Illicit financial flows: may be Africa is the 'net creditor to the world'

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Some experts and leaders in Africa have been arguing that because most African countries exports are sold in their raw or primary form (as fruits and vegetables, coffee beans, cotton lint, iron ore), these countries are actually 'donors' to the developed countries that buy from the continent. That jobs are exported. And that this accounts for the current unemployment and slow growth of some of the economies in SSA. Are they wrong? Partly no. An economy which does not export a value added and manufactured product face stiff competition in the market for primary or raw materials – and fetches little. On the other hand, countries that export processed or manufactured products fetch higher prices. Those that export IT solution and especially software can even not meet the rugged international logistics or transport hurdles. They can even attach a file to an email and click and it is sent. Such a file may be an export of more than US$1 million! A sack of coffee beans is cheaper than some small sized pack of Nescafe!

How about illicit financial flows from SSA countries that end up in developed countries?

Global Financial Integrity (GFI 2010) simplifies the definition of illicit money. It states that "Illicit money is money that is illegally earned, transferred, or utilized. If it breaks laws in its origin, movement, or use it merits the label"[1]. Illicit money violates the national government's criminal and civil codes, tax laws, customs regulations, VAT assessments, exchange control requirements, or banking regulations of those countries out of which the unrecorded/illicit flows occur[2]. Illicit flows are residual an unaccounted for external funds flows (explained by the World Bank Model below), and generated through the mispricing of trade transactions, is captured by the trade mis-invoicing. There are several other ways of illicit flows that cannot be captured by economic models – the activities of the 'shadow' economy. These include illicit flows generated through smuggling, transactions in narcotics and other contraband goods, human trafficking, violations of intellectual and property rights, and the sex trade.

[1] Global Financial Integrity (2010): "Illicit Financial Flows from Africa: Hidden Resource for Development", p. 7
[2] Global Financial Integrity (2010): "Illicit Financial Flows from Africa: Hidden Resource for Development", p. 7

World Bank Residual model[3] compares a country's source of funds with its recorded use of funds. Sources of funds the countries inflows of capital include increases in net external indebtedness of the public sector and the net inflow of foreign direct investment. The net external indebtedness is derived by calculating the change in the stock of external debt which was obtained from the World Bank's Global Development Finance database. The use of funds includes financing the current account deficit and additions to central bank reserves. Both these data series along with data on foreign direct investment were obtained from the IMF Balance of Payments database. According to the model, whenever a country's source of funds exceeds its recorded use of funds, the residual comprises unaccounted-for, and hence illicit, capital outflows.

Trade mis-invoicing[4] has long been recognized as a major conduit for illicit financial flows. By overpricing imports and underpricing exports on customs documents, residents can illegally transfer money abroad. To estimate trade mis-invoicing, a developing country's exports to the world are compared to what the world reports as having imported from that country, after adjusting for insurance and freight. Additionally, a country's imports from the world are compared to what the world reports as having exported to that country. Discrepancies in partner-country trade data, after adjusting for insurance and freight, indicate mis-invoicing. However, note that this method only captures illicit transfer of fund abroad through customs re-invoicing.

GFI 2010 quotes that smuggling[5] tends to be rampant when there are significant differences in cross-border prices in certain goods between countries that share a long and porous frontier. The profits from smuggling often end up as part of outgoing illicit flows since smugglers seek to shield their ill-gotten gains from the scrutiny of officials, even as smuggling distorts the quality of bilateral trade. As a result, trade data distortions due to smuggling may indicate that there are inward illicit flows into a country when in fact the reverse is true.

In 2010, the US based Global Financial Integrity released their analysis of illicit financial flows from Africa in the report titled, "*Illicit Financial Flows from Africa: Hidden Resource for Development*"[6]. In this report, they show that for 38 years from 1970–2008, illicit financial flows from the continent may be closer to US$1.8 trillion. According to Governor of Kenya central Bank, Mr. Ndung'u (2007) *capital flight has had adverse welfare and distributional*

[3] Global Financial Integrity (2010): "Illicit Financial Flows from Africa: Hidden Resource for Development", p. 7
[4] Global Financial Integrity (2010): "Illicit Financial Flows from Africa: Hidden Resource for Development", p. 7
[5]Global Financial Integrity (2010:8): "Illicit Financial Flows from Africa: Hidden Resource for Development"
[6] Global Financial Integrity (2010): "Illicit Financial Flows from Africa: Hidden Resource for Development".

consequences on the overwhelming majority of poor in numerous countries in that it heightened income inequality and jeopardized employment prospects[7].

The GFI 2010 report shows that in absolute figures, all regions of Africa have had increasing illicit financial flows. It also shows that in even given the rates of change (real 2008 deflated) are also increasing. The same report shows (with this caveat in mind) that the estimates indicate that Africa lost around US$29 billion per year over the period 1970-2008, of which the Sub-Saharan region accounted for $22 billion. On average, fuel exporters including Nigeria lost capital at the rate of nearly $10 billion per year, far outstripping the $2.5 billion dollars lost by non-fuel primary commodity exporters per year[8].

There is a critical comparison showing that the ratio of illicit financial flows (IFF) to ODA is increasing. There is more IFF out of Africa than ODA into Africa according to the GFI 2013. In 2009, illicit financial flows out of Africa were over three times the amount of ODA received. This is a big loss to the economies on this continent and there is need to curtail illicit financial flows. The doing business indicators and governance of these countries need to improve. Improvements in governance and the business climate can improve the productivity of both domestic and foreign capital (FDI) needed to boost economic growth and transform the economies depending on agriculture gradually to industries and services.

According the report authored jointly by the African Development Bank and the US based Global Financial Integrity 2013, indicates that Africa was a *net creditor* to the world, as measured by the net resource transfers, to the tune of up to US$1.4 trillion over the period 1980-2009 (adjusted for inflation). That is a period of 29 years. The report also shows that the distribution of gains and losses of transfers among African countries was asymmetrical, resulting in a net loss of transfers from Africa. The top five countries that gained transfers over the period 1980-2009 are South Africa, Sudan, Tunisia, Morocco, and Cote d'Ivoire, while Algeria, Libya, Nigeria, Botswana, and Egypt lost such transfers. The volume of transfers lost from the latter five countries far outstripped those gained by the former five[9]. The same report indicates (that based on the broad measure of recorded transfers), Africa's transfers increased from an average inflow of about US$27 billion per annum in the 1980s and 1990s before declining to US$8.7 billion in the last decade ending 2009. However, the broad measure[10] does not show that Africa swung from net debtor to net creditor to the

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[7] Cited in Global Financial Integrity (2010:6): "Illicit Financial Flows from Africa: Hidden Resource for Development"

[8] Global Financial Integrity (2010:11). "Illicit Financial Flows from Africa: Hidden Resource for Development"

[9] Joint Report by African Development Bank and Global Financial Integrity Africa Progress Panel, "Illicit Financial Flows and the Problem of Net Resource Transfers from Africa: 1980-2009", May 2013.

[10]Narrow Measure: In real terms, the financial account or Narrow measure declined from an average annual inflow of US$9.6 billion for Africa as a whole in the 1980s (or 2.3 percent of GDP) down to US$4.6 billion in the 1990s (or 1 percent of GDP). In the last decade (up to 2009), it is estimated that about US$30.4 billion per annum (or 3.2 percent of GDP) flowed out of Africa in net recorded transfers (as measured by Narrow Measure). About 80 percent of these outflows, or US$25.2 billion, was out of North Africa. (See

world in the 2000s mainly due to substantial current and capital transfers such as remittances, migrant transfers, debt forgiveness and write-offs, and other non-financial transfers which provided off-setting effects[11]. The report also notes the following:

i) *In resource-rich countries*, the natural resource sector is usually the main source of illicit financial flows. These countries generally lack the good governance structures that would enable citizens to monitor the amount and use of revenues from the natural resource sector.
ii) *In resource-poor countries*, illicit financial flows largely arise from the mispricing of trade by companies of all sizes. This activity is a form of money laundering and tax evasion.

Urging Developed countries help stop capital flight out of Africa

Most political leaders in Africa have got fat bank account and properties in the rich capitals of Europe, USA and recently in East Asia. "Illicit financial flows facilitated by tax haven secrecy and anonymous shell companies are the most damaging economic problem facing the African continent"[12]. According to Baker (2013), anonymous shell companies are the most-widely used method for laundering the proceeds of crime, corruption, and tax evasion. These phantom firms facilitate sex slavery, terrorism, and tax evasion. Therefore, central public registries of meaningful corporate ownership information are essential to curtailing these pernicious crimes[13].

Former Secretary General of the UN and Chair Africa Progress Panel has requested the rich countries to remove the veil of secrecy on companies which has been the protection of illicit financial flows from Africa. Mr. Annan[14] puts it that "It is time to draw back the veil of secrecy behind which too many companies operate. He continues that "Every tax jurisdiction should be required to publicly disclose the full beneficial ownership structure of registered companies. Switzerland, Britain and the United States all major conduits for offshore finance

GFI 2013 p.17).Broad Measure: which, in addition to the financial account balance, includes net current transfers (e.g., workers' remittances) and net capital transfers (e.g., debt forgiveness and write-offs) and is therefore more representative of the African flows given the prominence of remittances and debt forgiveness in African economies (See GFI 2013 p. 17).

[11] Joint Report by African Development Bank and Global Financial Integrity Africa Progress Panel, "Illicit Financial Flows and the Problem of Net Resource Transfers from Africa: 1980-2009", May 2013, p.2

[12] This was said by GFI President Raymond Baker, a longtime authority on financial crime at the launch of GFI 2013 report on Africa (Source: http://www.gfintegrity.org/content/view/616/70/ (accessed on 11/23/13))

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[14] Source: http://www.gfintegrity.org/content/view/616/70/ (accessed on 11/23/13)

should signal intent to clamp down on illicit financial flows. And the G-8 and the G-20 should work together to expand the scope and reach of the *Dodd-Frank* (which contains provisions concerning the use of minerals to finance military operations in eastern Congo (Kinshasa))"[15]

With regard to conflicts and efforts at democracy, the foreigners should work with the neighbours of a country in question, the AU (and the UN later). The foreign governments have to help reduce wars in the world. It is in the interest of all to solve wars and conflicts. Some conflicts in Africa or Asia may have spillover effects for US and Europe. But how a foreigner intervene matters and can't do it alone.

References:

Joint Report by African Development Bank and Global Financial Integrity Africa Progress Panel, "Illicit Financial Flows and the Problem of Net Resource Transfers from Africa: 1980-2009", May 2013

Global Financial Integrity (2010): "Illicit Financial Flows from Africa: Hidden Resource for Development".

[15] *Dodd-Frank:* In July 2010, the U.S. Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act, which contains provisions concerning the use of minerals to finance military operations in eastern Congo (Kinshasa). All companies registered with the U.S. Securities and Exchange Commission (SEC) that sell products containing cassiterite, columbite-tantalite, gold, or wolframite are required to disclose whether these minerals originated from Congo (Kinshasa) or adjoining countries. Companies that sell products containing cassiterite, columbite-tantalite, gold, or wolframite that originated in Congo (Kinshasa) or adjoining countries are required to submit annual reports to the SEC describing the due diligence measures taken, the smelters that processed the minerals, and the companies' efforts to determine the mine of origin (*See Thomas R. Yager, Omayra Bermúdez-Lugo, Philip M. Mobbs, Harold R. Newman, Mowafa Taib, Glenn J. Wallace, and David R. Wilburn(2012: 1.2), "The Mineral Industries of Africa"2010 Minerals Yearbook: Africa, USGS).*