Reserve Bank of Malawi.

Table 3.2. Breakdown of Suspicious Transaction Reports by (assumed)
Predicate Offense, Malawi, January 2008–October 2010

Activity Type	Number
Fraud	18
Tax fraud	14
Illegal foreign exchange dealing	5
Human trafficking	4
Corruption	2
Various / unknown	4
Total	47

Source: Malawi FIU.

In addition to the creation of the FIU and receiving STRs, Malawi has made progress in the following areas: the Malawi Revenue Authority has acted on financial intelligence related to tax fraud and recovered revenue for the government; banks have enhanced their AML procedures to meet the requirements of the *AML Act*; the Reserve Bank of

Malawi has conducted five AML examinations since 2009 and plans on examining three banks in 2011; and more than 50 public sector officials from various government agencies responsible for combating money laundering have been trained in financial investigation skills (tracing ill-gotten money).

Sources of Ill-gotten Money

How representative are the STRs of the overall money-laundering situation in Malawi? Table 3.3 provides an overview of the main findings of our research in Malawi and identifies the main sources of ill-gotten money in Malawi. An attempt is made to provide an initial rough estimate of the magnitude of various flows of ill-gotten money in the country. The analysis of the economic effects is mainly a qualitative assessment due to a lack of data.

The sources of ill-gotten money in Malawi will be described in as much detail as possible in the following sections. Main areas of concern, from an economic point of view, are government corruption, tax evasion, and various forms of fraud. Other prevalent forms of crime for profit in Malawi are smuggling of (counterfeit) goods, the production and export of cannabis, organized motor vehicle theft, violent housebreakings, human trafficking, and labor exploitation.

The overall impression is that the organized crime problem is relatively modest in Malawi. There is no evidence to suggest major global operating criminal gangs—such as the Italian or Russian Mafia, South American drug cartels, or Asian Triads—have a foothold in Malawi. Cross-border criminal networks are mainly active from neighboring countries within the region.

Organized crime in Africa involves collusion with public sector officials. It might also entail powerful private actors, including criminal groups and wealthy business interests who buy off weak politicians and bureaucrats. In this context, Tambulasi (2009) discovered that the highly successful Malawi fertilizer program, which was launched in 2005, has been used by criminals taking advantage of corruption in the country to obtain subsidized fertilizers that they sell either locally at higher prices or smuggle to neighboring countries. The relation between corruption and organized crime has been described in numerous studies. For an overview of this discussion, see Tambulasi (2009).

Corruption

Corruption is considered to be one of the major deterrents to economic development in Malawi.[6] It takes away scarce resources that could have been used for development purposes and diverts them to private personal gain.

In a 2010 survey by the Centre for Social Research of the University of Malawi, respondents from the Malawi business community identified corruption as the second major constraint to business development, after access to finance and before crime and problems related with the Malawi exchange rate (table 3.4). The businesses surveyed are prepared to pay a mean percentage of additional taxes of 12 percent in order to eliminate corruption. Household sector respondents labeled corruption as the third major factor negatively affecting development.

Table 3.3. Ill-gotten Money and the Economy: Malawi

Sources	Magnitude *Estimates (% of GDP) and actual data*	Recycling channels	Economic effects *Not exhaustive and based on interviews in Malawi*[b]
Corruption Prevalent in government ministries and statutory organizations (political financing, tendering, procurement fraud, embezzlement, bribery). Involved are: government officials, politicians, embassies, NGOs, the private sector.	Estimate: 5% of GDP (see chapter 3.2.1).	Cash and bank based	• Allocation effects: leakages to expenditures with lower multiplier effects • Undermines welfare-maximizing programs • Undermines the countries credit rating • Income effects: increases (high-level) and narrows (low-level) income bracket • Long-term effect: Erodes confidence in the integrity of public institutions, kills the spirit of hard work, and creates resentment • Direct effects: no or poor delivery of products and services • Facilitates other crimes, including money laundering • Deters foreign direct investment
Tax fraud Tax fraud mainly involves large-scale evasion of value-added taxes, of corporate taxes, and of import and export duties by trade mispricing.	Estimate: 8–12% of GDP (see chapter 3.2.2).	Cash and bank based	• Loss of government tax revenue • Enhances culture of tax evasion • Increases the tax burden on salaried employees • Creates unfair business competition
Fraud Forgery of official documents, specifically with respect to payment of government allowances. Involves collusion with legal professionals, bank employees, and government officials.	Reported fraud cases in 2010: 133 with a total amount of MWK 263 million (US$1,753,333)[a]	Mainly bank based	• Direct loss of funds and misallocation and misappropriation of money • Erodes confidence in the institutions (financial sector, legal professionals) • Erodes confidence in the use of various financial instruments such as checks
Illegal foreign exchange dealing On a large scale by black market forex dealers (nonbank forex bureaus were closed down in 2009). Forex is externalized by smuggling (cash couriers and cargo) and trade mispricing techniques.	Estimate: 20% of official market. The spread between the official rate (MWK 154 per US$) and black market rate (MWK 185 per US$) is about 20% of the official rate (Reserve Bank of Malawi).	Cash and bank based	• Increases official foreign exchange shortages • Fuels the existence of a parallel economy and "big informality"

(Table continues on next page)

Table 3.3 (continued)

Sources	Magnitude *Estimates (% of GDP) and actual data*	Recycling channels	Economic effects *Not exhaustive and based on interviews in Malawi*[b]
Smuggling of goods (including import of counterfeit goods) Smuggling is one of the most prevalent organized criminal activities in the Southern African region, including Malawi. A large variety of goods are involved.	It is estimated that 30 to 40% of the normal trade in Malawi is smuggled or counterfeit goods. (Malawi Chamber of Commerce and Industry)	Cash based	• Negatively impacts the competition with goods that are obtained legally • Distorts the pricing of goods because the smuggled goods are sold cheaply • Losses of tax revenue to the government
Theft and armed robbery Organized motor vehicle theft, cash-in transit heists, robberies and (violent) burglary (houses, offices, banks, shops) to steal cash and high-value items.	Reported cases in 2010: motor vehicle theft (78), robberies (3,236), and burglary (12,238).[a]	Cash based	• Loss of property by legitimate owners • Feeling of insecurity • Increases insurance costs • Potential impact of the perception of the investment climate in the country • Theft (stealing cash) can be a redistribution of money from the rich to the poor
Cannabis production and export Cultivated mainly in remote areas. Majority for export purposes to surrounding countries, South Africa, Kenya, and overseas markets. Trade is organized by professional traffickers.	Average seizures 70,000 kilograms per year. Export street value of 0.2% of GDP. See appendix B.	Cash based	• Most of the profit is earned in export markets and by traders and traffickers • Poverty relief and income to growers (positive) • Creates dependency on (mostly foreign) organized crime groups
Human trafficking Human trafficking of foreign nationals (mainly to South Africa). Internal trafficking of Malawi nationals (including children) for labor exploitation purposes. Collusion with corruption.	About 840 interceptions (with various numbers of people involved) per year.[a]	Cash based	• Social, psychological, and physical consequences for victims (children) who are involuntary trafficked for exploitative purposes • Various costs for tracking, retaining, and sending back illegal immigrants • Government has to bear the cost of repatriating the trafficked people when they are discovered

Sources: Interviews conducted during the World Bank mission in Malawi in November 2010, a workshop in February 2011, and various open sources.
Notes: a. *Source:* Malawi Police Service. b. The interviews were held in November 2010 and February 2011 (workshop). Costs for prevention, detection, law enforcement, and prosecution are excluded.

Table 3.4. Key Constraints to Economic Development and Business Operation, 2010

(percentage of respondents—more answers possible)

	Household survey	Business enterprise survey
1.	Unemployment (92%)	Access to finance (42%)
2.	High prices of goods (89%)	***Public sector corruption (39%)***
3.	***Corruption (79%)***	Crime/theft/disorder (38%)
4.	Low quality of health care (71%)	Exchange rate (34%)
5.	Low quality of education (69%)	Inflation (30%)

Source: Centre for Social Research 2010, figures 6 and 7.

Since Malawi's transition to a multiparty democracy in 1995, corruption has become increasingly the focus of government policy (see box 3.1). In 1995, Malawi's Parliament passed its anticorruption law, the *Corrupt Practices Act*. The Act established the Anti-Corruption Bureau (ACB), which began operations in 1997. After the 2004 elections, the new Mutharika government declared a zero-tolerance stance on corruption in 2004, which was renewed in 2007.

Box 3.1. Malawi Corruption in Historical Perspective

From independence in 1964 until the first democratic elections in 1994, Malawi was ruled by medical doctor Hastings Kamuzu Banda (1897–1997). Banda had spent most of his life abroad, mainly in England. After independence Malawi became a one-party state under Banda's Malawi Congress Party (MCP) rule. Banda's dictatorship degenerated into controlling every aspect of Malawian society (politics, government, the economy), running the country as his personal fiefdom: "Everything is my business—everything," he said (Meredith 2005, 163). Banda constructed a huge business empire—"Press Holdings"—which expanded into tobacco, ranching, transport, property, oil distribution, pharmaceuticals, insurance, and banking. According to Meredith (2005, 380) it eventually accounted for one-third of Malawi's GDP and 10 percent of the wage earnings labor force.

Malawi presidents (independence July 6, 1964)		
1964	Hastings Banda	Malawi Congress Party (MCP)
1994	Bakili Muluzi	United Democratic Front (UDF)
2004	Bingu wa Mutharika	Democratic Progressive Party (DPP)

Public pressure begun by the Catholic Church in Malawi led to a referendum in 1993 on the transition to a multiparty political system and the first free elections in 1994, after which Bakili Muluzi, of the opposing United Democratic Front became president. Muluzi closed prisons for political prisoners, and introduced freedom of speech and print and free primary school education. The Muluzi government made several economic reforms. However, the fundamental socioeconomic structures remained securely in place, the politics of patronage was scarcely disturbed, and attempts to address the problem of poverty remained largely rhetorical (Morrow 2006, 153). It is alleged that Muluzi used to travel with large sums of cash, which his handlers would distribute at meetings and visits to individuals and institutions, never asking for receipts (Morrow 2006, 154). Morrow speaks of an "atmosphere of easy money and lack of accountability in the context of grinding poverty." (Morrow 2006, 154)

In 2002, after failing to pass a bill that would give his presidency a third term, Muluzi chose Bingu wa Mutharika as his successor. After winning the 2004 elections, Mutharika quit the UDF and set up his own party, the Democratic Progressive Party (DPP). Mutharika implemented a policy of zero-tolerance of corruption, stepped up the fight against HIV, attempted to attract foreign investments, and set up a successful fertilizer program.

Source: Authors.

The ACB has adopted a two-tier approach, which includes enforcement and prevention. It recently brought to court various high-level corruption cases against former cabinet ministers and political leaders. However, it is still difficult to get these cases prosecuted and concluded (table 3.5). Corruption is also subject to the Malawi AML legislation. The Malawi FIU is considered to be a vital additional institution in the fight against corruption. However, only two STRs related to corruption have been reported to the FIU.

Forms of Corruption

There is consensus among Malawian interviewees that corruption has trickled down from the top to lower levels of society. As one interviewee put it, "During the one-party-state, corruption in Malawi was confined to the top brass; after 1994 it was democratized." Corruption among midlevel public sector officials and statutory organizations is a serious concern. It includes various forms of abuse of office such as political financing, tendering, procurement fraud (both public and private), embezzlement of government and donor funds and bribery for contracts, and corruption within Malawi embassies abroad and NGOs. Table 3.5 provides an overview of 10 significant corruption cases in Malawi over the last decade.

Table 3.5. 10 Significant Corruption Cases in Malawi over the Last 10 Years

Case	Description	Estimated amount involved (MWK)	Legal status
Case 1	Corruption in relation to payment of toll fees	8,600,000	Matter concluded in court. Accused acquitted.
Case 2	Corruption in award of contract to rehabilitate primary schools by the Ministry of Education	187,000,000	MWK 50,000,000 (US$333,000) worth of property seized. Pending in court.
Case 3	Corruption in the award of contracts to supply spare parts	10,000,000	ACB seized two vehicles that were directly linked to bribery. Matter in the constitutional court.
Case 4	Corruption in the award of contracts to purchase emergency drugs	200,000,000	Contract cancelled on recommendation of the ACB.
Case 5	Corruption in the award of contract to supply national identity cards	1,395,000,000	Contract cancelled on recommendation of the ACB.
Case 6	Corruption in the award of contracts to supply fuel products	67,500,000	Matter concluded. Accused convicted and sentenced to 6 years. Court ruled recovery to US$25,000.
Case 7	Ministry of Finance corruption in relation to abuse of office and theft by the Secretary to the Treasury	20,000,000	Case still ongoing in court but money recovered.
Case 8	Corruption in the way grain reserves were depleted from silos	3,000,000,000	Case in Constitutional Court.
Case 9	Abuse of office, theft, possession of unexplained property	1,700,000,000	The matter is ongoing in court. Assets worth MWK 350 million (US$2.3 million) were seized by court order pending finalization of trials.
Case 10	Corruption in relation to smuggling of asylum seekers in Malawi	35,000,000	Case still ongoing in court. Assets seized but not valued.
Total Amount 10 Cases		**MWK 6.6 billion = US$44 million**	

Source: Anti-Corruption Bureau, Malawi.

In addition, various reports have indicated the widespread existence of low-level or "petty corruption" in Malawi.[7] Bribes and graft are commonly demanded and paid to influence public and private officers and circumvent rules and regulations. One of the causes of widespread petty corruption in Malawi is low government salaries. The average cost of living in Malawian cities is about MWK 50,000 (US$328) a month.[8] Eighty percent of government employees earn about or less than MWK 20,000 (US$131). Although petty corruption might be harmful to economic development, it is less relevant from an AML perspective, since the individual sums of money derived from petty corruption are often small and will be used directly on daily expenses.

Surveys on corruption in Malawi indicate that Malawian citizens identified as areas of concern institutions such as the Directorate of Road Traffic, Public Procurement, Parliament, Political Parties, the Administrator General, the Malawi Revenue Authority, and the Malawi Housing Corporation and Immigration (Republic of Malawi, National Anti-Corruption Strategy (2008). Corruption within the Malawi police is generally considered as another major area of concern (see case described in box 3.2). The survey by the Centre for Social Research of the University of Malawi (2010), cited above, rated the Immigration Department, Parliament, Political Parties, the Administrator General, and the Traffic Police as the least honest.

Box 3.2. Police Uniforms

According to an analysis done by the Malawi Economic Justice Network of the Auditor General's annual reports, one of the institutions involved in corruption is the Malawi Police Service. According to the Auditor General's report, between June 2005 and March 2007, the Malawi Police Service spent MWK 58 million (US$418,000) without authority. One case in the audit report involves the acquisition of police uniforms. The police spent MWK 820 million (US$5.9 million) on uniforms outside the budget provision, of which MWK 615 million (US$4.4 million) was spent on six different companies belonging to one individual supplier. By using different names, the supplier managed to get all the contracts despite excess charges compared to other suppliers, and probably in collusion with public officials.

Source: Malawi Economic Justice Network 2009.

Causes of Corruption

The causes of corruption in Malawi are extensively described in various reports.[9] Explanations vary from sheer poverty, low government salaries, weak institutions, and a lack of ethical leadership, to a culture of regionalism, tribalism, and patronage. Our interviews with public sector officials suggested four main causes of corruption in Malawi: (a) bureaucracy; (b) low government salaries; (c) greed (interviewees indicated that especially medium- and high-level corruption has to be considered as purely "rent-seeking behavior"); and (d) weak institutions including a lack of supervision.

Embezzlement of government money is facilitated by a lack of effective supervision (see box 3.3). The Malawi Auditor General's Office, for example, is understaffed and lacks financial resources (Malawi Economic Justice Network 2009). According to the MEJN's analysis, government bodies do not submit their annual accounts on time for audit. In many cases, the accounts do not follow accounting standards and contain serious mistakes. Fraud at lower levels is rampant, and there is a lack of capacity to execute effective control. The cash-based nature of government transactions creates opportunities

for embezzlement of government funds, as well. A number of Malawian interviewees confirmed that the Integrated Financial Management Information System (IFMIS) has been only partially implemented, and many government expenditures are still made in cash.

Box 3.3. Corruption in Public Procurement in Malawi

Illustrative of the wide variety of midlevel corruption in present-day Malawi are the results of an analysis by the Malawi Economic Justice Network of the public audit that the Auditor General conducted for 2005–07.

The Auditor General identified MWK 2.5 billion (US$193 million) in unaccounted for government expenditures. Reported irregularities included failure to account for cash and fees, failure to recover loans and advances, overinvoicing of supplies, payments without supporting documents, unauthorized payments, payments for undelivered goods or incomplete work, and dubious procurements, such as payments to ghost teachers.

Institutions involved included the Office of the President and Cabinet, the National Assembly, various ministries (Ministry of Agriculture and Food Supply, Ministry of Education, Ministry of Health, Ministry of Lands, and Ministry of Local Government and Rural Development), the Road Traffic Directorate, the Poverty Alleviation Trust Fund, the police (the police training school, police stations, and regional police headquarters), various hospitals and schools, and various city and district assemblies.

Source: Malawi Economic Justice Network 2009.

Magnitude and Economic Effects

How big is corruption in Malawi? The Malawi ACB estimates that, annually, 35 percent of Malawi government revenue (about 10 percent of GDP) is lost through corruption and fraud (ACB 2008). This estimate is derived from Hussein (2004), who has stated that Malawi loses a third of its annual revenue through waste, fraud, bribery, and corruption. This very intuitive guess is probably based on earlier estimates by the African Union that corruption costs African economies more than US$148 billion a year, representing 25 percent of Africa's GDP.[10]

The estimate by Hussein seems to be too high. Table AA.1 in appendix A shows that one- fourth of the government budget is used for wages and salaries, interest payments, and net lending. If 20 percent of the remaining government expenditures (goods and services, subsidies, transfers, development expenditures) is reallocated by corrupt practices, then 5 percent of the GDP is involved in corruption (see calculation in appendix A). These estimates should, of course, be treated with caution.[11]

There is a significant literature on the relationship between corruption and economic development (see, for example, Kaufmann 2005; Svensson 2005; and World Bank 2010). The Malawi ACB lists in its 2008 Strategy various tangible and intangible costs of corruption, ranging from undermining development efforts to threatening democratic values and violating human rights (ACB 2008).

The most prominent economic effect of corruption in Malawi seems to be the diversion of money from the government budget to expenses with lower multiplier effects (see chapter 2.2.1). For example, if money meant as an investment in economic development or poverty relief is diverted as a result of embezzlement or other forms of public corruption toward private spending, it will in most cases be transferred to expenditures

with a lower multiplier effect, such as imported "Hummers" instead of medicines in the hospitals, for example, or foreign fittings in newly built middle-class city mansions instead of school materials.

Some interviewees expressed their concerns over the intangible effects of corruption. "Corruption kills the spirit of hard work," as one interviewee said. "It creates resentment, which in the end could lead to instability of the society as a whole." The main economic effects mentioned by Malawi experts during the World Bank mission and workshop are shown in table 3.3. Box 3.4 illustrates how corruption affects the day-to-day lives of ordinary Malawi citizens.

Another effect from the perspective of the business community is that corruption presents an administrative and financial burden on firms. According to the World Bank's Enterprise Survey of Malawi of 2009, "corruption creates an unfavorable business environment by undermining the operational efficiency of firms and raising the costs and risks associated with doing business."[12] It is not surprising, therefore, that in the survey by the Centre for Social Research, businesses surveyed were prepared to pay a mean percentage of additional taxes of 12 percent to eliminate corruption.[13]

Box 3.4. Taxes, Duties, and Bribes

Women who belong to the National Association of Business Women in Blantyre who travel to other countries in the region to sell their goods mentioned to the authors that paying small taxes and bribes poses a burden on their activities. One of them, who sells curios in South Africa, normally has to pay duties, taxes, and bribes six or seven times on one trip for a total of MWK 60,000 (US$398). About the same amount has to be paid during the return trip.

Source: Authors (interview with the National Association of Business Women in November 2010).

Tax Fraud

Tax evasion is a widespread phenomenon in Malawi. Avoidance of value-added taxes, evasion of taxes on income and profit, and trade mispricing are three main areas of concern according to the Malawi revenue authorities. Trade mispricing is used both to avoid taxes and to illegally externalize foreign currency.

Tax evasion in Malawi is largely a result of a combination of poverty, relatively low levels of education, low levels of financial inclusion, and limited capabilities of the government to create awareness on tax obligations and enforce revenue mobilization. However, there is also a widespread "culture of tax evasion" in Malawi, as many experts noted. In the formal sector, for example, the use of three parallel business accounts is not uncommon—one account for personal use, one account for the bank, and one account for the tax authorities.

The large informal economy and cash-based character of most transactions also fuels evasion of taxes, such as value-added taxes. Tax evasion by vendors and informal businesses increases the tax burden on salaried employees. The MEJN has urged the Minister of Finance to broaden Malawi's tax base (*The Daily Times* 2010). Many informal vendors make more money in a day than an average civil servant makes in a month, according to the MEJN. However, most informal sector traders do not even have bank accounts and are being spared from paying taxes at the expense of low-paid formal workers. Accord-

ing to the MEJN, another untaxed segment of Malawian society is landlords who own houses in Malawi; no proper mechanisms exist to tax them.

How big is the Malawi tax gap? The Malawian tax authority is of the opinion that the government would not need any donor money to finance its own expenditures if all taxes were properly collected (interview of November 2010). Acceding to this intuitive guess, the tax gap would amount to one-third of the Malawi government budget or 12 percent of GDP (see table AA.1 in appendix A). An alternative estimate could be based on the estimated size of the informal economy. Based on the Cobham approach (see table B3.1 in box 3.5), the Malawi domestic tax gap is about 9 percent of GDP.

Box 3.5. Estimating the Domestic Tax Gap

The "tax gap" is commonly defined as the difference between the tax that would be raised under a hypothetical perfect enforcement of tax laws and actual tax payments (Fuest and Riedel 2009). The tax gap is mainly caused by underreporting of income and nonfiling of returns. Attempts to quantify the tax gap can be divided in two broad methodological approaches: macro and micro. Micro approaches are mainly bottom-up approaches based on data from individual taxpayers (tax audits) or surveys. Macro approaches are based on analysis of national accounts, monetary physical supply, and demand variables.

A "rule-of-thumb" macro approach for estimating the size of the domestic tax gap is provided by Cobham. According to this approach the tax gap is simply a function of the size of the informal economy. Cobham (2005) defines the tax gap as the difference between the "hypothetical" (T_0) and actual ($T_{1)}$ tax revenue (est. [T_0 – T_1] = tax-revenue-to-GDP ratio x GDP x shadow economy as percent of GDP).

Table B3.1. The Cobham Approach of Domestic Tax Losses for Malawi and Namibia, 2009

	Malawi	Namibia
Ta- revenue-to-GDP ratio	22.2	26.5
GDP (billion US$)	4.9	9.3
Shadow economy as % of GDP	38.7	33.9
Cobham formula:		
Domestic tax gap (billion US$)	0.42	0.84
Tax gap as % of GDP	8.6	9.0

Source: Author's calculation based on table AA.1 in appendix A, and table 2.2 (GDP, shadow economy).

The Cobham approach raises several questions. For example, its accuracy depends highly on the definition and accuracy of the underlying indicators, such as estimates of the informal economy. If criminal activities are a relatively large component of the informal economy (which is not the case in both Malawi and Namibia), the Cobham approach would overestimate the overall tax gap. GDP data partly include estimates for informal economic activities (such as is the case with World Bank GDP data). This could lead to double counting in the Cobham equation, and thus another overestimation of the overall tax gap. In addition, the Cobham approach assumes that economic behavior is not sensitive to tax enforcement changes. This is not always true. If individuals are taxed, their incentive to invest or otherwise make money might decline. This means that economic activity might be scaled back when it is drawn out of the informal into the formal economy. However, the Cobham formula provides an initial estimate, which could be validated by further research.

Source: Authors.

Cannabis Production

Malawi is renowned for growing the best and finest Cannabis sativa (Indian hemp) in the world. Locally known as "chamba," cannabis is cultivated in remote parts of central and north Malawi.[14] Most of the growers cultivate small fields that are almost inaccessible by road, far up remote mountain hills, hidden in bushes, or intercropped with other field crops such as cassava, maize, or sugarcane. Cannabis has long been a common crop in Africa (box 3.6), and geographic conditions in Malawi are well suited for the cultivation of cannabis; it does not require additional farming inputs, which many other Malawi cash crops do. Prices for cannabis are considerably higher than for other tobacco products (appendix B, table AB.2).

Box 3.6. A Brief History of Cannabis in Africa

More cannabis is produced on the African continent than anyplace else in the world. The continent produces 10,500 metric tons of cannabis herb—roughly 25 percent of world production. Nineteen of the continent's 53 countries have reported cultivation of cannabis on their territory. Cannabis is produced in North Africa (Egypt and Morocco), West Africa (Ghana and Nigeria), East Africa (Kenya and Tanzania), and Southern Africa. The major cannabis producers in the Southern African region are South Africa, Swaziland, Lesotho, Mozambique, Zambia, Zimbabwe, and Malawi. The majority of African cannabis is destined for the more lucrative markets in North America and Europe (ISS 2010). An estimated 38.2 million African adults, or 7.7 percent of the adult population, consume cannabis at least once a year (UNODC 2007). Both the production and use of cannabis in Africa show a long-term increase (ISS 2010; UNODC 2007, 2009).

Cannabis was probably introduced in East Africa by Arab merchants. The earliest evidence of cannabis in Sub-Saharan Africa comes from 14th century Ethiopia, where pipe bowls containing traces of cannabis were discovered during archaeological excavations. From Ethiopia, cannabis seeds were carried to the south. The plant entered local cultures for both religious and recreational use. Cannabis was also widely used as an intoxicant and as medicine (in treating anthrax, dysentery, fevers, malaria, and in treating snakebites).

Sources: Abel 1980; Doctors Independent Network 2010; Du Toît 1975, 1980; Laurent, 2006; UK Cannabis Internet Activists Website (undated).

While most cannabis farmers cultivate it on a small scale (less than 1 hectare), there are larger commercial cultivators, as well. Cannabis growers in Malawi are mostly poor smallholder farmers. Whole rural communities are often engaged in the cultivation of the plants and processing the harvest. The villages use black magic to protect themselves and their fields. As one individual interviewed by John-Allan Namu (2010) said, "All I need is someone to give me some magic and no one will touch my fields."[15]

Most growers sell their produce from their field or homes to professional cannabis traffickers. Only a small minority of the growers take the crop to the market themselves. The cargo is hidden in cars or large trucks or transported in bags through public transportation to destinations in or outside Malawi. Police roadblocks and border controls need to be circumvented. According to a Malawian trucker who shared his experience with the authors on condition of anonymity, bribing of police or customs officials is common. According to this trucker, this could cost between MWK 150,000 (US$996) and MWK 200,000 (US$1,300), depending on the amount of cannabis involved.

The majority of this "Malawi Gold" is produced for the export market. It leaves the country through Mozambique and Zimbabwe, to South Africa and to overseas markets. It is also increasingly exported to neighboring countries such as Kenya and Tanzania. There is a growing demand for Malawi cannabis in the informal settlements of Kenya's large cities (Namu 2010). One "cob"[16] of pure, smokable marijuana is worth US$1.97 on the street in Kenya, of which about US$0.32 is paid to the original farmer (see appendix B, table AB.2).

Growing, dealing, and possessing cannabis is a punishable offense in Malawi. The antidrug policy of the Malawi Police Service involves burning the cannabis harvest, destroying the fields, and arresting cannabis traffickers (box 3.7). Seizures of cannabis vary widely from year to year but increased steadily to an average of over 70,000 kilograms a year over the last 10 years (see appendix B, table AB.1). The antidrug policies are hindered by corrupt practices within the police forces.

Little effort is made to gain intelligence about the organizations behind the trade in cannabis within Malawi and across its borders. The fact that both Malawians and foreigners have been arrested and convicted for drug trafficking suggests that transnational networks may be involved (ISS 2010).

Box 3.7. Destroying Cannabis

The Malawi Police Service has made a priority of stamping out cannabis plantations (burning the harvest and destroying the fields), targeting the growers, and tracing and arresting cannabis traffickers.

Source: Malawi Police Service.

Our own calculations suggest that Malawi cannabis has a street value of MWK 1.4 billion (appendix B, table AB.3), which is equal to 0.2 percent of Malawi's GDP. However, since the majority of the cannabis is exported, and since Malawi farmers receive only about a fifth of the price for which it is being sold in foreign consumer markets (Namu 2010), the positive effect of the production of cannabis on the overall Malawi economy is negligible.

Other Crimes for Profit

Interviews with experts in Malawi in November 2010 revealed several other criminal activities. There are, however, few accurate numbers of the overall incidence of these crimes in Malawi or the amounts of money involved.

Only selected crimes are included in this overview, since our study concentrates on crimes that are specifically aimed at generating financial profit. Violent offenses, including murder and sexual offenses, deliberate damage to property, assault, theft of crops and livestock, theft of bicycles, and various other forms of crime are not included, nor is the relatively new but alarming problem in Malawi concerning the theft of, and trade in, human body parts.

The National Crime Survey (Pelser, Burton, and Gondwe 2006) presents an overview of the crime situation in Malawi. The study is based on a survey of 2,984 respondents over a 12-month period in 2002 and 2003. The study found that reporting of crime to the police is relatively low. This is due to the apparently common perception among victims of crime that the crime was not important enough to warrant reporting to the police. Crimes are most often reported to traditional authorities instead of, or in addition to, the police.

The most prevalent crime in Malawi is crop theft, experienced by 17.2 percent of survey respondents, the majority of whom had maize stolen. Of the sample, 8.5 percent had livestock, mainly poultry, stolen. The next-most-common experience of crime was that of corruption, reportedly experienced by 5.6 percent of the sample. Home burglary was experienced by just 4.6 percent of those interviewed, while theft of personal property was experienced by 3.8 percent. Violent crimes, such as assault (1.5 percent of survey respondents); robbery (0.5 percent); murder (0.2 percent); and sexual assault, which includes rape (0.1 percent), were significantly less common.

The study also reveals a distinct spatial pattern to crime and victimization in Malawi, with residents of rural areas experiencing more crop and livestock theft, and residents of urban areas experiencing more corruption, home burglary, and theft of personal property. Indeed, residents of Malawi's four main urban areas—Blantyre, Lilongwe, Mzuzu, and Zomba—experience corruption, home burglary, and theft of personal property at a rate three times greater than residents of rural areas.

Theft and Armed Burglary

Our information suggests that violent housebreakings have been increasing considerably, particularly those targeted at citizens who are known to have large amounts of cash in their houses. Shops, businesses, and (non)governmental organizations are also targeted. Being a cash-based economy, the proceeds of these housebreakings might be considerable, making robbery an important source of ill-gotten money in Malawi. Table 3.6 presents a selection of 10 significant armed robberies in the first four months of 2009.

The average amount involved was MKW 43 million per robbery—which is equivalent to over US$300,000 (note that the average cost of living in a Malawi town is MWK 50,000, or US$328 a month).

Table 3.6. Selection of Significant Robberies in Malawi during the First Four Months of 2009

Victim	MWK million	US$
Department of Immigration	2.0	14,286
Accountant General's Office	7.0	50,000
Golden Forex Bureau	4.6	32,857
Global Distribution Shop	0.8	5,715
Siku Transport	9.0	64,286
Foodzone Hyperzone	4.0	28,571
Deekay Suppliers	2.4	17,143
Standard Bank Premises	4.2	30,000
Lorgat Trading	9.0	64,286
HTD	0.05	357
Total 10 incidents	**MWK 43,050,000**	**US$307,501**
Average per incident	4.3	30,750

Source: Banda 2009 (based on newspaper articles).

Motor Vehicle Theft

Organized motor vehicle theft is a large problem in Malawi, as it is in surrounding countries (ISS 2010). Both Malawians and non-Malawians are involved. There are connections with criminal networks in Mozambique and South Africa. Vehicles are stolen within the country, or outside Malawi, and smuggled into the country by criminal groups. Motor vehicle theft often involves armed robbery. Cars are stolen for personal use, to be sold (outside the country), or to commit other crimes. There are also accounts of vehicles being stolen and then sold for parts to shops in major towns in Malawi. Criminal groups from Zambia are known to obtain their stolen merchandise from Malawi and other neighboring countries (ISS 2010).

Fraud

The Fiscal Fraud Unit of the Malawi Police Service has confirmed various forms of fraud such as the forgery of bank checks, identity cards, import/export documents, vehicle registration documents, and pension and other employee compensation certificates (for example, the creation of false or "ghost" public workers).[17] Many of these activities are conducted with the involvement of professionals within legal organizations. Bank officers, for example, have been convicted for conniving with criminals. For an overview of the fraud cases during 2006–10 at the Fiscal Fraud Unit of the Malawi Police Service, see appendix C.

Insurance fraud is also significant in Malawi. This involves payments of money by insurance companies due to the creation of fake documents issued by professionals. Police collude with fraudsters to issue fake police reports, while medical doctors issue hospital reports and lawyers push insurance companies to pay fake claims (Banda 2008).

Table 3.7 provides an overview of the reported cases of fraud, motor vehicle theft, robbery, and burglary by the Malawi Police Service in 2009 and 2010. These cases are an unknown fraction of the overall magnitude of these crimes.

Table 3.7. Reported Cases of Fraud, Motor Vehicle Theft, Robbery, and Burglary by the Malawi Police Service, 2009 and 2010

	2009	2010
Fraud	149	133
Motor vehicle theft	106	78
Robbery	3,988	3,236
Burglary	12,337	12,238

Source: Malawi Police Service.

Smuggling of Goods and Counterfeit Goods

Smuggling and illegal importation of goods and counterfeit goods is one of the most prevalent organized criminal activities in the South African region (ISS 2010). Smuggling is aimed at doing business on favorable conditions, evading taxes, or involves the transportation of counterfeit or stolen goods or illegal products (such as drugs) across jurisdictions. Corruption by way of bribing of officials across the route is common.

Smuggling of goods in and out of Malawi involves a wide variety of products including cigarettes (genuine branded products from low-tax countries and smuggling of counterfeit cigarettes), tobacco, batteries, skin- and hair-care products, medicines, and pirated audiovisual materials. Smuggling is one of the most common organized criminal activities in Malawi (ISS 2010). Malawi's long and porous borders and weak border controls facilitate smuggling. However, smuggling of firearms is not very common in Malawi.

Lake Malawi has been used to transport large quantities of dried fish from Mozambique, and consignments of sugar and alcoholic spirits to Mozambique (ISS 2010). The route from Malawi (especially Salima) could also be used to illegally transport high-value goods such as drugs, gold, and ivory. The lake is a weak point along Malawi's borders due to underresourced marine patrols.

Human Trafficking and Child Labor

It is difficult to quantify the extent of human trafficking and child labor in Malawi, because of a widespread lack of awareness and poor record keeping by the relevant agencies. Interviews with law enforcement and national intelligence officials in Malawi indicated that the country is used as a regional transit route for passage from other African countries, including Ethiopia and Somalia, en route to South Africa. In addition, Malawi is also a source, transit, and destination country for men, women, and children trafficked for the purposes of forced labor and sexual exploitation (U.S. State Department 2009). Children are trafficked within the country for forced labor in agriculture, animal herding, domestic servitude, prostitution, and to perform forced menial tasks for small businesses.[18] The incidence of internal trafficking is believed to be higher than that of transnational trafficking (U.S. State Department 2009).

Child trafficking in Malawi is fueled by poverty, low education (illiteracy), the HIV pandemic, lack of awareness, lack of resources, and weak policies (Mkwambisi 2008).

Rural areas, especially, are vulnerable to child trafficking, where people have limited knowledge of what child trafficking is all about. Parents are offered money and clothes and are sometimes tricked into thinking that their children are going to be sent to schools and to work in good jobs in towns and cities, not realizing that they are actually selling their children (Chirambo 2010).

Illegal Foreign Exchange Dealing

Dealing in foreign currency without permission from the Reserve Bank of Malawi is prohibited according to the *Malawi Exchange Control Act*. However, there is a thriving illegal market for foreign exchange in the country. In November 2010, the dollar was traded at 151 MWK on the official market and at around 180 MWK unofficially. Externalizing foreign exchange is done through physically smuggling cash over land or through the Malawi airports. Trade mispricing techniques are also used to circumvent cash control regulations.[19] Additional techniques are overpricing (or overinvoicing) of imported duty-free products (such as capital goods or used clothing) or paying for services that are not to be delivered.

The illegal market has its roots in the shortage of foreign exchange, which has worsened considerably over the last few years (due to a combination of factors, such as a basic imbalance between exports and imports, a significant fiscal deficit, and the policy of managing the floating exchange rate). Spreads between the official and unofficial rate of the MWK against the U.S. dollar increased from 10 basis points in 2008 to 35 basis points in the summer of 2009.

In mid-2009, the Reserve Bank of Malawi closed all nonbank foreign exchange bureaus in an attempt to kill the parallel market for foreign exchange dealing. The nonbank forex bureaus were thought to be aggravating the shortages by hoarding large amounts of foreign currency, and were suspected of being used as conduits for transferring ill-gotten money abroad. However, many nonbank forex dealers unofficially continued their businesses. The operations of the illegal market for foreign currency are done openly throughout Malawian cities (box 3.8). Inefficiencies of the formal banking system contribute to the existence of a thriving illegal market for foreign exchange in Malawi. Getting foreign exchange from the commercial banks is still a challenge. Banks often have to announce that they do not have any foreign currency to sell, or a customer will have to wait for some time (two to four weeks is not unusual).

In addition, the illegal market for foreign exchange thrives on the large informal sector and the widespread use of cash. As in most African countries, doing business with cash is common in Malawi. Business people are used to traveling with a considerable amount of cash—within the country and across borders. According to media reports and discussions with interviewees, the black market for foreign exchange in Malawi is mainly operated by Malawi citizens with strong foreign business relations and by foreign business people in Malawi: Malawians with an Asian background (Malawi has a small but tight-knit and economically influential community of over 7,000 people of Southeast Asian descent), Chinese business people and, recently, Nigerians.

According to interviewees at the February 2011 workshop, the estimated size of the foreign exchange black market in Malawi is believed to be 20 percent of the official

Box 3.8. Illegal Forex Dealing in Lilongwe

The Malawi black market for foreign currency is conducted openly throughout Malawian cities, such as at this parking lot near the downtown Nico Shopping Centre in Lilongwe's Area 3.

Source: Author.

market. This estimate is based on the spread between the official rate (MWK 154 per US$) and the black market rate (MWK 185 per US$), which is about 20 percent of the official rate. The illegal market for foreign exchange is primarily used for legitimate business and private purposes. It is also suspected of being used for concealing proceeds of crimes and externalizing ill-gotten money. Illegal foreign exchange dealing reinforces the existence of the informal economy and the widespread use of cash.

Transfer Pricing

During the World Bank mission in November 2010, experts in Malawi often referred to violations of transfer pricing guidelines by multinational corporations as a source of "ill-gotten money"—although transfer pricing is not illegal in most cases. Transfer pricing abuse in Malawi mainly occurs in relation to the exports of tobacco and certain other agricultural products.

Transfer pricing is the use of intragroup charges to allocate profits among related entities of a multinational corporate group to take advantage of differing tax rates across jurisdictions. The transfer price is how much is paid to a related entity for a service or

good. Transfer pricing can be used to repatriate profits to low-tax jurisdictions or to get around exchange controls. Transfer pricing is not on the face of it problematic. However, there are certain internationally accepted guidelines for ensuring that the prices established can be supported and are in line with what arm's length parties would charge.

In 2009, the Malawi government adopted transfer pricing regulations that are based on these guidelines (the Organisation for Economic Co-operation and Development (OECD) guidelines) (box 3.9). This framework will provide a basic mechanism to address the unsubstantiated shifting of business profits from Malawi to other jurisdictions, and will give the tax authorities some power to deem profits in situations where improper transfer pricing is believed to exist. A new section 127A has been inserted into the *Malawi Taxation Act* to provide a legal instrument for addressing these potential transfer pricing violations. Regulations have also been issued by the tax authorities to implement the provisions under section 127A. It was not clear whether the regulations will have an impact on reducing the number of transfer pricing violations.

Box 3.9. Transfer Pricing

Transfer pricing is a global phenomenon, since more than 60 percent of world trade takes place within branches or subsidiaries of the same multinational corporations (OECD 2002). It is widely believed that transfer pricing by multinationals can deter economic development and poverty reduction in low-income countries (Baker 2005; Christian Aid 2009; OECD 2010). Transfer pricing erodes the tax base. It aggravates exchange rates and shortages and has a negative impact on domestic spending (especially reinvestment of corporate profits). There are also allocation effects resulting from price distortions through transfer pricing. It gives an unfair advantage to multinational corporations and renders domestic businesses unable to compete on a level playing field. A vibrant domestic private sector, however, is considered a necessity for stable long-term economic growth and the eradication of poverty (Christian Aid 2009). Developing countries face the challenge of protecting their tax base while not hampering foreign direct investment and cross-border trade (OECD 2010).

The OECD has developed guidelines for regulating transfer pricing. Article 9 of the OECD Model Tax Convention is the framework for bilateral treaties between OECD countries. It contains the OECD "arm's length principle," which prescribes that a transfer price should be the same as if the two companies were two independents. Many non-OECD countries have adopted the OECD guidelines in their legislation. A proper application of the "arm's length principle," however, is not easy.

Source: OECD 2002, 2010.

Other forms of perceived abusive behavior include internal revenue tax avoidance (activities to reduce taxes in a way that runs counter to the spirit and purpose of the law without being illegal), and collusive pricing through cartels (box 3.10). However, activities that are formally not illegal cannot be subject to the AML legislation.

Spending Patterns

Our research in Malawi revealed several specific uses of the proceeds of corruption and crime. Table 3.8 illustrates the manner in which the proceeds from different levels of corruption are recycled (or reallocated) into the Malawian economy. The findings are based on expert interviews and individual cases as they are described in various press reports.

Box 3.10. Collusive Pricing

U.S.-based leaf-buying companies, Universal Corporation and Alliance One International, purchase Malawi's tobacco and sell it to cigarette producers such as Philip Morris and British American Tobacco (BAT). Malawi's tobacco industry is a de facto duopoly: Limbe Leaf—in which Universal Corporation and Malawi-government-owned Press Corporation Limited have 58 percent and 42 percent interest, respectively, buys 51 percent of the Malawi leaf. Alliance One International buys 40 percent of the leaf, and three locally owned companies share the remaining 9 percent.

In a 2005 study, the Anti-Corruption Bureau concluded that Limbe Leaf and Alliance One operate a tobacco cartel and collude with each other, reducing competition and decreasing auction prices (ACB 2005). Malawi's Tobacco Control Commission—in which Limbe Leaf and Alliance One sit on the Board to represent the interests of tobacco-buying companies—has been unable to end the alleged price fixing.

In 2007, the Malawi government began setting minimum prices for various grades of tobacco in an attempt to improve the price at which the tobacco leaf is purchased from farmers on the auction floors. This government minimum pricing policy has been largely ineffective, as evidenced by persistent closures of the auction floors due to disagreements on prices between farmers and leaf buyers. However, in 2009, Malawi deported four executives from leaf-buying companies for exploitatively offering low prices. The buyers argued that the crop was of poor quality, which the tobacco farmers vehemently denied.

Sources: www.sidewalkradio.net/wp-content/uploads/2007/02/ACB_report.pdf; Anti-Corruption Bureau (2005). Allegations of corruption and connivance among tobacco buyers, Auction Holdings Limited, and other stakeholders in the tobacco industry. Lilongwe, Malawi; see also: http://ihps.medschool.ucsf.edu/pdf/Otanez-Malawi_leaf.pdf.

Table 3.8. Spending Behavior at Different Levels of Corruption in Malawi

Level	Mode of transaction	Typical spending behavior
High-level (political and government) corruption	Cash and bank based	Mainly spending on lavish life styles. Some hoarding of bank accounts. Entrepreneurial investments play a marginal role.
Midlevel administrative corruption	Mainly cash based	Mainly used to attain (higher) middle-class living standards: family expenditures, education, cars, and private dwellings.
Petty corruption	Cash based	Addition to—mostly inadequate— regular income.

Source: Interviewees in November 2010 and February 2011.

On the lowest level—petty corruption—illegitimate income is mostly used as an addition to (insufficient) regular incomes and is, consequently, mostly spent on daily necessities, education, and other family expenditures. Family support is considered to be an important driver behind widespread low-level corruption, or "petty corruption," in poor countries (World Bank 2010).

When the proceeds of corruption exceed amounts that are needed to meet daily necessities, they will be mostly spent on the acquisition of cars, durable consumer goods, private dwellings, and luxury items; that is, expenses to attain a (higher) middle-class living standard. In addition, proceeds of (midlevel) corruption are spent on establishing a middle-class life style. As one interviewee put it, "It is spent on family support; posh cars; and first-class, beautiful houses…. People live beyond their means."

Almost all the interviewees observed (at times with examples of people they know in their communities) that midlevel government corruption is one of the driving factors that has contributed to a high demand for houses in Malawi's capital, Lilongwe (such

as in Lilongwe's expensive area 9) and in the commercial city of Blantyre. Rentals and prices of moderate-to-expensive houses in Lilongwe have increased significantly. Corruption is, of course, not the only factor behind the real estate boom in Lilongwe. The population of the city has grown substantially, but the housing stock has hardly grown at all.

Our impression, based on a wide range of interviews, is that the majority of the proceeds of corruption are spent within the country. Most of the ill-gotten money is used for daily necessities and daily consumption. In addition, we found examples of conspicuous consumption of money—money that is being spent on a gaudy mansion or posh vehicles and hoarded in national bank accounts (see box 3.11). Entrepreneurial investments of ill-gotten money in Malawi seem to be marginal. Only an unknown but likely small percentage is externalized to other jurisdictions. There is no indication of large-scale capital flight from Malawi. However, this needs to be further validated by additional research.[20]

Box 3.11. Conspicuous Consumption

In one case, an accused person was alleged to have diverted donor money to his personal account. The High Court in Malawi had allowed the ACB to seize the accused person's property, including a lavish residence in Blantyre, a multimillion kwacha building, and 44 vehicles, and froze his bank accounts. Information from the Road Traffic Directorate showed that the accused was a registered owner of 149 vehicles, but not all of them could be traced. The trial was ongoing at the time of preparing this report.

Source: The Malawi Post 2010.

The spending patterns we have observed in Malawi reveal why a possible majority of ill-gotten income is not "laundered" in the narrow sense ("made white through the banking system"), but simply spent on daily consumption and lifestyle items. The issue of magnitude is relevant in this context, as well. Van Duyne and Soudijn (2010) rightly argue that "money laundering," in the narrow sense of legitimizing illegal income, is rather a necessary consequence for the middle and upper echelon of criminal earners. The common man's economic crime may be substantial in cumulative terms, but per earner it is too little for money-laundering activities. This notion is also relevant for Malawi when seen from the spending pattern perspective.

Policy Considerations

Challenges for AML. The main challenges in the development of the AML framework in Malawi are (a) using AML as an additional tool in following the proceeds of corruption; (b) how to ensure that the real estate sector, car dealerships, and the legal sector of the economy report STRs; (c) adapting or adjusting the AML framework to conform to a cash- and informal-based environment; and (d) the FIU should be proactive in following up on STRs and not just be reactive, by perhaps considering restructuring the FIU to take on investigatory responsibilities.

Priorities. Tax evasion and the fight against corruption should be prioritized in the application and further design of the Malawi AML system. Corruption and tax evasion are by far the largest sources of ill-gotten money in Malawi.

Tax evasion. The tax gap in Malawi has an estimated value of 8 to 12 percent of GDP. Tax evasion negatively impacts revenue mobilization on the part of the government. The Malawi Revenue Authority has already used the AML framework to go after the proceeds from tax evasion. The successes gained from such a proactive approach should be consolidated and scaled up to be part of the enforcement strategy of the Malawi Revenue Authority.

Corruption. According to our estimates, income derived from corruption amounts to about 5 percent of GDP. There is general agreement on the direct negative impact of corruption on economic development and poverty alleviation, ranging from poor delivery of products and services to a majority of the population to leakages in government expenditures with lower multiplier effects and a long-term negative effect on confidence in government institutions. And, as one interviewee said, "it kills the spirit of hard work." The authorities, specifically the ACB, should use the financial intelligence information in the FIUs database to follow the trail of suspected proceeds of corruption. This has not been the case up to this point.

Financial inclusion. Promotion of financial deepening and financial inclusion is important in making the AML system relevant in Malawi. The cash-based character of the economy impedes effectiveness of the AML system in Malawi. Spending of ill-gotten money in Malawi probably simply occurs mainly through the direct purchase of goods and services, cash investments in real estate or business enterprises, or family support.

Informal sector. Financial inclusion strategies should also be targeted at the rich population segments of Malawian society. Informality and the use of cash are not only restricted to small-scale economic activities. A significant number of Malawians with small- and medium-size businesses, Chinese business people, and business people from other African countries have a preference for using cash, as well. Moreover, some members of Malawian society prefer to avoid the banking system for cultural and religious reasons (there are no Islamic banks in Malawi).

Impact of AML policies. AML is generally perceived as not having a negative impact on financial inclusion strategies (see box 3.12). Banking sector inefficiencies, tedious bureaucratic procedures, high costs, negative real interest rates, and lack of confidence, are considered to be major barriers to an increased role of the financial sector in the day-to-day economic relations of individuals and business firms in Malawi.

Gatekeepers. Despite the fact that cash dominates the Malawian economy, and a significant majority of all transactions are in cash, at one point or another lawyers, real estate agents, and car dealers will have dealings with individuals and businesses that want to spend their ill-gotten money. As such, the authorities should consider focusing most of their attention on ensuring that these gatekeepers undertake appropriate due diligence when engaging in large transaction, preferably above a specified threshold. Hitherto, most attention has been paid to the financial sector (primarily banks), but as observed in this chapter, most financial activities take place outside the formal financial system. Consequently, it is recommended that implementing the AML measures in the case of the securities and insurance sectors may not be the optimal way.

Transfer pricing and forex dealing. Transfer pricing abuse and black market forex dealing have a negative impact on economic development in Malawi, particularly when one considers the small resource base of the country. Nevertheless, using AML as a tool to tackle these issues is not the right policy response. Transfer pricing abuse has to be

Box 3.12. Causes of Financial Exclusion

A Genesis Study (2008) analyzed the effects of AML regulation on access to finance in Indonesia, Kenya, Mexico, Pakistan, and South Africa. The study also included case studies on the United Kingdom, the United States, and the Philippines. The main take away from the study was that "AML regulation is not the only factor impacting on financial inclusion."[a]

AML measures can negatively affect access to, and use of, financial services if the measures are not carefully designed.[b] In the case of Malawi, in 2009 and 2010, the number of accounts per adult increased from 124/1,000 in 2009 to 163/1,000.[c] While one cannot read much into this increase, it can be argued that it is likely the case that AML measures have not impeded the growth of the accounts. Moreover, when it comes to documentation required to open an account, Malawi has an exception from requirements for low-income applicants of small accounts.[d]

Main causes of financial exclusion are as follows:

Clients denied access. Lack of physical access to service points may prevent people from seeking formal financial services, especially in rural areas or locations with few branches, automatic teller machines, or other ways of accessing an account. Affordability is another barrier; it includes minimum balances for deposit accounts imposed by financial institutions, account fees, transaction fees, and other costs of using the product. Finally, regulatory barriers, such as ID requirements based on documents that are not freely available to low- income people, may block access.

Clients opting out. People may opt out of formal services if they see more benefits, in terms of cost, convenience, or cultural links, in going to informal financial service providers. Often, informal services are perceived as less costly, requiring less documentation, conveniently located, and welcomed to this market segment.

Market inefficiency. Formal financial institutions may not yet see market advantages to providing access, or they may be discouraged from expanding their clientele by regulatory burdens. At the same time, informal financial institutions (for example, NGOs, associations, and so forth) may not be allowed to receive licenses or access other benefits of the formal financial sector if appropriate regulations are not available.

Regulatory costs. Providers may exit markets and potential providers may be barred from entering a market if the regulatory compliance costs are too high. If there are fewer providers, customers may find it more difficult to access appropriate products at an affordable price.

Source: Isern and de Koker 2009.
Note: a. Genesis Analytics 2008, p. 26. b. Genesis Analytics, 2008, p. 31. c. See table 1 in Financial Access 2010, p. 57 (CGAP 2010); and table S1 in Financial Access 2009, p. 55 (CGAP 2009). d. See table P1 in Financial Access 2009, p. 63 (CGAP 2009).

tackled from a tax policy and tax administration perspective. It may also require a global collective action similar to the way corruption has been dealt with. In terms of black market forex dealing, the fundamental approach is the relaxation of foreign exchange controls in order to provide an incentive for individuals and business firms to return foreign earnings to Malawi.

Other crimes. The proceeds of most other crimes (such as dealing in stolen vehicles, smuggling, robbery, production of cannabis, and so forth) are relatively small compared to corruption and tax evasion. The spending of the proceeds largely takes place in the context of the informal economy of Malawi. The economic consequences vary widely including the possible positive consequences such as a redistribution of money from rich to the poor (in the case of burglary), or proceeds from cannabis production used to send children to school.

Data collection and empirical research. Development of data and additional empirical research in Malawi are necessary to shed light on the magnitude and impact of the proceeds of crime, corruption, and, generally, ill-gotten money in developing countries and on subsequently prioritizing AML policies.

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Notes

1. The Enhancing Regional Responses Against Organised Crime (EROC) Project of the ISS and SARPCCO is the first large in-depth study of organized crime in South Africa. The project ran from January 2008 to December 2010. For earlier ISS publications on crime in Malawi, see Gastrow (2003) and Goredema (2007).

2. Movement from rural to urban areas is increasing. The urban population in Malawi was estimated at about 850,000 in 1987 and 2 million in 2008. The four biggest cities are Lilongwe, Blantyre, Zomba, and Mzuzu (Government of Malawi 2008).

3. See the Reserve Bank of Malawi and Malawi FSAP publication of May 2008; and IMF Article IV, Malawi Staff Report 2009.

418. They are 22 Microfinance Institutions affiliated to the Malawi Microfinance Network (MAMN) and 55 financial cooperatives (SACCOs) affiliated to Malawi Union of Savings and Credit Cooperatives (MUSCCO).

5. www.bis.org.

6. Republic of Malawi, National Anti-Corruption Strategy, 2008.

7. For an overview, see Transparency International (2005).

8. Interview with the Malawi ACB.

9. See, for example, Transparency International (2005); a baseline survey by the Millennium Consultancy Group (2006); the follow-up study by the Centre for Social Research of the University of Malawi (2010); and various reports by the Malawi ACB (ACB 2008).
10. Report by the African Union, presented before a meeting in Addis Ababa in September 2002.
11. The corruption survey by the Centre for Social Research revealed that a mean estimate of 9 percent of procurement contracts involve some kind of gratification, while the mean estimate of the contract value that must be offered in gratification in order to secure contracts is 7 percent. Firms seeking to do business with the state sector must pay an average gratification of 14 percent (Centre for Social Research, University of Malawi 2010, pp. 43–44).
12. Enterprise Surveys, Malawi Country Profile 2009 (World Bank 2009).
13. Governance and Corruption Survey 2010, p. 43 (University of Malawi, Centre for Social Research).
14. Cannabis is cultivated in the Nkhotakota district along the banks of the Lupache River, in the Mzimba district's Likwawa hills, in Nkhata Bay, Kasungu, and, to a lesser extent, in Dedza, Mwanza, Ntcheu, and Ntichisi. There are two main cannabis products. Cannabis herb refers to the leaves and flowering tops of the cannabis plant and is also known as "marijuana," "ganja," "weed," or "chamba" in Malawi. Cannabis resin refers to the pressed secretions of the plant. This is known as "hashish" in the Western Hemisphere and "charas" in India. The Malawi Cannabis sativa is predominantly processed into marijuana. A negligible amount of the crop is processed into hashish.
15. Instigative journalist John-Allan Namu, winner of CNN's 2009 African Journalist's Award, spent several months investigating the trade and use of marijuana, an assignment that took him from the farms where the weed is planted to the route it takes to the market. In 2010, he produced a documentary, "Weed, Inc.," about his investigation.
16. Farmers process the flowering tops into so-called "cobs," which are tightly bound packages wrapped in banana leaves and are about the size of a maize cob.
17. Based on ISS (2010, 73).
18. A report by the Malawi Ministry of Labor shows that there are 1.4 million child workers in Malawi. Forty-one percent of children under age 15 are working part of full time, while 78 percent of rural children aged 10 to 14 work at least part time on their parents' farms. Most of the child labor is found on tobacco and maize farms, herding cattle, in the fishing industry, street vending, and domestic servitude (particularly for girls). Several nongovernmental and human rights organizations report that Malawi is using child labor to produce coffee, tea, and tobacco.
19. The import of Malawi kwacha and foreign currency into Malawi is unlimited. The export of Malawi kwacha is limited to MWK 3,000 (US$20). Anyone who brings foreign money into Malawi is required to declare it at time of entry. The export of foreign currency may not exceed the amount imported and must be declared on departure.
20. Collier, Hoeffler, and Parrillo (2004) found that "the severe financial capital flight that Africa experienced until the late 1980s has started to be reversed." The factors that have accounted for this repatriation are, according to the authors, probably "the reduction in the parallel market premium and African indebtedness, the reduction in the incidence of civil war (a phenomenon true only of our sample countries, rather than a general African phenomenon) and the decline in real U.S. interest rates." (p. ii15)

CHAPTER 4

Country of Focus: Namibia

The Bank of Namibia (BoN), on its public Web site, explains why money laundering is bad for the Namibian economy:

> *"Namibia will be regarded as a money laundering haven and will become the most attractive economy in the world for criminals to stay and launder the proceeds of criminal activities; financial institutions will be associated with criminal activity and legitimate institutions could suffer extensive loss of public and investor confidence with a resultant loss of legitimate profits that contributes to the country's Gross Domestic Product (GDP); it can lead to loss of donor funding as Namibia will be regarded by the international community as a country that aids and supports criminals and criminal activities."*[1]

Are these worries by the BoN justified? Is ill-gotten money indeed harmful to the Namibian economy? How much ill-gotten money is being laundered in Namibia? And is Namibia indeed attractive for ill-gotten money and criminals from abroad, as the BoN states? And what about corruption? How important is corruption as a predicate offense to money laundering in Namibia?

Namibia has a legal and institutional framework for curbing crime, corruption, and money laundering. This includes signing the United Nations Convention against Transnational Organized Crime, the *Prevention of Organized Crime Act of 2004*, and the *Financial Intelligence Act of 2007*. Namibia enacted its *Anti-Corruption Act* in 2003 and established an Anti-Corruption Commission in 2007. Crime and public corruption, and their effect on the economy, nonetheless remain of concern in the country. We explore these issues below.

Like in the case of Malawi, the analysis here is based on open-source literature and interviews with government, private sector, academia, and civil society organization representatives conducted by a team of World Bank and Namibian FIC staff in November 2010. A literature research is based on various writings by investigative journalist John Grobler and on publications in *Insight Magazine* and the daily newspaper *The Namibian*. A comprehensive overview of the causes, structure, and main activities of organized crime and corruption in Namibia can be found in Grobler (2003) and Goba (2007). The Institute for Security Studies (ISS 2010) recently provided research on organized crime in the whole South African region. For writings on the political root causes of corruption in Namibia, see for example Melber (2006, 2010). Also like in the case of Malawi, not all forms of crime are included in the analysis. Reference to "crime" refers to those acts that generate financial profit or gain to the perpetrator.

The Namibian Economy

Namibia is a vast, empty country that is bordered by Angola and Zambia on the north, Botswana on the east, South Africa on the south, and the Atlantic Ocean on the west. It covers a surface area of 825,000 square kilometers and has a population of only 2.2 million. Namibia is the second-least-densely-populated country in the world, after Mongolia. Gross domestic product (GDP) is over US$4,276 per capita, which makes Namibia an upper-middle-income country.

Namibia's resource-based economy is mainly driven by agriculture, fishing, food processing, mining, and tourism. Exports amount to one-third of the country's overall GDP. As an export-dependent economy, Namibia was hit by the global economic downturn, but recovered unexpectedly quickly and relatively unscathed. Economic growth is expected to be back to around 4 percent or higher in the next few years. The country benefits from a strong institutional environment (World Economic Forum 2010). Property rights are well protected and the judicial system is perceived as independent from undue influence. The country's transport infrastructure is excellent by regional standards. The level of development of the financial system in Namibia meets western standards.

Table 4.1 provides a comparison of Namibia with its surrounding countries, Angola, Zambia, Botswana, and South Africa. Namibia's population is somewhat larger than its eastern neighbor Botswana. Average living standards (GDP per capita) are slightly lower than in Botswana and South Africa and slightly higher than in Angola. All four countries are characterized by very large income differences. The Namibian economy is the smallest in the region (GDP of US$9.3 billion). Levels of corruption are perceived to be comparable with South Africa, higher than Botswana, but much lower than Zambia and Angola. The Ibrahim Index of Governance ranks Namibia sixth, making it one of the continent's best-governed African countries, just behind Botswana and South Africa. Levels of financial exclusion are, however, relatively high by regional standards.

Table 4.1. Namibia and Surrounding Countries: The Economy, Corruption, Governance, and Financial Exclusion

Factors	Botswana	South Africa	Namibia	Angola	Zambia
Classification	Upper MIC	Upper MIC	Upper MIC	Lower MIC	Lower MIC
GDP per capita (US$)	6,260	5,760	4,270	3,750	1,070
Population (million)	1.9	49.3	2.2	18.5	12.9
GDP (US$ billion)	11.8	285.4	9.3	75.5	12.7
Gini coefficient	61.0	57.8	70.7	58.6	50.7
Corruption ranking	33/178	54/178	56/178	168/178	101/178
Governance ranking	3/53	5/53	6/53	17/53	42/53
Financial exclusion	33%	26%	52%	na	66%

Sources: World Bank: GDP, population, classification, 2009; Gini coefficient: World Bank 2010b; Corruption: Transparency International 2010; Governance: Overall 2010 Ibrahim Index; Financial exclusion: Finscope.
Note: MIC = middle-income country; LIC = low-income country.

Trade Relations

Exploitation of Namibia's rich natural resources is the pillar of the Namibian export sector, which includes agricultural products, animals, fish, tourism, and mining (rough

diamonds, uranium, high-quality zinc, acid-grade fluorite, lead concentrate, copper, top-quality gemstones, and salt). Mining contributes over 17 percent of the Namibian GDP and about 50 percent of its merchandise exports. Namibia is the world's sixth-largest supplier of diamonds and the fourth-largest producer of uranium. The country is currently undergoing a "uranium rush"; rising global demand for uranium has led to a worldwide boom in uranium exploration activities, including in Namibia. Foreign oil companies expect to soon find off-shore commercially recoverable oil revenues off the coast of Namibia. Namibia's major export markets are South Africa and the United Kingdom. Other export destinations include Angola, Spain, and the United States.

South Africa supplies over 70 percent of Namibia's imports. China, Germany, and the United Kingdom are other important sources of Namibia's imports.[2] Motor vehicles, petroleum products, and industrial diamonds are major commodities imported into Namibia.

China has been investing heavily in Namibia, constructs government buildings, and participates in various development projects (Odada and Omu Kakujaha-Matundu 2008). In Oshikango, the region in the north of Namibia, the number of Chinese shops quadrupled between 2004 and 2006 (Grobler 2006). As elsewhere in Africa, China has become a major player in the competition for natural resources. It has, for example, acquired a 12 percent stake in the Australian-based Rio Tinto group, which has a 69 percent interest in Namibia's major uranium mine.

Population

The population of Namibia is culturally and ethnically diverse. Over half the population belong to the Ovambo and several other minority ethnic groups such as the Herero (120,000 people), Kavango, Khoikhoi, San, and Damara. About 100,000 Namibians are of European descent. Approximately two-thirds speak Afrikaans, one-quarter speak German, and most of the rest speak English. German Namibians have had an influence on Namibia that is inversely proportional to their numbers. Although Germany held Namibia as a colony for only a short time (until World War I), the influence of the German community that remained is tangible in nearly every aspect of urban life in Namibia.[3] Over 85,000 Namibians are of mixed origin (Basters and Coulerds). Many of them speak Afrikaans.

Namibia hosts a thriving Angolan community comprised of Angolan families that have been in Namibia since the 1930s, refugees from the early days of the Angolan civil war (30,000 at the peak in 2001); and newcomers, mainly well-to-do Angolans who are attracted by Namibia's vast economic opportunities, high standards of living, and favorable business climate.

Namibia also hosts an increasing number of Chinese nationals—currently about 35,000—who are permanently or temporarily in the country. Chinese are especially engaged in the construction industry and retail businesses. Chinese shops in Namibia are in most cases branches of bigger Chinese retail networks. Chinese nationals in Namibia include both wealthy businesspeople, low-income groups (construction workers, small traders, vendors in Chinese shops), and even illegal immigrants.

Development Challenges

Policies of the postindependence government have not yet led to a significant redistribution of wealth. Although Namibia is an upper-middle-income country, its income

inequality is the highest in the region and one of the highest in the world (with a Gini coefficient of over 0.70; see table 4.1). Over 40 percent of its households are rated below the poverty line. The extremely skewed income distribution is a legacy of the apartheid system before 1990, which created a highly dualistic society. Class structures in Namibia have an ethnoregional correlation; the language groups existing among the whites are generally far better off in terms of education, health, and income than the groups speaking local vernaculars (Melber 2006).

One of the big challenges in Namibia is the high unemployment rate, which is over 50 percent, according to the most recent estimates.[4] Namibia inherited a highly segmented labor market, with a major underlying factor being unequal access to education and, sometimes, total lack of access to education (IMF 2006; Njini 2010a; World Bank 2010). The investor-friendly policies aimed at encouraging investment in the agriculture, manufacturing, and minerals sectors have not created jobs for the majority of the Namibians. Unemployment is especially high among young Namibians and Namibians living in rural areas. The high unemployment rate has been blamed for the rising crime rate and for the rise in the illegal drug trade, intakes, and prostitution (Njini 2010b).

SWAPO, which has governed Namibia since independence in 1990, has implemented a land resettlement program (through the *Communal Land Reform Act, 2002*) and a comprehensive black economic empowerment (BEE) policy (of which the basis is set out in the *Affirmative Action Employment Act, 1998*). BEE provides for a shift in the ownership of private-sector firms in favor of "historically disadvantaged Namibians," including minimum equity stakes for BEE entities. However, the growing perception that BEE initiatives have worsened corruption and resulted in the enrichment of groups of politically well connected Namibians may cause the authorities to reexamine the means of implementing BEE.[5]

The Financial Sector

The Namibian financial sector is one of the most diversified and developed on the African continent. The financial sector encompasses four commercial banks, about 30 insurance companies, 500 pension funds, asset management companies, unit trust management companies, some specialized lending institutions, microfinance organizations, and a stock exchange.[6]

There are four state-owned, specialized financial institutions that support specific public policy objectives—the Namibia Post Office Savings Bank (NamPost), the Development Bank of Namibia (DBN), the Agricultural Bank of Namibia (AgriBank), and the National Housing Enterprise Limited. The NamPost Savings Bank focuses on the delivery of affordable financial services to all Namibians. Every post office in the country is also a savings bank branch. In 2009, the BoN issued a provisional license to the first microfinance-oriented bank, Financial Systems Development Services (FIDES) Bank Namibia Limited (Bank of Namibia 2010a).

The Namibian banking sector is mature, profitable, and well capitalized.[7] Nonbank financial institutions are well developed, as well.[8] Assets of Namibia's contractual savings sector (pension funds and life insurance companies) are valued at 100 percent of GDP, most of which is invested in South Africa. Unit trusts, brokers, and asset managers mainly provide services to pension funds and insurance companies. Many of them are affiliates of South African financial institutions. Namibia has a relatively small money

market. Most Namibian banks manage their liquidity with banks in South Africa (especially their parent banks). Namibia has, however, a relatively well developed government securities market, including an active secondary market in treasury bills. The stock exchange plays a relatively small role in Namibia's economy (with a market capitalization of only 13 percent of GDP in 2009).

Foreign (South African) ownership of banks in Namibia, and outflow of savings toward South Africa and limited outreach of the financial sector to the population are major sources for concern. Three of four commercial banks are subsidiaries of South African banks and the fourth, Bank Windhoek, has a South African bank (ABSA) as its largest shareholder (36 percent). This has raised the debate about changes needed in the *Banking Institutions Act of 1998* to give more legal power to the BoN to set the ownership and shareholding structure of foreign-owned banks. In 2010, the BoN refused a proposed deal by South Africa's ABSA Group to buy the majority shareholding in Capricorn Investments Holdings, the majority shareholder of the Namibia-owned bank, Bank Windhoek. In the meantime, Namibia is a net exporter of national savings. In 2009, the country exported NAD 7.7 billion (US$1.1 billion) to South Africa, and in 2010 it exported another NAD 8.9 billion (US$1.3 billion).[9] These capital outflows are overwhelmingly portfolio investments and foreign direct investments.

More than half (52 percent) of the adult population is "financially excluded," according to the 2007 Finscope survey. Use of the formal financial system in Namibia is low compared to the two neighboring upper-middle-income countries, Botswana (33 percent) and South Africa (26 percent) (table 4.1). Namibia's financial inclusion level has been stagnant since the first Finscope survey in 2004. The drop-out rate of people from the financial system increased from 4.3 percent in 2004 to 6.3 percent in 2007. The distance between rural villages and urban centers, where most commercial banks are located, limits access to credit for small- and medium-size enterprises and private borrowers in rural areas. Notwithstanding these high rates, it is noteworthy that between 2009 and 2010, the number of adults with bank accounts increased from 466 per 1,000 in 2009 to 757 per 1000 in 2010.[10] It could be that the number of financially excluded may have come down a bit. Moreover, the increase in bank account holders rose within the same period when the AML framework was introduced.

Poverty, low (financial) education ("People are afraid of banks"), the important role of the informal sector in the lives of many people, the limited presence of banks in remote areas, and inefficiencies and high costs of having and using bank accounts, partly explain the important role of cash in Namibia. Regional differences need to be taken into account, as well. In the north of Namibia, most business is done in cash, while the Windhoek economy is more bank based. A widespread "culture of cash" is an important additional factor in a deeply rooted preference for cash, such as a psychological attachment to the physical possession of money and a widespread reluctance to be indebted (as was the case in many western countries 50 years ago). Some degree of distrust of the formal banking system also contributes to the preference for cash, partly because, for some, large banks connote corruption and kleptocracy, and partly because of the important role of foreign-owned banks in Namibia.

Broadening access to financial services is one of the key strategic objectives in realizing balanced economic growth and achieving the development goals as reflected Namibia's long-term strategy Vision 2030.[11] It is also a necessary condition for increasing the outreach of the Namibian anti-money laundering system.

The Anti-Money Laundering (AML) System

The Namibian AML system has made great strides in its first one-and-a-half years in existence, both quantitatively and qualitatively. It has yielded a wide variety of suspected money laundering cases, as tables 4.2 and 4.3 show. One case allegedly involving corruption, which is ongoing in the Namibian High Court—the Nuctech case—was brought to light as result of the AML reporting obligations for Namibian banks.[12]

Two laws are most important to Namibian AML efforts:

- The Namibian *Prevention of Organised Crime Act of 2004*. This law is designed to combat organized crime, money laundering, and people trafficking. It criminalizes money laundering and imposes reporting obligations on suspicions of unlawful activities and provides for the establishment of a Criminal Assets Recovery Fund and a Criminal Assets Recovery Committee. Money laundering is defined by the law to include "self-laundering," which means that even possessing and spending ill-gotten money is considered to be money laundering. Namibia has adopted a list and threshold approach to define predicate offenses to money laundering, which includes any offense punishable by more than 12 months' imprisonment. Passed by parliament in December 2004, the *Prevention of Organised Crime Act* did not come into force until formal publication in the *Gazette Notice* in 2009.
- The *Financial Intelligence Act, 2007* (FIA). This law, which took effect in May 2009, is meant to complement the *Prevention of Organized Crime Act*. The FIA mandates that financial institutions and designated businesses implement adequate policies and procedures, such as know-your-customer policies and customer due diligence, and send suspicious transaction reports (STRs) to the Financial Intelligence Centre, which the Act establishes within the BoN as the administering authority. The law designated the BoN as the national, central agency for collecting, processing, analyzing, and assessing all reports and information received, and for disseminating information to the relevant authorities (ESAAMLG 2007). The BoN, in implementing the FIA and its regulations, created the Namibian Financial Intelligence Centre (FIC) within the BoN. The FIC became operational in May 2009. The FIA establishes an Anti-Money Laundering Advisory Council (AMLAC), chaired by the governor of the BoN, as the policy-making body on Namibian AML matters.
- Since the AML system was introduced, and in addition to setting up the FIC, Namibia has made progress in the following areas: it has brought banks, bureau de change, money exchangers, law firms, real estate agents, auctioneers, trust and company service providers, stock brokers, insurers, pension funds, micro-lenders, securities firms, casinos, and car dealers under the AML requirements; it has disseminated more than 170 financial intelligence reports to the tax and anticorruption authorities; and more than 50 public sector officials from the ACC, BoN, FIC, Police, Prosecutor General, National Intelligence, and Tax and Customs divisions have been trained in financial investigation skills (tracing ill-gotten money).
- One challenge in developing an AML framework that meets Namibia's needs remains: using AML as an additional tool to trace the proceeds of corruption and tax evasion.

Financial institutions and a wide variety of nonfinancial service providers (legal practitioners, real estate agents, casinos, car dealers, dealers in second-hand goods, dealers in precious stones, and so forth) are subject to AML requirements such as customer due diligence, record keeping, STRs, and other AML preventive measures. The FIC has adopted a step-by-step approach to bring all relevant institutions into the AML system.

From May 5, 2009 to December 15, 2010, the FIC received 171 STRs from accountable institutions and nine requests for information from foreign FIUs and local law enforcement agencies (see table 4.2). As of December 2010, jewelers, dealers in precious stones, totalisator agencies, and dealers in second-hand goods had yet to be brought under the AML system.

Table 4.2. Breakdown of Suspicious Transaction Reports by Reporting Agency, Namibia, May 5, 2009–December 15, 2010

Entity	Number
Banks	112
Money remitters	38
Legal practitioners	7
Law enforcement	2
Unit trusts and asset managers	4
Insurance brokers	1
Accountants and auditors	1
Other, including individuals	6
Total	171

Source: FIC Namibia.

One hundred forty-one cases were opened, of which 33 were set aside after analysis determined that no money laundering or criminal offense was committed. One hundred twenty-six intelligence reports were disseminated to applicable law enforcement agencies, including the Namibian Police, the Anti-Corruption Commission, the Ministry of Finance Department of Inland Revenue, the Prosecutor General, the Namibia Central Intelligence Agency, and foreign FIUs. The majority of the STRs (37) were found to be related to tax evasion. Other STRs were related to corruption (8), various scams (8), diamond smuggling (5), drug trafficking (4), and foreign exchange dealing (3) (table 4.3).

Table 4.3. Breakdown of Suspicious Transaction Reports by (assumed) Predicate Offense, Namibia, May 5, 2009–December 15, 2010

Suspicious Transaction Reports	Number
Tax evasion	37
Corruption	8
Scams and 419 fraud	8
Diamond smuggling	5
Drug trafficking	4
Foreign exchange dealing	3
Terrorism financing	2
Various (no clear predicate)	104
Total	171

Source: FIC Namibia.

How representative are the STRs of the overall money-laundering problem in Namibia? What are the main sources of ill-gotten money in Namibia? And how harmful is ill-gotten money to the Namibian economy?

Sources of Criminal Money

As a middle-income country, crime and corruption in Namibia covers a wide range of activities. The main findings based on interviews with experts, in Namibia and corroborated by information from open-source literature, are summed up in table 4.4.

Table 4.4. Ill-gotten Money and the Economy: Namibia

Sources	Magnitude *Estimates, reported cases, and actual data*	Recycling channels	Economic effects *Not exhaustive and based on interviews in Namibia*[a]
Corruption Procurement fraud Collusive tendering Kickbacks Fraudulent investments Embezzlement Bribery *High-, medium-, and low-level corruption* *Corruption in state-owned enterprises*	Individual cases vary from a few million N$ to 10 (US$1.4 million) or 100 million (US$14 million) of N$ diverted through corruption. No estimates on overall magnitude of medium-level and petty corruption.	Mainly bank based	• Self-enrichment of new political and entrepreneurial elite • Increase of rich-poor divide • Erosion of confidence in the government and state • Potential environmental harm • Inflation of real estate prices
Organized crime Motor vehicle theft Cannabis import and transit Cocaine import and transit Diamond smuggling Other protected resources Cash-in-transit heists Cattle theft Smuggling of goods Counterfeit goods Counterfeit currency	Reported cases of motor vehicle theft, drug trafficking, and protected resources (including diamonds) had an overall value of N$50 million (US$7 million) in 2009 and 2010. No data on overall value of smuggled and counterfeit goods, cash-in-transit heists, or cattle theft.	Mainly cash based	• Direct financial loss to victims • Price distortions and unfair competition • Influence of (foreign) organized crime groups
Organized fraud Document fraud (public and private) Pyramid and Ponzi schemes Credit card scams Check fraud (declining) 419 scams	Reported cases of "commercial crime" had an overall value of N$6 million (US$0.9 million) in 2010.	Mainly bank based	• Direct financial loss to victims
Tax fraud	Estimated to be 9% of GDP (see table in box 3.3)	Cash and bank based	• Erosion of the tax base • Reduces revenue for government
Inflow of foreign ill-gotten money	No data, only cases.	Cash and bank based	• Inflation of real estate prices • Reputation to Namibia • Spill-over effect to crime

Source: Own investigation.
Note: a. The interviews were held in November 2010 and February 2011 (workshop). Costs for prevention, detection, law enforcement, and prosecution are excluded.

Based on data on reported cases by the police or in the press, it can be concluded that, in terms of financial magnitude, government corruption is a larger problem than other forms of organized crime and fraud. Illicit diamond dealing is one of the oldest organized crimes in Namibia, followed by drug trafficking and car smuggling. However, in recent years, embezzlement of government funds and fraud with public money has increased dramatically.

Several large corruption cases taken together involve more money than reported cases of other crimes taken together. These cases will be discussed in the subsection titled "Forms of Corruption in Namibia." Nevertheless, the lack of hard data on the magnitude of various forms of crime and corruption vis-à-vis the Namibian economy makes it difficult to determine reasonable estimates in terms of a percentage of overall GDP.

As is the case for Malawi, Namibia also struggles with a large tax gap, which will briefly be discussed in the section titled "Organized Crime."

The reported and detected cases of organized crime are an unknown percentage of the overall crime problem. Some forms of sophisticated crime for profit tend to co-occur with corruption, buying influence, and legal economic behavior (see, for example, the pizza connection case, box 4.5), making it hard to differentiate legal money flows from crime or corruption money management.

Namibia is especially vulnerable to inflow of foreign ill-gotten money. This will be discussed in the section titled "Cross-border Money Flows." In part due to its developed financial sector and its economic and geographic links with South Africa to the south and Angola to the north, foreign criminals are likely to find Namibia a most attractive country in which to stay and launder the proceeds of their criminal activities.

Corruption

Observers generally agree that Namibia's legal and institutional framework for curbing corruption is adequate and among the most functional in the region. Namibia ratified the United Nations Convention against Corruption. Namibia's *Anti-Corruption Act* came into force in 2003. This Act specifies and criminalizes offenses of corruption and provides for the establishment of the Anti-Corruption Commission (ACC). Corrupt practices are defined as including passive and active bribery, attempted corruption, extortion, bribing a foreign public official, money laundering, and abuse of public office and resources for private gain. The ACC began operations in 2007. Every citizen is obliged by law to report corrupt practices to the ACC, which has the power to initiate investigations in cases of alleged corruption. At present, 36 cases are with the Prosecutor General for prosecution. Trials of some of these cases have already begun.

Anticorruption is high on the Namibian national agenda. President Pohamba declared a zero-tolerance corruption policy when he took office in 2005, and proclaimed that he would set a personal example. The anticorruption campaign is backed by a strong civil society and the media (press freedom is among the highest in the region).[13] Interviewees indicated that public corruption is not endemic, as in other jurisdictions in the developing world. Despite these efforts, corruption is nonetheless widely considered to be a matter of serious concern.

Forms of Corruption in Namibia

Over the last few years, Namibia has been subject to a range of rent seeking activities involving civil servants and individuals who are connected to influential citizens siphoning off state resources and accepting bribes or kickbacks for personal enrichment. All those interviewed during the World Bank's November 2010 mission shared the perception of corruption and unethical activities on the part of government officials and politicians, and expressed concern over this perception.

It is alleged that high-level corruption in Namibia manifests itself through tendering and the irregular issuing of licenses and bribery to issue them, procurement (at various ministries and at the local level), and investment schemes. Kickbacks and nondeclaration of conflict of interest is a common feature in many corruption allegations.[14] Table 4.5 presents an overview of selected cases involving suspected corruption activities in recent years in Namibia.

Table 4.5. Selected Corruption Cases in Namibia, 2000–10 (proven and still pending in court)

- Social Security Commission (SSC) channeled NAD 30 million (US$4,112,110) through Avid investments, a special purpose vehicle set up to receive and launder money
- Offshore Development Corporation (ODC) lost NAD 100 million (US$13,707,035) in a fraudulent investment scheme involving Great Triangle Investments
- NAD 120 million (US$16,448,442) lost from the Ministry of Finance; the government and the City of Windhoek incurred further costs for subsidies and grants for land, road, electricity and water infrastructure, and for repairing environmental damage caused by the Ramatex company
- Namibia Liquid Fuel (NLF): Namibia's state oil corporation, NamCor, awarded a profitable contract to the NLF, a joint venture with senior government officials as major shareholders; proved to be not illegal but public perception was that it was unethical
- Government Institutions Pension Fund (GIPF): An estimated NAD 1.8 billion (US$260,524,747) lost through investments in the Development Capital Portfolio
- Nuctech: A bribery scheme that secured a US$55.3 million contract (at inflated prices) to install 13 Nuctech scanners in return for kickbacks to Teko trading (Namibian "consultant").

Sources: Auditor General Reports; All Africa 2010a.

There have been allegations of activities involving misappropriation of public financial resources in institutions in which the government has an interest, such as the Social Security Commission (SSC), the Offshore Development Company (ODC), and the Government Institutions Pension Fund (GIPF) (box 4.1). Moreover, the gravity of these activities has been acknowledged by the government. The Minister of Information, as quoted by the Namibian press, has stated that "the Government, and not just its workers, are victims of the GIPF investment scandal and those guilty, regardless of how powerful, will have to face the law. Nobody will be protected. Everybody will be dealt with accordingly, whether the culprits are trustees of the GIPF or those who milked millions from the Development Capital Portfolio."[15] Other cases involve pure rent-seeking activities such as the most recent Nuctech case, which is still ongoing in the High Court of Namibia (box 4.2). Other cases were in accordance with the law in a technical sense, but are broadly considered to be against the spirit of the law, as the debate on the Liquid Fuel Case has shown (box 4.3).

Box 4.1. Government Institutions Pension Fund Case

There is an ongoing investigation by the government involving the Government Institutions Pension Fund (GIPF). About NAD 600 million of public servants' pension money was disbursed from 1994 to 2006 as loans through the Development Capital Portfolio scheme into about 21 Namibian companies, which failed to pay back the money to the GIPF and which was written off as bad debt. The companies were owned by a small group of well-off local businessmen. Several companies were liquidated, while some appeared to be briefcase entities that did not have any assets that the GIPF could have attached as guarantee for any defaults. Based on a normal return on investment each year, the loss to the members of the pension fund would be over NAD 1.8 billion.[a] The Namibia Financial Institutions Supervisory Authority (Namfisa) and the Auditor General are now investigating the GIPF issue. The ACC is not investigating this case because most of the transactions took place before it was constituted.

Source: The Namibian. 2007
Note: a. This includes NAD 1.2 billion (US$164,484,425) in opportunity costs, that is, money Namfisa believed was lost because of opportunities forgone in the GIPF's choice of one investment over another (Duddy 2010).

Box 4.2. Nuctech Case (Case Ongoing in Court)

According to the *New York Times* (and other media reports and court filings), Namibian prosecutors accuse the Africa representative of Nuctech Company Limited—a leading global provider of security scanning equipment—and two Namibians of joining an alleged bribery scheme that secured a US$55.3 million contract in May 2008 to install 13 Nuctech scanners at customs intersection points across Namibia. It is alleged that the contract price had been inflated.

The Government of Namibia is reported to have initially paid a cash deposit of about US$12.8 million to Nuctech. The purpose of this payment, as set out in the contract, was to enable Nuctech to start production of the scanning equipment. However, Nuctech entered into a back-to-back contract with Teko Trading, a Namibian company listed as a Nuctech consultant, in which it agreed to pay this exact sum to Teko as a "commission payment." It is alleged that about US$4.3 million was paid to Teko Trading pursuant to this deal, which was then split among Nuctech's Africa representative and the two Namibian suspects.

The case came to light because of the anti-money laundering law that requires Namibian banks to routinely report large money transfers to investigators. It is alleged that the three defendants in the Nuctech case appear to have spent much of the money on an "enormous spending spree" in a few days' time: 15 motor vehicles, two luxury apartments, several houses, a unit trust fund, and a farm.

In April 2010, the suspects pled not guilty to 13 charges of corruption, money laundering, and fraud. In May 2010, the Nuctech case went to the high court. The number of charges was increased to 18. According to the court filings, the charges include two main counts of fraud, six counts under the *Anti-Corruption Act*, two charges under the *Prevention of Organised Crime Act*, three charges under the *Immigration Control Act*, three counts under the *Close Corporation Act*, and two charges under the *Value Added Tax Act*.

At the time of writing this report, the case was still pending before the court in Namibia.

Sources: Wines 2009; http://www.namibian.com.na/index.php?id=28&tx_ttnews%5Btt_news%5D=72864&no_cache=1. For a summary of the allegations and charges of the case as filed in the High Court of Namibia, see http://www.scribd.com/doc/41722454/Summary-of-Substantial-facts-Tecko-Trio.

Goba (2007) analyzed four large cases of suspected fraud and corruption that were allegedly committed under the pretext of investment.[16] The cases show a similar modus operandi: use of insider information and shell companies, collusion between insiders

and outsiders, the use of family and social ties, weak management, and weak operational and internal control. In some cases, the same individuals were involved in more than one case, which indicates a degree of specialization.

Medium-level Corruption

Small-scale corruption occurs at lower levels of society and among local governments, although the general acceptance of corruption had diminished as a result of the anti-corruption efforts of the Namibian Government. The ACC indicated that corruption in recruitment (favoritism, nepotism) and bribery of government officials (customs, police, Inland Revenue) are still regularly practiced in Namibia. Inefficiencies and delays in government services are generally still a factor encouraging bribery of government officials, "which makes it seem that greasing the palms is the only way to get officials to cooperate" (*Insight Magazine*, August 2008). Most of the interviewees indicated that corruption at the local level and within parastatals (state-owned enterprises) is generally another area of concern.[17]

The above-mentioned observations are broadly in line with results of the latest Perceptions in Corruption Afro Barometer, conducted in 2008 (table 4.6) (Afro Barometer 2009). The perceptions of corruption are based on face-to-face interviews in November 2008 with 1,200 respondents all over the country. The study showed that corruption perceptions remained stable or declined slightly for most categories of officials since earlier surveys in 2003 and 2005–06.

Table 4.6. Perceptions of Corruption in Namibia

(% of respondents who believe that all or most of the indicated officials are involved in corruption)

Category	2003	2005–06	2008
National government officials	30	35	50
Police	37	44	42
Tax officials	na	37	39
Local councilors	na	29	26
Local government officials	na	34	26
Parliament	na	27	20
Office of the President	15	22	17
Judiciary	22	32	17

Source: Afro Barometer 2009.

The survey also shows that perceived levels of corruption among the police force and among tax officials are still high. Forty-two percent of the respondents believe that all or most police officials are involved in corruption and 39 percent believe that there is widespread corruption among tax officials. Perception of corruption among both local government authorities and local councilors had declined to 26 percent. Perception of corruption in the national government has, however, increased. In 2003, 30 percent of the respondents believed that all or most national government officials were corrupt. By 2008, this number had increased to 50 percent.

However, the well-publicized incidents of high-level corruption may have influenced these perceptions. As one interviewee noted, "Corruption in Namibia is more exposed than in many other African countries, as a result of our good corporate governance structures and freedom of the press…Things are blown out of proportion."

Main Causes of Corruption in Namibia

Many observers consider the influential role of one party to be one of the root causes of present-day concerns of corruption in Namibia (see, for example, Melber 2006 and 2010). Moreover, the distinction between corrupt and abusive or unethical activity is sometimes unclear.

State capture is an issue of debate in Namibia.[18] Critics speak of institutionalized corruption, or legalized corruption, through the laws passed since Namibian independence. Government officials are allowed to undertake business—unless they declare it, it is outside their span of government control and activities take place outside office hours (box 4.3).

In discussions during the November 2010 mission to Namibia, it was observed that privatization has strengthened the relationship between the business class and the political elite. Many Black Economic Empowerment (BEE) managers have become business tycoons, and are influencing parliamentary decisions and lobbying for legislation that will ultimately secure their wealth (All Africa 2010b). BEE ("affirmative action") is highly debated and is perceived as creating economic distortions. "BEE is not about empowering certain groups. It is about empowering individuals who have business ideas and need information and capital to take off" (Weidlich 2010).

Some of the interviewees spoke of a "culture of entitlement to state resources" that is "fairly significant." Boundaries between public and private resources are sometimes unclear in Namibia. The general feeling is that government officials misuse public funds for their own private benefit. "Namibia has a small, well-educated elite who currently fabulously enrich themselves through corrupt and nonethical practices" (Namibian interviewee).

Box 4.3. Liquid Fuel Case

According to the *Public Service Act of 1995,* civil servants are not allowed to hold positions in the private sector while employed by the State. However, the Public Service Commission or the Prime Minister can give permission to individual civil servants to undertake work in the private sector. This has spurred some criticism following the Namibia Liquid Fuel case, in which a large government tender was awarded to a company in which some government officials were major shareholders; these officials had been given permission to carry out these activities.

The ACC found that the country's state oil corporation, NamCor, had followed proper bidding procedures and that such bidding had been correctly awarded to a Black Economic Empowerment outfit called Namibia Liquid Fuel (NLF). NLF is a joint venture by top former high government officials and other politically well-connected people. NLF reportedly earns slightly more than US$110 million in profit per year, and a small group of former government officials share more than US$55 million of that profit.

Source: Afrol News 2007.

Other factors that promote corruption in Namibia are insufficiency of controls[19] and loopholes in, for example, the tendering system, that still need to be closed. Public procurement of goods and services is made through the Tender Board of Namibia, which comprises representatives from various government ministries. The aim of the board is to ensure that tenders are awarded according to the principles of an open bidding

process. Namibia's official procurement system has been reviewed and was found to be fully compliant with international standards. Only a few cases of suspected bias or irregularities have been uncovered within the last few years. There are, however, loopholes. One of the current problems is that many contracts never go before the Tender Board. The Namibian procurement policy permits preferential treatment of bids that meet certain socioeconomic goals and strategies. According to *Insight Magazine*, tender exemptions have increased in number and value, rising from NAD 170 million (US$24.5 million) in 2005–06 to NAD 3.4 billion (US$490 million) in 2007–08.[20] Other critics argue that the system is still inscrutable and needs to be made more transparent (*Insight Magazine*, June and October 2010).

A special source of concern is corruption related to the exploration of Namibia's natural resources (farming, fishing, and mining concessions), and how to balance the huge potential economic benefits of mineral extraction with the long-term environmental protection of Namibia's natural environment (box 4.4). This is of particular importance because massive oilfields on a scale similar to those in Angola are being developed.

Mismanagement of mining operations can threaten Namibia's vulnerable natural "protected areas" and environmental resources, including water shortages. These impacts may in the long term result in economic losses at the local and national level as mining activities degrade or destroy existing or potential competing uses of the land, such as agriculture or ecotourism.

Box 4.4. Tendering and Namibia's Natural Resources

During Namibia's first decade of independence, the Namibian Government enacted a number of laws and policies intended to economically manage mining operations for the benefit of the whole Namibian economy and the Namibian people and, at the same time, protect fragile ecosystems or at least mitigate potentially adverse impacts on the environment, people, and wildlife.

A report by the Stanford Law School Legal Assistance Centre of Namibia (Stanford Law School 2009) explores a number of ways in which the Namibian Government could address this critical development tension. A crucial factor is proper tendering. However, the tendering and licensing process is suffering from gaps in the legal structure and from enforcement problems, due to understaffing ("the MET does not have nearly enough personnel to monitor the vast expanses of protected land around the country" p. 12), inadequate technical skills and training, and a slow and inefficient permitting process that is sometimes tainted by corruption. Companies have been allowed to begin prospecting and mining activities without completing all the necessary steps. Mining companies were allowed to bypass the process rules and policies, and used political and personal connections instead. Politically connected individuals reportedly have been exploiting this situation to gain access to exploration licenses, which they on-sell to foreign resource companies looking to build a mining or oil and gas portfolio. Unlicensed, and therefore illegal, mineral exploration and mining operations are taking place in remote sections of protected areas, undisturbed by law enforcement oversight.

According to the Stanford Law School report, "Mining companies place more importance on their own investments than on compliance with the law. Even when the letter of the law is followed, mining companies sometimes do not engage in the permit process in good faith…. These flaws leave the door open to environmental abuse, and at the same time discourage responsible investment. Well-intentioned companies shy away from the unclear, slow regulatory process, and instead invest in projects in other countries in the region. Thus, the poor regulatory environment deprives Namibia of both environmental protection and investment—the worst of all possible worlds….Such practices created additional opportunities for corruption" (p. 11).

Source: Stanford Law School 2009.

Organized Crime

Lucrative illicit activities that have been identified by various interviewees are smuggling of high-value and counterfeit goods, drug trafficking, motor vehicle theft, armed robbery, cash-in-transit heists, illegal diamond dealing, and various forms of fraud, all of which will be discussed below. Geographically high-risk areas are Oranjemund (the diamond area, close to South Africa) and Oshikango (the border crossing to Angola in the north).

Crime in Namibia is strongly connected with its geographic position between Angola and South Africa and the strong cultural and historical relations with both countries that date back to the pre-independence era. Criminal networks, especially cross-border ones, tend to have their roots in the pre-independence political struggle (Grobler 2003).

Due to its geographic position between Sub-Saharan Africa's largest and third-largest economies (South Africa and Angola) and its good infrastructure, Namibia is also a transit country for stolen or illegal goods, such as motor vehicles, drugs, and gemstones. Risks for crime are geographically determined to Oranjemund in the south (diamond region), Windhoek, Walvis Bay, and Swakopmund, and the Oshikango region on the border with Angola.

Smuggling of High-value and Counterfeit Goods

Smuggling of high-value goods is one of the most common crimes in the Southern African region (ISS 2010). For example, cigarettes and liquor from China, Dubai, and Zimbabwe are smuggled through Angola into Namibia through land borders (Ngoma and Oshikango) and Walvis Bay. Smugglers use Namibia as a transit route to South Africa (ISS 2010). Smuggling of goods might involve bribery of customs officials. Media sources and a number of interviewees indicate that Chinese criminal networks are linked to the noticeable increase in the availability of counterfeit goods in Namibia (Grobler 2003).

The police at the northern Oshikango border to Angola have investigated cases of fuel smuggling from Angola. Police and customs in Oshikango deal on a regular basis with various other crimes such as car theft, cattle rustling, corruption, human trafficking, prostitution, and violence. Trafficking of women and children into prostitution has also become a source of profit for organized crime groups in Namibia.

Drug Trafficking

Being a middle-income country, Namibia is an increasingly important destination market for drugs—mainly cannabis, cocaine and, recently, ecstasy. Cocaine and ecstasy are mostly used by well-to-do Namibians.

Cannabis is widely available in Namibia. The bulk of it is brought in from South Africa, into and through Namibia to its northern neighbors. Cannabis is usually smuggled in trucks. Trafficking networks involve South African drug syndicates and Namibian nationals who have been known to put money together in clubs or joint ventures to import cannabis. The imported cannabis is shared and distributed among members of this joint venture. The proceeds are reinvested in the importation of more cannabis or are laundered (Goba 2007).

Namibia also has become a conduit for the smuggling of cocaine from Angola to South Africa. In January 2010, two Angolans were convicted of smuggling 30.1 kilograms of cocaine valued at NAD 15.5 million (US$2,056,055) from Luanda in Angola to

South Africa hidden under a Toyota vehicle. This is the largest quantity of drugs ever seized by the Namibian police. Cocaine is also brought into the country by bus or by plane (directly from South America) by using "mules" who have the drugs hidden in their luggage or in their bodies (swallowed in small pallets).

Armed Robbery and Motor Vehicle Theft

Motor vehicle theft is a widespread crime in Namibia. Vehicles are stolen from South Africa and find their way to Namibia by various highly organized syndicates (Grobler 2003). Stolen cars from Angola enter Namibia and are exported to surrounding countries. New luxury vehicles are mostly stolen in Windhoek and the surrounding area and then driven into Angola and Zambia (ISS 2010). Old, light-vehicle theft takes place mostly in the countryside and the vehicles are sold for spare parts.

Diamond Smuggling

Diamond smuggling was a major issue in Namibia. It has decreased—partly due to the present-day strong preventive measures, but also due to the global recession, which forced the local diamond industry to a virtual standstill in early 2009. It is, however, still a problem and could resume now that African diamond production has picked up.

Diamond stealing and smuggling is one of the oldest and by far most lucrative forms of organized crime in Namibia. Before independence, stealing of diamonds was considered an act of resistance against the white establishment. It is, however, highly difficult to operate because of the present-day drastic precautionary measures by the Namibian authorities. It is also very difficult to gain access to diamonds. The only way to steal them is through collusion. In addition, Namibia is a participant in the Kimberly Process Certification Scheme (designed to certify the origin of rough diamonds), which severely complicates selling stolen diamonds (Goredema 2007; Grobler 2003).

However, the pre-independence situation created Namibian experts in diamond smuggling. According to those interviewed during the World Bank Namibia mission in November 2010 and at the workshop in February 2011, Namibia still houses experts in illegal diamond dealing, their networks are still in existence, and there is still a market for stolen diamonds in the country—both for Namibian diamonds and diamonds from mines in other countries. False diamonds and other fake gemstones are also sold in and through Namibia.

In addition, members of the Italian Mafia have reportedly been linked to the Namibian diamond business in the recent past (see box 4.5). Grobler (2009) observes a shift in the interest of the Italian Mafia from, for example, prostitution and racketeering, to "respectable" markets such as diamonds. Research has led him to believe that Mafia families from different nationalities used their political connections in Namibia to obtain diamond-cutting licenses. Namibia was targeted because of its lucrative mining industry and easy access to influential people, while South Africa's lack of border controls and its stable economy was ideal for money-laundering operations.

Fraud

Various forms of fraud in Namibia involve (among others) transfers through the internet, insurance fraud, forgery of documents, Internet-based pyramid schemes (Namib-

Box 4.5. The Pizza Connection Case

According to a front-page story published in *The Namibian* on March 23, 2007, the Sicilian Mafia used front companies to acquire existing diamond-buying, -cutting, and -polishing licenses in Namibia, and had allegedly obtained an interest in Namibia's fledgling diamond-cutting industry (Grobler 2009). Investigative journalist John Grobler revealed that Don Vito Palazzolo and his Namibian-based associates owned a string of companies seeking to cash in on the gem trade, thereby affording the Mafia a huge money-laundering opportunity. Originally from Sicily, Vito Palazzolo was granted South African citizenship 13 years ago and has lived in Cape Town since then. He was convicted in Switzerland in the mid-1980s of laundering drug money and spent three years in a Swiss prison. He was also convicted, in absentia, by a tribunal in Palermo, Sicily of associating with the Mafia and sentenced to nine years.

Sources: Grobler 2007. See also "Have the Mafia Moved to SA?"; http://mafiatoday.com/general-breaking-news/have-the-mafia-moved-to-sa/, July 27, 2009.

ian pyramid scams such as the recently discovered "Millionaires List" [see below] and Nigerian 419 fraud), credit card scams (often targeted at tourists, this reached its peak during the 2010 World Cup tournament in South Africa), and check fraud (declining because of the decreasing use of checks and the encouragement of electronic banking and debit-card banking).

The BoN has become aware of a network and scheme known as the "Millionaires List" that is operating in Namibia and whose activities resemble those of a pyramid scheme[21] through which investors are promised to become millionaires in just three months.

Reported and Detected Cases

Data provided by the Namibian police reveal that motor vehicle theft is one of the most prominent crimes in Namibia in terms of value of reported cases (N$31 million [US$4,429,360] in 2009 and N$26 million [US$3,714,947] in 2010) (table 4.7). Drug trafficking and illegal diamond dealing have shown to be very volatile in terms of the overall value of detected cases. Detected cases of illegal dealing in diamonds (only 17 cases in 2009 and 18 cases in 2010) had an overall value of N$0.3 million (US$42,864) in 2009 and N$20 million (US$2,857,746) in 2010. Other crimes in connection with protected resources are dealing in protected game products (horn, ivory, and tusk), illegal hunting, illegal possession of protected game products, and trade in high-value materials. Drugs seizures had an overall value of N$19 million (US$2,714,859) in 2009 and only N$4 million (US$571,539) in 2010. Cannabis and cocaine are the most prominent drugs trafficked or consumed in Namibia (table 4.7).

In 2010, the Namibian Police reported an overall value of approximately N$6 million (US$856,976) of detected so-called "economic crimes" involving fraud through Internet transfers, insurance claims, claims to employers, documents, credit and debit cards, ATMs, false checks, income taxes, and pension money (table 4.8). The overall value of reported and detected cases is considerably lower than proceeds from (reported) motor vehicle theft and detected diamond smuggling in 2010.

Table 4.7. Motor Vehicle Theft, Drug Trafficking, and Protected Resources Related Crime in Namibia: Value in N$ (2009 and 2010)

Category	2009	2010
Motor vehicle theft [a]	31,440,000	26,240,000
Protected resources [a]	1,755,608	20,208,113
Illegal dealing in diamonds [a]	308,375	19,832,435
Dealing in protected game products	188,171	102,208
Illegal hunting of protected game	1,177,300	215,920
Illegal possession of game products	40,000	48,900
High value minerals (gold, uranium, silver)	41,762	8,650
Drug trafficking [b]	17,994,490	3,814,710
Cannabis	3,408,990	623,010
Mandrax	10,300	800
Cocaine, powder	14,530,000	3,174,500
Cocaine, crack	33,500	16,400
Cocaine, moons	10,500	na
Ecstasy	1,200	na
Total	**51,190,098 (US$ 7,385,690)**	**50,262,823 (US$ 7,252,266)**

Sources: Namibian Police 2011. a Reported cases in 2010: motor vehicle theft (238), protected resources (49), of which illegal dealing in diamonds (15). b. See also table 4.7.

Table 4.8. Commercial Crime in Namibia: Value in N$ (2010)

Total commercial crime	5,714,476	US$824,449
Transfer through Internet	3,500,000	US$504,971
Insurance policy	1,200,000	US$173,160
Fraudulent employer claims	241,000	US$34,773
Forged documents	193,953	US$27,933
Credit agreement	154,000	US$22,220
ATM/debit card fraud	140,000	US$20,198
Purchase order	100,632	US$14,518
False checks	99,576	US$14,367
Income tax	48,573	US$7,008
Pension funds	36,742	US$5,301

Source: Namibian Police 2011.

Tax Fraud

Tax evasion and tax avoidance are generally considered critical problems for domestic resource mobilization in developing countries. Namibia is no exception. Tax revenues in Namibia amount to about 90 percent of total government spending. The current government revenue-to-GDP ratio is about 26.5 percent (see table B3.1 in box 3.5). The main sources of tax revenues are taxes from international trade, taxes on incomes and profits, and domestic taxes on goods and services.[22] Taxes on international trade account for over 40 percent of the total tax revenue. Taxes on income and profits to total government

revenue averaged 36 percent over the past 20 years. Tax reform is needed to collect more taxes in this category. Property tax's contribution to total tax revenue has been minimal.

According to the office of Inland Revenue, tax evasion is a widespread problem in Namibia. The root causes are (a) unwillingness of individuals or corporations to pay their taxes, and (b) lack of awareness of tax obligations. Moreover, based on discussions with several interviewees, most people do not even register their businesses, and as a consequence do not declare their taxes.

Forms of tax evasion prevalent in Namibia include evasion of value-added taxes (VATs), evasion of customs duties (smuggling and trade mispricing), forms of corporate income tax evasion, various other forms such as the misuses of the special zero percent VAT rate, tax evasion related to the gambling industry, and tax evasion by nonprofit organizations.

Notwithstanding incidences of tax evasion, since the establishment of an anti-money laundering framework in Namibia, a significant number of STRs made to the FIC are related to tax evasion. For example, from May 2009 to December 2010, 37 tax-evasion-related STRs were made. Analysis by the FIC revealed that tax evasion is likely involved in these suspected activities or transactions premised on the following reasons: the analysis revealed that the subject or entity is involved in trading activities but is not registered for tax, the subject or entity is registered for tax but fails to declare revenue, and the subject or entity is registered for tax but underdeclares revenue. The majority of the tax evasion cases are related to individuals, sole proprietors, and closed corporations.

Cross-border Money Flows

Money laundering in Namibia occurs within and across territorial borders and involves both local and foreign nationals. Cross-border flows of ill-gotten money are an issue of concern in Namibia. The BoN states that if Namibia does not have a good AML system, it could be regarded as "a money laundering haven" and could become an attractive economy for criminals from all over the world to stay and launder the proceeds of criminal activities.[23]

Namibia is considered to be highly vulnerable to the inflow of proceeds of crime and corruption from other jurisdictions. Namibia's relatively small economy is located between a large and booming economy in the north (Angola; GDP US$75 billion) and the biggest African economy in the south (South Africa; GDP US$285 billion), both with a large and thriving criminal economy. In addition, South Africa has an effective AML system, established asset forfeiture policies, and the same currency and banking system as Namibia. There are no estimates on the amounts of unrecorded cross-border flows of cash.

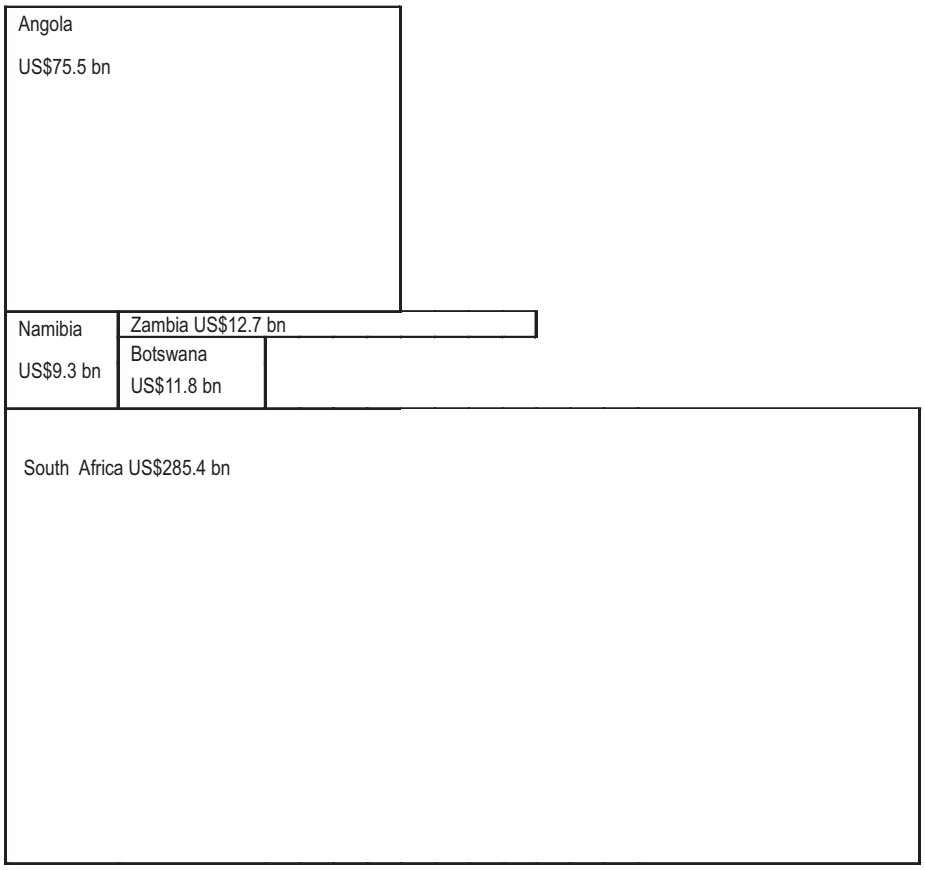
The proceeds of crime are moved across the Namibian borders in cash; through official financial and banking channels; and through business links with influential locals, including lawyers and accountants (Goba 2007). Namibia is easily accessible, through its long and porous borders, open-sea access through Walvis Bay harbor, and relatively limited financial resources for effective customs controls. In addition, the country is "economically accessible" through its well-developed financial system, which is deeply interconnected with South Africa. Property rights are well protected and there is an overall level of good governance.

Interviewees during the World Bank mission in November 2010 and February 2011 observed that Angolans—who have benefited directly and indirectly from the Angolan

oil boom and very fast economic growth over the past decade—spend large amounts of cash in the Namibian economy, doing business, driving up real estate prices, outbidding Namibian entrepreneurs, and enjoying the favorable living circumstances in Namibia. The spending pattern of the Angolan population is not surprising considering that the Angolan economy is cash dominated. Moreover, according to the BoN, two factors account for this: (a) even rich Angolans often prefer using cash instead of the Angolan banking system (there are several reasons for this, including a lack of trust in the formal banking system), and (b) the financial infrastructure between Angola and Namibia is not well developed. It is easier to bring cash in than to use a banking channel.

Namibia is considered to be a secure place to invest ill-gotten money for other nationals including Europeans, as well—it is a long way from Europe (figure 4.1). And again, Namibia is a very lucrative country for foreign investors. The country's favorable economic perspectives, its richness in natural resources, and booming real estate market attract foreign business people, including illicit enterprises and money launderers. Namibia is considered one of the best African countries for doing business (World Bank

Figure 4.1. The Namibian Economy Compared to Surrounding Countries in Terms of Overall GDP: In- and Outflow of Money



Source: Authors.

2010a, table 4). Other positive factors for non-African criminals are the widespread use of cash and the attractive living conditions for criminals who not only want to invest or hide their proceeds of crime but intend to take up residence along with their money in Namibia (it has natural beauty, low population density, attractive housing, and availability of European and American standard of goods and services).

There have been several cases in recent years of foreign criminals from different nationalities outside Africa who have made investments in Namibia or held assets in Namibian bank accounts (see, for example, the famous cases of Vito Biggioni di Mazara, Hans Juergen Koch, and Jacob Alexander, as described by Goba 2007; see appendix A). These cases, however, date from before the Namibian AML system was implemented. It is not known to what extent the AML system has already had a deterrent effect.

Currency export regulations are stricter than currency import regulations in Namibia. Importation of foreign banknotes is unlimited unless it is declared. Nonresidents are allowed to export foreign currencies and travelers checks up to the amounts imported and declared, and provided departure is within 12 months after entry. One of the interviewees noted: "We have officially no problem with money entering the country, because we benefit from it. What we don't want is cash leaving the country." Inflows of ill-gotten money can stimulate crime in Namibia (the "spillover effect").

Anecdotal evidence shows ill-gotten money also flows from Namibia to South Africa and overseas tax havens. The absolute and relative magnitude of in- and outflows of ill-gotten money in Namibia is, however, unknown. Another issue of concern is regular cases of—mainly foreign—nationals who are caught at the Namibian borders and airports attempting to smuggle large amount of undeclared U.S. dollars out of the country.

Spending Patterns

Recycling Channels

The majority of the proceeds of common "organized crime," various forms of lower-level corruption, and some forms of fraud in Namibia are derived in cash (table 4.9). Money derived from crime and corruption in Namibia is laundered through various channels and is spent in various ways, partly depending on the nature of the underlying offence. Money derived from organized crime and low-level corruption will tend to find its way directly into the economy through the purchase of goods and services. High-level corruption, especially, is bank-based and will be laundered or spent through

Table 4.9. Recycling Channels

Typical spending behavior	Mode of transaction
Expenses or investments in the informal sector	Cash
Purchase of basic goods	Cash
Purchase (and sale) of livestock, diamonds or other gemstones	Cash
Purchase of luxury goods and lifestyle items	Cash
Purchase of property	Cash and through banks
Investment in legal enterprises	Mainly through banks
Expatriation through normal banking channels	Banks
Expatriation through physical transportation of cash	Cash
Bank accounts of relatives and acquaintances (banks)	Banks
Through the trust of an account firm into regular bank accounts	Banks
Closed corporation constructions (consultancy business, real estate)	Banks

Source: Own investigation based on interviewee feedback.

formal financial channels with a varying degree of sophistication. The real estate market seems to be an important recycling channel and destination of ill-gotten and corruption money—both from within Namibia and from foreign countries.

High-level corruption, such as embezzlement of public money in the form of under-the-table and other illegal kickbacks, is mostly bank based. Tenders, for example, will not be rewarded without a bank guarantee. Most money seems to be spent on lifestyle items, cars, houses, farms, and apartments (the popular seaside resort of Swakopmund; and flats in Cape Town). The proceeds of tenders often have to be shared by many parties: "When a tender is awarded, it is like a fountain: money flows directly in various directions" (Namibian interviewee). Only small kickbacks and forms of petty corruption (for example, petty bribery) are cash based.

Cases analyzed in Namibia have not demonstrated the use of sophisticated money-laundering techniques. The AML system is new to the country and has yet to demonstrate it is effective in terms of convictions. However, there are some influences on behavior. In some cases, closed corporations (such as consultancy firms) are set up in order to conceal illegitimate sources of kickbacks and bribes. These structures can be considered an elementary step to cover up the illicit or irregular origin of money.

Sophisticated trust structures and foreign companies, set up with the help of legal professionals, intended to disguise a paper money trail are not seen on a large scale in Namibia. The behavioral explanation for this could be that people want to enjoy the benefits of their activities as much as possible and thus, preferably, spend it within the country. However, it is also a matter of scale. High-end corruption in Namibia involves tens of millions of dollars at a minimum. Corruption in Namibia does not involve the typical grand state capture style of corruption seen in other African countries in recent decades, where there are hundreds of millions of dollars controlled by a single family or clique and where it is impossible to hang onto that volume of money and spend it locally.

There is no empirical research on the spending patterns of these perpetrators and their accomplices and families, but law enforcement officials observe that ill-gotten money is used for the direct acquisition of basic consumer goods, luxury items and lifestyles, cars, and real estate (houses, farms, land). Ill-gotten money also finds its way into the informal economy. During the February 2011 workshop, interviewees indicated that proceeds of crime have been used in the acquisition and subsequent sale of livestock. Diamonds and other gemstones are also used as investments for ill-gotten money.

The Real Estate Market

The real estate market in Namibia is a special source of concern, both from an economic perspective and from a "money laundering" point of view. Prices of real estate (houses, farms, land) have increased rapidly over the last few years, making it difficult for middle-class Namibians to acquire a farm or decent house in the few urban areas in Namibia.

The real estate boom in Namibia is fueled by various factors: a rise in demand from foreign nationals (rich Angolans, who often buy houses entirely with cash; an upsurge in demand from Chinese business people; and Europeans); a rise in interest by multinational corporations (related to the uranium boom and the expected discovery of oil); a demand by previous farmers who are no longer able to acquire land and by the new political elite; and an interest in real estate by pension funds that have few other possibilities for investing their funds within the country.

Legislative loopholes offer ample opportunities to launder and invest ill-gotten and corrupt money in the highly attractive Namibian real estate market without being caught by the AML system. It is common to buy and sell real estate in Namibia privately and completely in cash. Registration of property in a closed corporation, with a 100 percent interest of the owner, is another option. The sale of property through a change in ownership in the closed corporation, would involve no change in ownership of the property; registration in title deed, including payments of transfer and stamp duties, can thus be avoided. Ill-gotten money is said to have contributed to the real estate boom in Namibia, but the extent to which this is true is unclear.

Economic Effects

What are the economic effects of crime and ill-gotten money? Possible economic effects are extensively discussed in the economic literature on crime and corruption (see chapter 2). These include direct financial loss to victims (for example, as is the case with various forms of theft and fraud), price distortions and unfair competition (for example, as a result of smuggling of goods or the illegal importation of counterfeit goods), negative allocation effects of embezzlement of public funds (related to various forms of corruption at different levels of the Namibian society), and corruptive penetration in the upperworld and acquisition of political power (as is the case of collusion of criminals with politicians).

Whether these effects occur in Namibia and—more important—to what extent they occur and affect economic development negatively—can only be determined through additional empirical research or development and extrapolation of proper data. There is, however, no doubt that these effects occur in present-day Namibian society. Table 4.10 provides an overview of the economic effects as they are perceived by the interviewees during the World Bank mission in November 2010 and Workshop in February 2011.

Table 4.10. Economic Effects of Crime and Ill-gotten Money in Namibia

Activities	Economic effects (based on interviews)
AML policies	Costs of AML system International level playing field Instrument in crime detection, prevention, prosecution, asset forfeiture
Corruption	Embezzlement of public money Self-enrichment of new political and entrepreneurial elite Increase of rich-poor divide Erosion of confidence in the government and state Potential environmental harm Inflation of real estate prices
Tax fraud	Erosion of the tax base
Organized crime	Direct financial loss to victims Price distortions and unfair competition Influence of (foreign) organized crime groups
Organized fraud	Direct financial loss to victims
Inflow of foreign ill-gotten money	Inflation of real estate prices Reputation Spill-over effect to crime

Source: Based on World Bank staff interviews in Namibia in November 2010 and on workshop interviews in February 2011.

In the long run, a comprehensive AML system will be a tool to fight and prevent crime, tax evasion, and the inflow of ill-gotten money from abroad. AML is needed to pursue asset forfeiture policies and will more generally be a necessary governance element of a mature financial sector.

Policy Considerations

Priorities. Countering tax evasion should be a priority in the application and further design of the Namibian AML system. Tax evasion is by far the largest source of ill-gotten money in Namibia. Ways to monitor the inflows of ill-gotten money should be considered. A starting point should be to estimate the amount of the inflows into Namibia.

Tax evasion. At an estimated 9 percent of GDP, tax evasion is clearly a challenge for Namibian authorities. The problem is characterized by a general lack of awareness of tax obligations by sole proprietors and small-to-medium-size business owners. We have also observed that the largest referrals of intelligence reports from the FIC are to the Inland Revenue authority—37 tax-related referrals. It is evident, therefore, that the AML system is a useful instrument in tackling the tax evasion problem. Two actions are recommended for consideration by the authorities.

The first is for the Inland Revenue to be proactive in following up on the referrals made by the FIC. The second action is to conduct an education campaign by the Inland Revenue authority targeted at sole proprietors and small business owners about their tax obligations.

Inflows of ill-gotten money. With significant economic activity in the North with an inflow of U.S. dollars and an inflow of South African rands from South Africa, much can be done by the authorities to monitor the currency flows into Namibia. However, very little has been done in this regard. The only time monitoring is done is on the outflows of currency from Namibia, although that is restricted to large amounts of money outside the Customs and Monetary Authority area, which includes Lesotho, Namibia, Swaziland, and South Africa. Consequently, it is important for the BoN through its Exchange Control Department to do more to monitor the inflows of foreign monies into Namibia, most of which, granted, will be legitimate. But as interviewees observed, Namibia is an attractive destination for foreign money—a percentage of which will be from criminal or illegal activities.

Magnitude of proceeds of corruption. We were able to estimate the magnitude of tax evasion, and it is possible to estimate the magnitude of other activities, as well. Specifically, since corruption is a growing concern in Namibia, gauging its magnitude is important to ensure that the problem does not become endemic and a drag on the economic development of the country. The authorities should use available data to estimate the magnitude of corruption in Namibia. Moreover, the growing number of referrals being made by the FIC to the ACC provides the data with which estimates can be made.

Organized Crime, Fit and Proper Tests (rigorous licensing process). The BoN, the Namibia Financial Institutions Supervisory Authority (NAMFISA), and other regulatory authorities (including self-regulatory organizations), should ensure that they have rigorous proper and fit tests when licensing market players in their respective sectors. There is, therefore, both the potential and risk that criminal elements could control and own part of the critical sectors of the economy, such as the diamond and uranium industries. Moreover, there could be a spill-over effect into other areas of the economy, such as the

tendering process, where we have observed concern. Hence, we see the importance of enhancing the licensing process for owners and senior management of business firms.

Data collection and empirical research. As in Malawi, further development of data and additional empirical research are necessary in Namibia to shed light on the magnitude and impact of the proceeds of crime, corruption, and generally ill-gotten money in developing countries—and subsequently to prioritize AML policies.

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Notes

1. www.bon.com.na.
2. Based on 2007–10 trade data from the Central Bureau of Statistics.
3. "The People and Population of Namibia"; http://www.namibian.org/travel/namibia/population/white.htm.
4. According to the 2008 Namibia Labor Force Survey (NLFS) (published in March 2010), the unemployment rate, broadly defined to include discouraged workers, was 51.2 percent. This figure is widely accepted as the official unemployment rate. Using the strict definition, counting only those who are actively seeking work, the unemployment rate reported in the NLFS was 37.6 percent. However defined, the current unemployment rate seems to be even higher, since it does not include recent retrenchments due to the global economic recession (Duddy 2010a).
5. The Economist Intelligence Unit, Namibia, December 2010.
6. Namibia Financial Sector Assessment Program of 2007 and data update from the Bank of Namibia Web site.
7. It has a financial intermediation rate of 50.3 percent of GDP; return on assets and return on equities of, respectively, 3.0 percent and 38.4 percent; a sectorwide capital adequacy ratio of 15 percent; and nonperforming loans only 8.7 percent of the total (IMF article IV, Namibia Staff Report of 2010).
8. Namibia Financial Sector Assessment Program of 2007 and data update from the Bank of Namibia Web site.
9. See "Financial Inclusion: An Imperative towards Vision 2030," Windhoek, October 28, 2010 (annual address by the Governor of the Bank of Namibia), stating that "Last year alone, Namibia recorded a net outflow of capital to South Africa to the tune of N$7.7 billion. Year to date, the net outflows are already N$8.9 billion. Imagine what the impact would have been, had we retained just a fraction of that money for investment within the domestic economy. This trend is not sustainable for a country that aspires to be a developed nation by 2030."
10. See table 1 in "Financial Access 2010," p. 57 (CGAP 2010) and table S1 in Financial Access 2009, p. 55 (CGAP 2009).
11. In June 2004, the Government of Namibia launched its long-term development strategy, Vision 2030. Vision 2030 is a comprehensive framework for fundamentally transforming the Namibian political and economic landscape in areas such as land reform, housing, the environment, health, and education. It is aimed at building an economy that provides equal opportunity for all. Major planning targets are (a) 5 percent unemployment (unemployment is currently over 50 percent), (b) a Gini coefficient of 0.3 (currently 0.7), (c) per-capita income at a high-income level, (d) manufacturing and service accounting for 80 percent of GDP, and (e) transformation of agriculture in an integrated modern economy. According to the plan, by 2030, Namibia should enjoy a high per-capita income, a highly educated nation, abundant prosperity, and "interpersonal harmony, peace and political stability."
12. Wines 2009.
13. The Namibian Constitution guarantees and protects press freedom. Generally, the media in Namibia are freer than in many other African countries.
14. A kickback is compensation provided to a contractor for the purpose of improperly obtaining or rewarding favorable treatment in connection with the contract. Is also refers to under-the-table payments for help or influence. The legality of a kickback depends on the specific legal circumstances.
15. http://allafrica.com/stories/201102240715.html.

16. See table 4.5, the two SSC cases, and the ODC case.
17. See, for example, Mongudhi (2010).
18. See, for example, Hellman and Kaufmann (2000) and Hellman, Jones, and Kaufmann (2003) on state capture in transition economies. By state capture is meant the efforts of firms to shape the laws, policies, and regulations of the state to their own advantage by providing illicit private gains to public officials.
19. The Office of the Auditor General of Namibia, for example, has a limited staff, but can contract external auditors. The office's limited powers were underscored when its reports revealed corruption in the police, who then confiscated all records (www.business-anti-corruption.com). See also Isaacs (2007).
20. http://www.hss.de/fileadmin/namibia/downloads/TRACKER_Oct2010.pdf, under the headline: "Tender Reform requires anti-graft approach."
21. The BoN defines a pyramid schemes as an illegal money-making venture in which individuals at the top of the pyramid recruit participants who are offered the promise of money if they successfully bring in others to join the pyramid.
22. Bank of Namibia (2010b).
23. www.bon.com.na.

CHAPTER 5

Summary, Conclusions, and Policy Considerations

Many developing countries have introduced anti-money laundering (AML) policies in recent years. The perception is that such moves were more the result of international pressure than genuine ownership of the AML agenda. This is difficult to substantiate, however, as is whether or how AML regimes contribute to the development path of developing countries. And the jury is still out on how best to use these tools in a developing country environment.

What is not questioned, however, is the fact that developing countries are more constrained in their capacity to implement AML standards than developed countries. Implementation of an AML framework might be seen as useful, but it is not a priority in the context of economic development and poverty reduction. It is feared that the costs (to both the public and private sector) will not outweigh the benefits. Some critics argue that AML is even harmful to developing countries because it might interfere with policies aimed at promoting greater access to finance or that it might hinder capital inflows.

This study explored the effects of the proceeds of crime and AML policies on economic development. The study focused on two developing countries: Malawi and Namibia. Notwithstanding the differences in their economic level, both countries have established an AML framework and have fully operational Financial Intelligence Units (FIUs), Malawi since 2007 and Namibia since 2009.

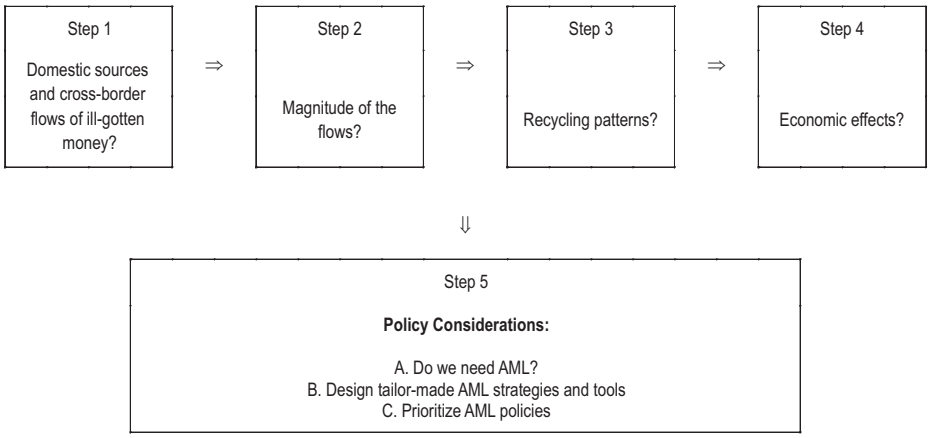
The starting point of this analysis is that anti-money laundering is essentially a tool to address criminal activities and that, as a result, it helps in understanding criminal activities and how proceeds of crime impact development. The purpose of this study was:

- To provide an initial answer to the question of whether and how measures to address proceeds of crime contribute to economic development
- To develop a framework to enable governments in developing countries to analyze the main sources of ill-gotten money and its effects on the economy, a precondition to a meaningful discussion on how best to use AML tools.

The overarching lessons that can be drawn from this study are that:

- Terminology must be clarified, particularly what proceeds of crime and money laundering are in economic language (see chapter 1). This is of critical importance with respect to tax evasion and how money laundering techniques make it difficult to tackle that problem.
- Methodologies are needed that allow for the improvement of the statistical and measurable understanding of proceeds of crime.

Figure 5.1. Framework for Analyzing the Amounts and Effects of Ill-gotten Money



Source: Author's formulation.

A five-step framework for analyzing the amounts and effects of ill-gotten money is provided in figure 5.1. The study tried to estimate the magnitude of the flows of ill-gotten money (step 2) and to identify the main recycling patterns (step 3) and economic effects of both the underlying offenses and the effects of the recycling of ill-gotten money within the economy or across its borders (step 4). This analysis leads into policy considerations (step 5) on whether an AML regime is needed, how AML can be tailored to the specific domestic environment, and how AML policies should be prioritized.

One key lesson from this work is that it is possible to devise such measurement tools and to therefore conduct a fact-based analysis of the impact of AML.

Main Findings

Corruption and tax evasion are the most critical criminal activities impacting development.

Table 5.1 compares the main findings of our research on Malawi and Namibia. As the table shows, proceeds of corruption and of tax evasion are relevant from a macroeconomic point of view in both countries. Tax evasion has an estimated magnitude of 8 to 12 percent of GDP in Malawi and 9 percent of GDP in Namibia. Corruption in Malawi is estimated to involve over 5 percent of GDP. In Namibia corruption is also significant, but we were not able to make a reliable estimate of the macroeconomic magnitude. However, several suspected (multi)million dollar corruption cases have been discovered in recent years (see table 4.5).

Corruption and tax fraud do have a negative impact on economic development because they divert public resources for private use and erode the government's tax base, which will ultimately impede efforts to reduce poverty. Using AML as an additional tool to fight corruption and tax evasion is likely to have a direct effect on recovering stolen money or lost revenue. Experience has proved this to be true in both Malawi and Namibia, but also globally. AML tools can be successfully mobilized to tackle these crimes.

Table 5.1. Malawi and Namibia: Main Findings

Factors	Malawi	Namibia
Sources of ill-gotten money:	• Tax fraud: 8 to 12% of GDP • Corruption: 5% of GDP • Financial fraud: Significant* • Various other crimes including: • Smuggling of goods and counterfeit goods, motor vehicle theft, burglary, cannabis production, and human trafficking	• Tax fraud: 9% of GDP • Corruption: Very significant* • Financial fraud: Significant* • Various other crimes including: Motor • vehicle theft, drug trafficking, diamond smuggling, cash-in-transit, cattle theft, counterfeit goods, and smuggling of goods
Recent or ongoing large corruption case:	• Case 9	• Nuctech case
Unethical activities:	• Improper transfer pricing multinationals	• "Legalized corruption" by politically well connected
Recycling patterns:	• Cash and bank based; direct consumption, cars, lifestyle items, and real estate	• Cash and bank based; direct consumption, cars, lifestyle items, and real estate (booming market)
Cross-border flows:	• Black forex market • No indications of large-volume capital flight	• Inflows of foreign ill-gotten money • No indications of large-volume capital flight
STRs:	• 39% tax fraud, 30% fraud, 31% various/ unknown	• 22% tax fraud, 5% corruption, 5% scams, 68% various/unknown
Reporting agencies:	• 100% financial institutions	• 88% financial institutions, 4% legal practitioners, 8% other
Vulnerabilities:	• Black forex market; porous borders and • cross-border historical, economic, and • cultural ties • Corruption	• Inflow of foreign ill-gotten money; porous borders and cross-border historical, economic, and cultural ties • Corruption
Policy considerations:	• Prioritize combating of tax fraud and corruption • Intensify collaboration with ACB, tax authority, and FIU • Promote bank deepening • Focus on gatekeepers • Relaxation of forex controls • Enforcement of transfer pricing regulations	• Prioritize combating of tax fraud and corruption • Intensify collaboration with ACC, tax authority, and FIC • Promote bank deepening • Focus on gatekeepers • Address loopholes in real estate legislation • Monitor inflow of capital

Sources: Interviewees and data from Malawi, Namibia, and open-source reports, tables 3.3 and 4.4.
Note: *Sufficient information of estimated magnitude as a percent of GDP was not available, but experts' best judgment is that the magnitude is significant.

A general observation about corruption in developing countries is that its relative importance is fundamentally different from its importance in most developed countries, where various forms of private sector fraud and drugs deliver large volumes of ill-gotten money.[1]

In many developing countries, corruption appears to be the second-largest source of ill-gotten money (after tax evasion), whereas in developed countries drugs are, in terms of volume, the most important crime for profit. Further research is clearly needed to validate these preliminary conclusions. If they prove valid, they would have serious implication for international AML good practices, since simply rolling out OECD-country experience on *how* to *use* the AML toolkit would not address the challenges of developing countries.

AML is, however, not the only solution. AML policies have to be complementary to other law enforcement policies and to policies aimed at fighting the root causes of crime and corruption. More needs to be done to make these connections as effective as possible.

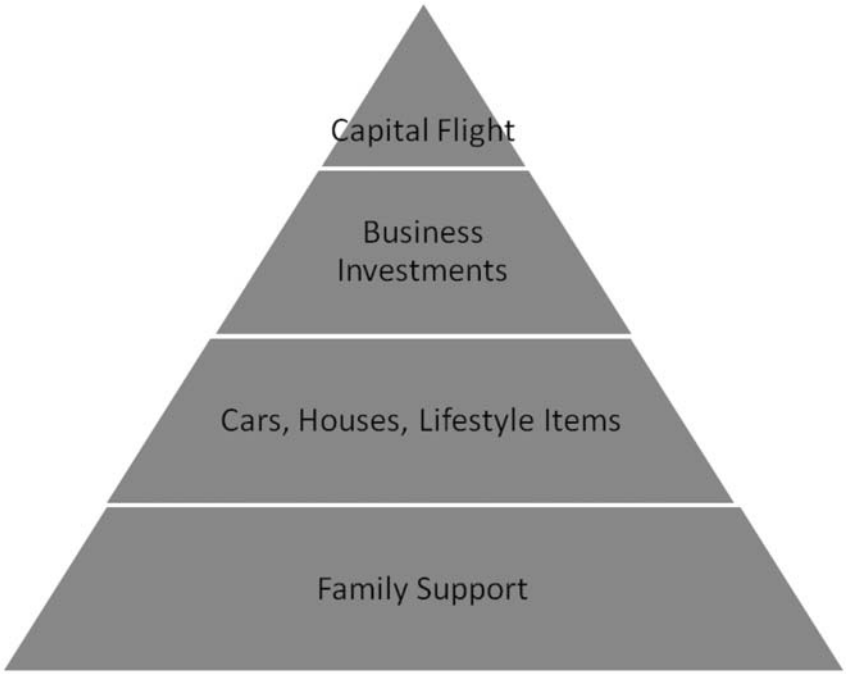
General Findings

This section presents the general finding of the study.

Spending Patterns

Research in Malawi and Namibia confirmed a probably universal pattern in which the proceeds of crime and corruption are spent. Figure 5.2 is inspired by the "Maslov Pyramid of Needs."

Figure 5.2. Hierarchy of Expenses of Ill-gotten Money



Source: Author's formulation.

The majority of the proceeds of crime or corruption will be spent on daily consumption (family expenses). Cases in Malawi and Namibia show that—if daily needs are met—money from crime and corruption is spent on cars, houses, lifestyle, and luxury items. As one Malawian official said in relation to medium-level government corruption in the country, "It is spent on posh cars and first-class beautiful houses."

Entrepreneurial investments (other than investment in the original crime business) will only be a third level of preference, with a bias toward "sterile investments" (Bartlett 2002) such as real estate.

In Malawi and Namibia, there are ample opportunities to spend or transfer ill-gotten money without ever entering the formal financial system. Part of the money laundering simply occurs through the direct purchase of goods and services or doing business with cash within the informal and formal economy. It is common, for example, in both countries to buy and sell real estate privately using cash.[2]

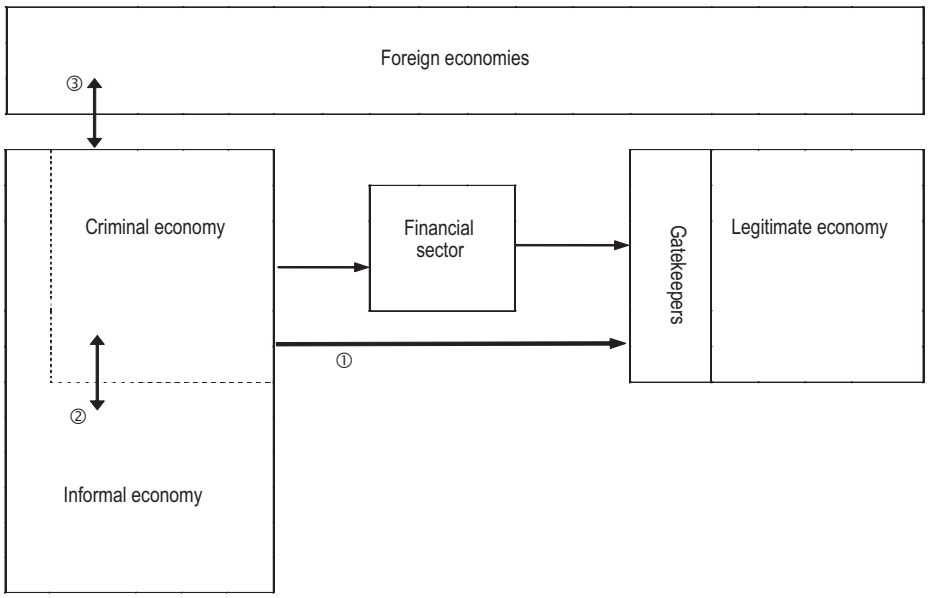
Cases analyzed in Malawi and Namibia have not demonstrated the use of sophisticated money-laundering techniques. The AML system is new to both countries and has not yet led to convictions. In some cases, closed corporations (such as consultancy firms) are set up to conceal illegitimate sources of kickbacks and bribes. These structures can be considered an elementary step to cover up the illicit or irregular origin of money. Sophisticated trust structures and foreign companies, set up with the help of legal professionals and intended to disguise a paper money trail, are not seen on a large scale in either country.

AML in a Cash-based Economy

Developing countries face a significant challenge in establishing an effective AML framework due to the existence of a large informal sector and the widespread use of cash. Cash is used not only for daily consumption but for even larger expenses, including the acquisition of real estate and business purposes.

The widespread use of cash reduces the effectiveness of an AML framework that is centered around setting up barriers for ill-gotten money within the financial sector, as figure 5.3 illustrates. A cash-based economy with a large informal sector is able to absorb large volumes of cash—both legitimate money and ill-gotten money. Ill-gotten money simply flows from the criminal economy directly into the legitimate economy, for example, for the consumption of durable consumer goods (such as cars), the acquisition of real estate, and even for investment and business purposes (see ① in figure 5.3). A large informal sector magnifies this "cash absorption capacity" even further (see ② in figure 5.3). In addition, if informal financial networks (such as "hawala" transfer systems)[3]

Figure 5.3. Flows of Ill-gotten Money in a Cash-based Economy with a Large Informal Sector



Source: Author's formulation.

are widely used for transmitting money within the country and across its borders, the system could be misused for transmitting ill-gotten money, as well (see ③ in figure 5.3).

In a cash-based economy, large volumes of ill-gotten money will be spent in cash on cars, real estate, and expensive lifestyle items. Gatekeepers such as lawyers, real estate agents, and dealers in precious articles are a crucial line of defense against recycling of ill-gotten money in developing countries. More should be done to adopt risk-based policies that focus on the gatekeepers' implementation of AML measures.

To be effective, AML efforts need to recognize the existence of cash and the informal economy, at the risk otherwise of irrelevance. This implies that AML measures should be designed to promote formalization. At the same time, formalization of the economy and the reduction of the reliance on cash is an agenda that goes well beyond AML.

Our research revealed additional factors such as a widespread distrust of the formal banking system, lack of the right products for some members of the society (for example, the Muslim community), inefficiencies (long delays, cumbersome bureaucratic obligations), low-to-negative interest rates on savings accounts, and the high costs of having a savings and bank account. Table 5.2 shows that in both countries the spread between the savings and lending rates is such that there is no incentive for customers to keep money in the bank even if they wanted to. In addition, all the banks charge a fee for ATM withdrawals irrespective of whether they are at their specific bank or part of the same network. For Namibian banks, there are charges levied even when depositing money into one's account.

Table 5.2. Examples of Bank Charges in Malawi and Namibia as of March 29, 2011

Rates/charges	Malawi Savings Bank	First Merchant Bank	NamPost	Bank Windhoek (EasySave*)
Savings account rate	4%	6.25%	1.75% (<US$727) 2.75% (US$728–1,456) 4% (US$1,456–7,280) 5% (US$7,280–145,602) 5.5% (≥ US$145,602)	0% (<US$145) 0.25% (US$146–1,456) 0.75% (> US$1,456)
Base lending rate	17%	17%	17.75	9.75% (Prime Rate) 6.0% (Repo Rate)
Inflation rate	7%	7%	3.1%	3.1%
Service monthly fee	US$0.98	US$0.32	US$0.87	US$0.32*
ATM Withdrawal	US$0.55	US$0.32	Not Available	US$0.30
Counter withdrawal	Nil	US$0.64	US$0.63	US$0.85*
Cash Deposit	Nil	Nil	US$0.50 0.70% (≥ US$51)	0.75%*

Sources: http://www.msb.mw/interest.html; http://www.fmbmalawi.com/rates.html; FMB Schedule of Charges as of March 1, 2011, received from FMB on March 29, 2011; https://www.nampost.com.na/download/tarrifs-2010.pdf; http://www.msb.mw/financials/MSB%20Tariffs-%20January%202011.pdf.
Note: *EasySave was launched in 2005 as a low-cost bank account aimed specifically at "unbanked" Namibians who for years were excluded from the formal banking sector due to various reasons such as affordability and access.

AML and Financial Inclusion

Experience has shown that an ill-designed and rigidly implemented AML regime could create barriers that prevent poor people from accessing the financial sector. However, as described above, there are multiple barriers to financial inclusion in both countries likely more detrimental than AML.

One of the basic Financial Action Task Force (FATF) recommendations, for example, requires financial service providers to verify a customer's identity "using reliable, independent source documents, data or information." Read in a rigid way, such a requirement might exclude many poor, undocumented, and low-income customers because they simply do not have such documentation and would be denied access to financial services as a result. Are these concerns justified?

Financial inclusion is high on the policy agenda in both Malawi and Namibia. Both countries have adopted a financial inclusion strategy aimed at achieving higher access to finance for poor people. But does AML impede financial inclusion efforts in Malawi and Namibia?

We found several motives on the part of the public for not using the banking system:

- First, the main reason is poverty. In both countries, surveys have indicated that people do not use the banking system because they do not have money to put into a bank account.
- Second, many aspects of economic activities are done in cash, so there is no incentive to have a bank account. In Malawi, for example, even government salaries in some instances are still being paid in cash.
- Third, in both countries high costs and inefficiencies of the banking sector discourage people from having a bank account. (See table 5.2 for an overview of the costs of banking services in four banking institutions in Malawi and Namibia.)
- Fourth, there are cultural and religious motivations for preferring cash. In Malawi, for example, some Malawians of Indian descent are Muslim, but banks in Malawi do not offer products that meet the religious requirements of this population.
- Fifth, individuals or businesses can have economic reasons for operating within the informal economy (such as an unwillingness to pay taxes) and as a consequence avoid the formal banking system.

Our analysis confirms that:

- Financial inclusion and AML are complementary goals in both Malawi and Namibia, because the widespread use of cash reduces the effectiveness of the AML system.
- Financial inclusion and AML basically should target different segments of the population in these countries (from a money-laundering risk perspective).

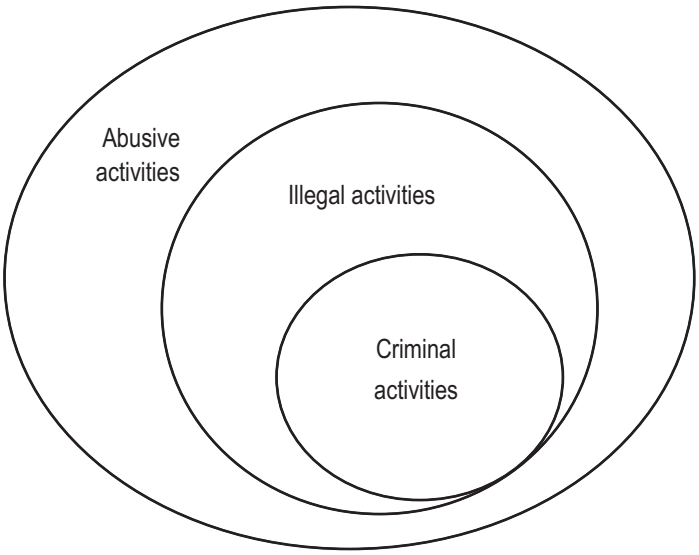
High-level corruption and large-scale tax evasion are crimes primarily committed by people with financial means. Financial inclusion strategies, in contrast, are primarily aimed at poor people.

Abusive Behavior

Boundaries among what is criminal, illegal, or just abusive or unethical (but legal) are fluid. However, it appears that using AML to fight improper transfer pricing by multinational organizations or forms of "legalized corruption"—whatever the negative economic impact of these practices—would be ineffective and a misuse of AML tools.

Figure 5.4 graphically displays the broad approach adopted in this report. Of the three concentric circles, criminal activities are at the heart, illegal activities are in a second circle, and unethical or abusive activities are in the outer circle.

Figure 5.4. Criminal, Illegal, and Abusive Activities



Source: Author's formulation.

Almost all interviewees in Malawi and Namibia identified "sources of dirty money" that were not strictly criminal or even illegal. In Malawi, foreign exchange dealing without a license from the Reserve Bank of Malawi was often identified as a money-laundering channel. Improper transfer pricing by multinationals was identified as one of the most prominent sources of "dirty money." In Namibia, examples of self-enrichment and patronage by public-sector officials were given in the area of tendering for bids. These activities are formally not against the law but were characterized as acts of corruption by many critics.

By definition, unethical or abusive behavior is not per se subject to AML provisions. However, boundaries of the judicial definition of "crime" vary by jurisdiction and might change during the course of history. Prostitution, for example, has become a legal and regulated profession in some countries but is highly punishable in others. Insider trading, however, has not always been a crime. Some consider it logical and efficient to let any competitive advantage inform decision making in the free market—a position some continue to embrace today.[4] Insider trading is now criminalized in many parts of the

world and is on the FATF list of 20 predicate offenses to money laundering. Cannabis, however, has long been used as a relaxant, social lubricant, and integral part of religious ceremonies in many parts of the world (including Africa), and it was criminalized only in the 20th century.

Key Recommendations

Following are the report's key recommendations.

Malawi

- Focus significant law enforcement and FIU resources on using an AML framework to combat corruption and tax evasion.
- Have a broader financial inclusion strategy that targets the rich population since the poor, as surveys show, do not have the income to save anyway.
- Allow new financial products for segments of the population that are "financially excluded," such as products that meet Islamic banking requirements.

Namibia

- Focus significant law enforcement and FIC resources on using an AML framework to combat corruption and tax evasion.
- Have a framework or mechanism that monitors the inflow of capital into Namibia.
- Enhance fit and proper tests for entrants to economically strategic sectors such as the diamond and uranium industries.

Follow-up Research

Our study shows that quantification of the order of magnitude of ill-gotten money is possible. A systematic collection of crime data, in-depth analysis of proven cases, sound information management, and empirical research on crime and ill-gotten money are necessary to establish an effective AML framework in developing countries. One key recommendation of this analysis is that such fact finding should be done much more systematically to improve decision making and measurement of impact when it comes to AML and to the fight against proceeds of crime.

In addition, cross-border flows of dirty money need to be explicitly taken into consideration in pursuing AML policies. The internationalization of crime and financial markets can put economic development in developing countries at risk. As mentioned, one way to mitigate this risk is by adopting rigorous fit and proper tests for entrants to economically strategic sectors in the country.

Conducting similar studies in other developing countries will be a next step in discovering general patterns and effects of the circulation of ill-gotten money in developing countries. In conducting these studies, special attention should be given to:

- Development of data and information management
- Flows of ill-gotten money in a cash-based economy
- Corruption typologies (spending and investing patterns)
- Cross-border transfers of ill-gotten money
- Cultural and ethnic specific financial management practices (legitimate and ill-gotten money)
- In-depth analysis of money-laundering cases (proven or under investigation).

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Notes

1. See, for example, Reuter and Truman (2004, tables 2.3 and 2.4); and Unger et al. (2005, tables 2.9 and 2.10).
2. See, for example, the Muluzi case in Malawi as described in box 3.1 and the Nuctech case in Namibia as described in box 4.2.
3. Hawala is an informal value transfer system whereby a customer approaches a hawala broker ("hawala-dar") in one city and gives a sum of money to be transferred to a recipient in another, usually foreign, city, but it can also be done within the same jurisdiction. The hawala broker calls another hawala broker in the recipient's city, gives disposition instructions of the funds (usually minus a small commission), and promises to settle the debt at a later date.
4. Randy (2009).

ECO-AUDIT

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Many developing countries have introduced policies to tackle ill-gotten money over the past years. This study explores the effects of ill-gotten money or the proceeds of crime and anti-money laundering policies on economic development through its focus on two developing countries: Malawi (a low-income country) and Namibia (an upper-middle-income country). The analytical starting point is that anti-money laundering efforts are a tool to address criminal activities—and criminal activities have a measurable effect on development. The study examines how measures to combat the proceeds of crime contribute to development and enables governments in developing countries to analyze the main source of ill-gotten money and its effects on the economy.

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