

# Illicit Financial Flows from Africa: the ECA Perspective

Financing for Sustainable Development~Illicit Financial  
Flows & Trade Misinvoicing

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# Outline



- 1. Background**
- 2. High Level Panel's Definition of IFFs**
- 3. ECA methodology for estimating IFFs from Africa**
- 4. Results**
- 5. Possible methodological extensions**
- 6. Way Forward**

## Illicit Financial Flows from Africa: the Journey from Lilongwe to Addis Ababa



- **March 2011:** African Ministers of Finance's resolution to establish HLP on IFF
- **February 2012:** Establishment of the HLP on IFFs, chaired by Thabo Mbeki, including President of Pan-African Lawyers' Union, former head of Coca-Cola Bottling Company Nigeria, head of Global Financial Integrity, Head of Action Aid Uganda, former Vice President of African Development Bank.
- **January 2015:** Adoption of the HLP report by the Heads of State & Government
- **July 2015:** Addis Ababa Action Agenda

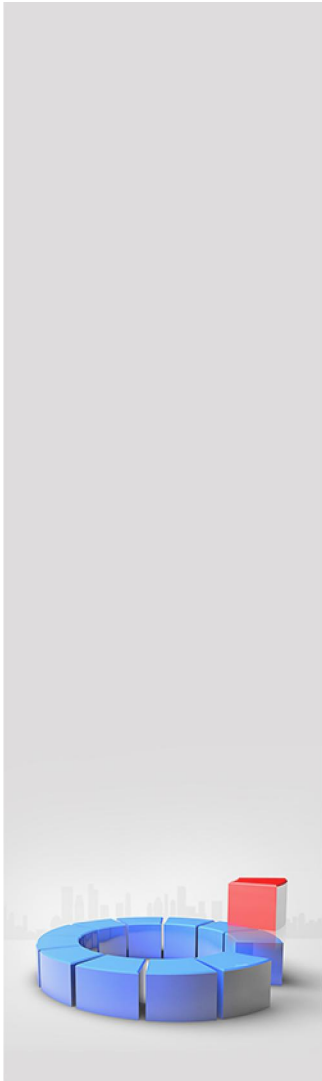
## Background: Development challenges of IFFs for Africa

- IFFs have damaging effects on African countries, including: (i) draining resources and tax revenues ; (ii) stifling growth and socio-economic development ; (iii) weakening governance.
- Africa loses significant volumes of financial resources, which could have been used to finance critical development projects, due to illicit outflows.



## Background: Political Economy of Illicit Financial Flows

- IFFs strengthen resources of those who benefit from them > undermine governments' ability to implement economic policies that run against powerful interests
- Financial globalization has provided a conducive environment for a 'capital strike' against undesired taxation or regulatory policies
- This has wider implications on the nature and the modes of development in Africa



## The Role of African Union Commission (AUC) and ECA



- AUC/ECA Technical Committee:
  - Provided technical advice and support to the HLP in matters pertaining to its core functions
  - Responsible for turning policy decisions of the HLP, into action, and for coordinating efforts in implementing these plans
  - Membership of the Technical Committee was from relevant divisions of ECA and AUC that are directly involved in activities related to combating IFFs.

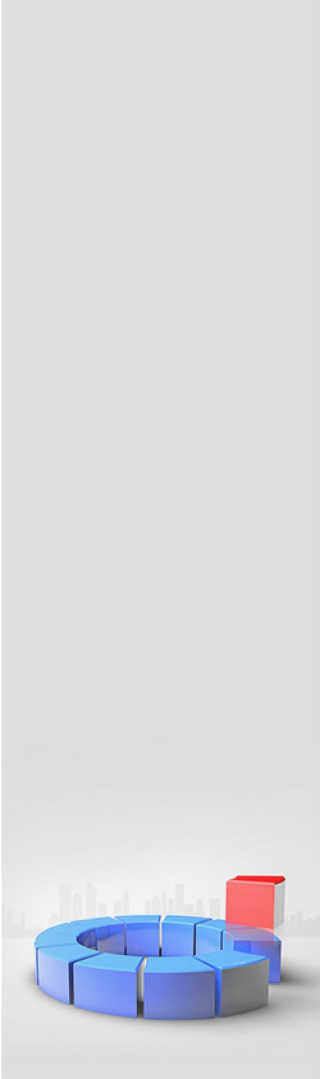
## HLP's approach to delivering on its mandate



- > Actions:
  - Background paper on the Scale and Development Challenges of IFF from Africa
  - In-depth country case studies
  - Regional and country consultations within and outside Africa

## The Research Analysis Component of the HLP Work

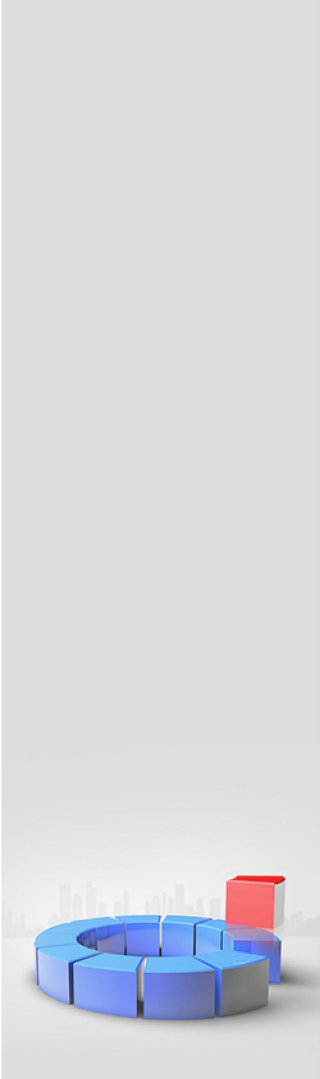
- Overall report with findings and policy recommendations
- Background documents on the “Scale and Development Challenges of Illicit Financial Flows from Africa” based on a model of trade mis-invoicing.
- Seven country case studies to examine the main drivers and dynamics of IFFs in the country and the main instruments and institutional settings designed to combat IFF.
- The template of the case studies was supported by a survey and interviews with the main stakeholders in the country.



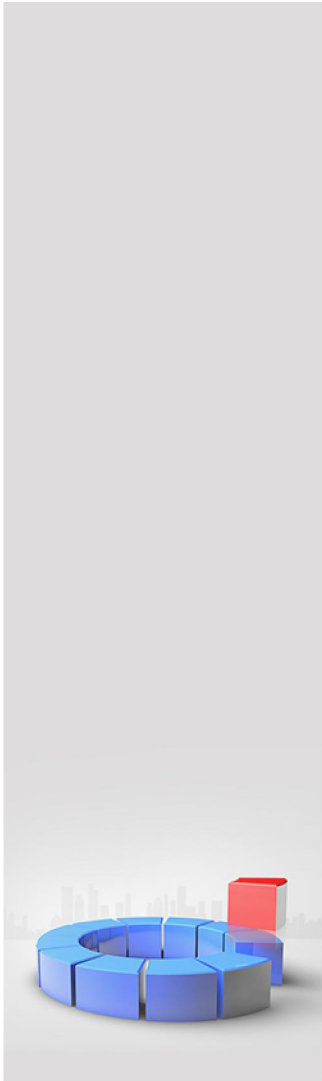
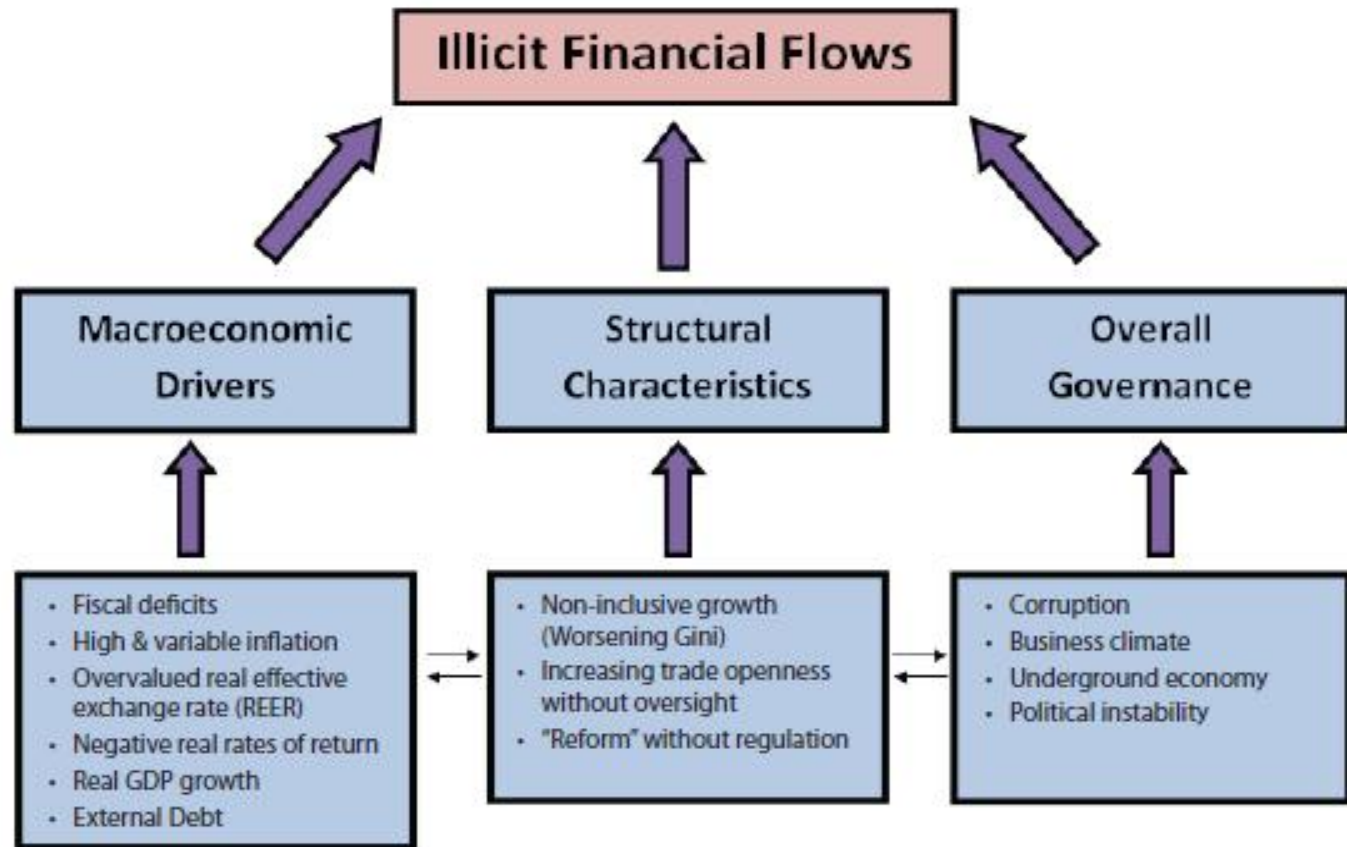


## Conceptual approach

- HLP defines IFFs as “money illegally earned, transferred or used”
- For estimation – unrecorded capital flows used as proxy (> why hide them unless there is an illicit aspect?)
- Emphasizes the role of governance at both the origin and destination jurisdictions of these flows
- Contrasts with term “capital flight” which **blames developing countries for driving capital away**
- Emphasizes the need for better regulatory environment at the national and global levels.

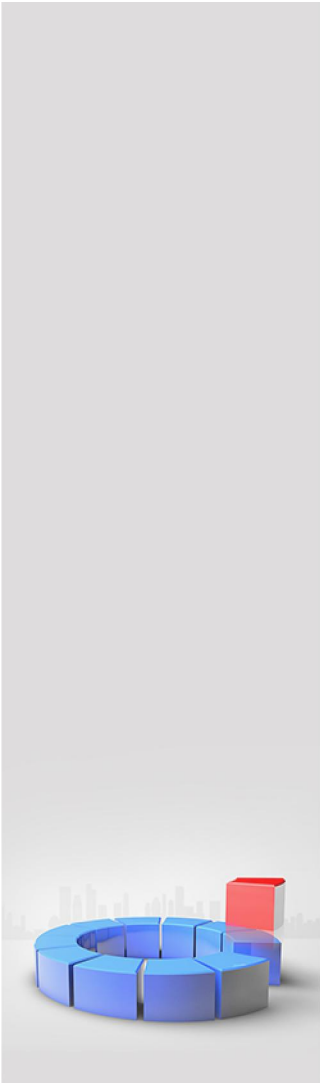


## Drivers of IFF



## Main Methods of Estimating IFFs

- Several attempts to quantify IFFs using different methods
- However, no attempt was conducted to disaggregate IFFs from Africa by subsector & by destination countries



## ECA Methodology: why measure IFFs through Trade Misinvoicing?



- 1) Disproportionate development impact of IFFs' commercial activities (estimated by Global Financial Integrity to account for 60% of illicit financial flows worldwide)
- 2) Corruption is extremely difficult to measure; dominated by perception-based measures
- 3) Similarly, criminal activities are also difficult to measure
- 4) Transfer pricing requires firm-level data (not readily available for most countries) & in-depth examination of individual MNCs behaviour, which is costly & often impossible to access
- 5) Wide coverage of Trade statistics (COMTRADE) for countries over time

## 2. Methodology

The ECA methodology builds on the IMF's Direction of Trade Statistics (DOTS)-based trade misinvoicing model

$$IFF = [X_i] - \frac{M_j}{\beta} + \left[ \frac{M_i}{\beta} \right] - X_j$$

$M$  = Imports

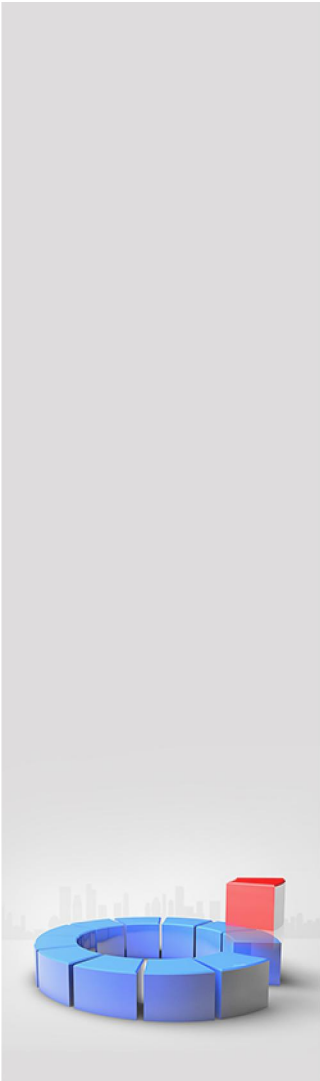
$X$  = Exports

$\beta$  = Converting Import prices c.i.f to f.o.b, by 10%.

$i$  and  $j$  = Countries

If  $M_i > X_j$  = import over-invoicing,

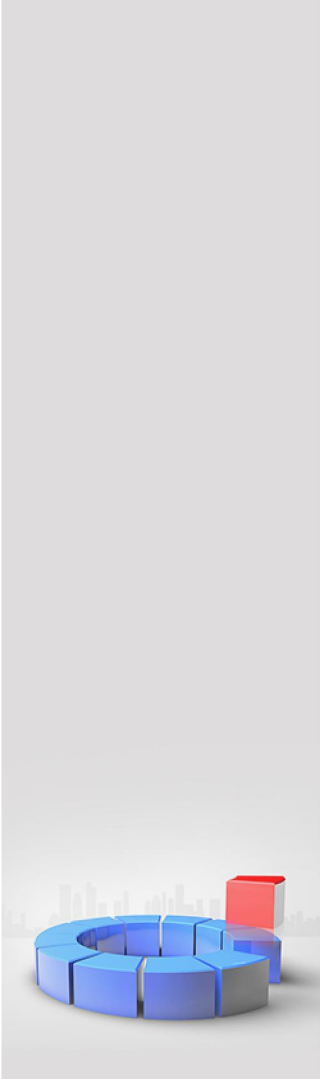
If  $X_i < M_j$  = export under-invoicing



# ECA Methodology vs. IMF DOTS Methodology

## 1. Data Source used

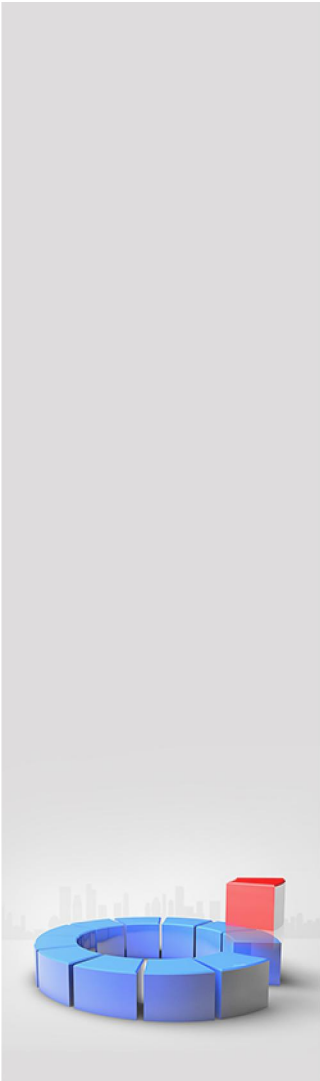
- IMF Methodology uses export/import statistics from DOTS at the country level (aggregated)
- ECA methodology uses UN COMTRADE data dataset which provides bilateral trade information for more than 200 countries -including most African countries- and 5,000 products, at the Harmonized System 6-digit (HS6) level



## 2. Unit of Comparison (c.i.f vs f.o.b)

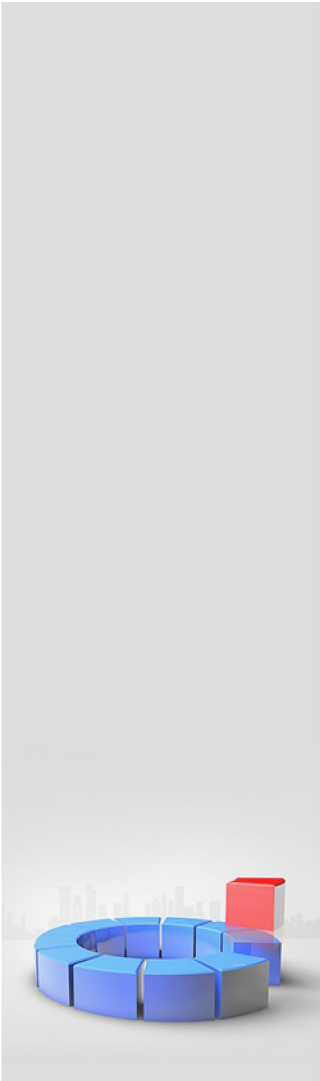
➤ Exports are usually expressed free on board (f.o.b.) prices, while imports are given inclusive of cost, insurance and freight (c.i.f.). Hence, before being compared, exports and imports must be expressed in the same unit

➤ Most (if not all) studies using the IMF DOTS methodology interact a **fixed coefficient (10%)** to get an import f.o.b (in accordance to DOTS practice)



## 2. Unit of Comparison (c.i.f vs f.o.b) ... (Cont'd)

- a. Using a fixed coefficient to convert import values from c.i.f. to f.o.b. may build some distortion between export and import statistics
- b. The residual is assumed to be IFF alone, which is not necessarily the case (e.g. does not account for missing data and time lags in reporting of trade statistics)







## 2. Unit of Comparison (c.i.f vs f.o.b) ... (Cont'd)

➤ ECA method introduced two measures to address these limitations:

- 1) Export statistics from UN COMTRADE, imports from BACI (by CEPII)

(imports in BACI have been converted to f.o.b. Units, subtracting insurance & freight costs specific to country pair and 6-digit product estimated using a gravity model. Adjustment also made for country or product specific systematic misreporting (modelled econometrically from trade discrepancies).



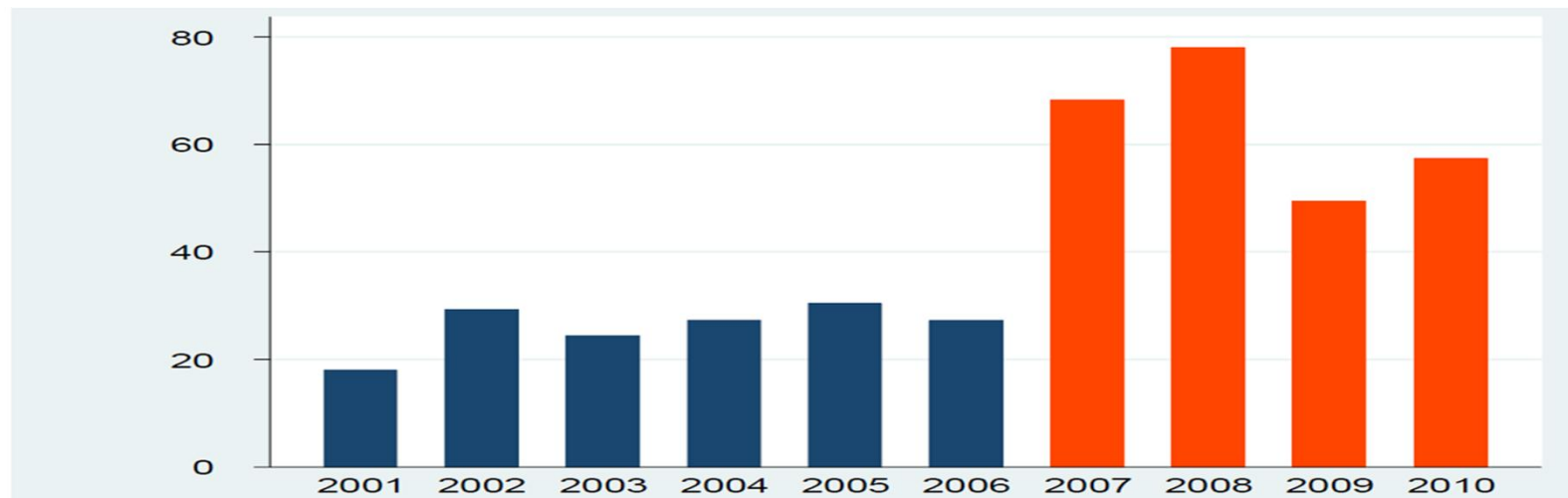
## 2. Unit of Comparison (c.i.f vs f.o.b) ... (Cont'd)

- 2) Time lags in export/import processes is accounted for, using time taken (World Bank dataset) for export/import between bilateral trade partners (multiplied by empirically estimated costs-per-day for country, sector, product (Minor and Hummels, 2011))

**Methodology estimates IFFs as discrepancies between exports and imports, after adjustment for insurance/freight costs reporting errors and time differences. Estimates net outflows (i.e. outflows minus inflows)**



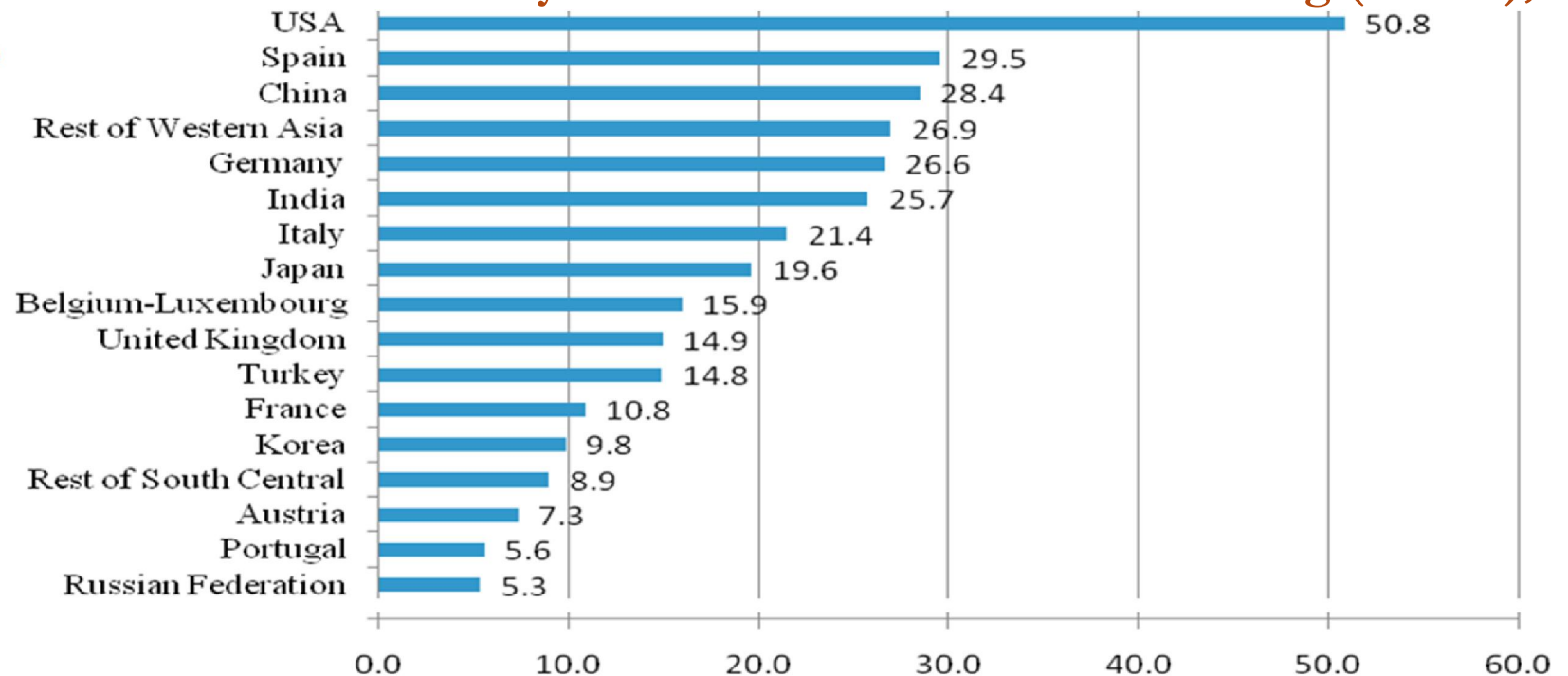
## 2. Results: IFF from Africa via trade mis-invoicing, \$ bn, 2001-10



- Between 2001 and 2010, it is estimated that **USD 409 billion** left Africa as IFF



## 2. Results: IFF from Africa by destination via trade mis-invoicing (>\$5bn), \$bn,



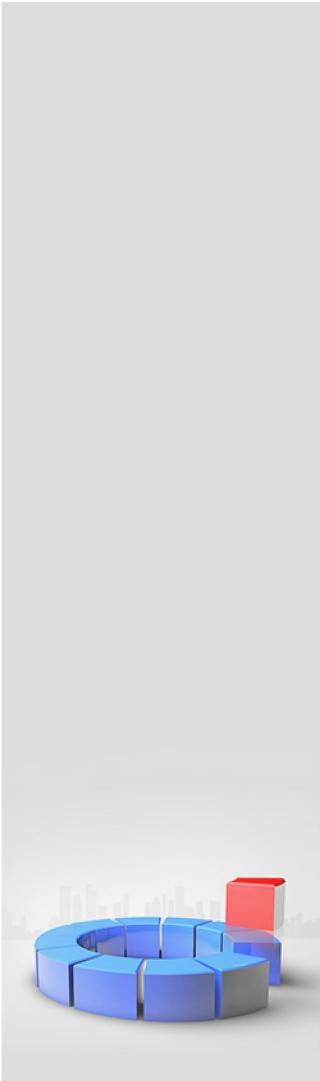


## 2. Results: Cumulative IFF from Africa by sector via trade mis-invoicing, 2001-10

GTAP Sector	USD Billion
Metals nec (Copper & Gold and other non-ferrous metals)	84.00
Oil	69.59
Natural gas	33.99
Minerals nec (non metallic minerals eg. Cement, gravel, plaster etc)	33.08
Petroleum, coal products	19.98
Crops	17.06
Food products	16.86
Machinery and equipment nec	16.82
Wearing apparel	14.00
Ferrous metals (Iron & steel)	13.15

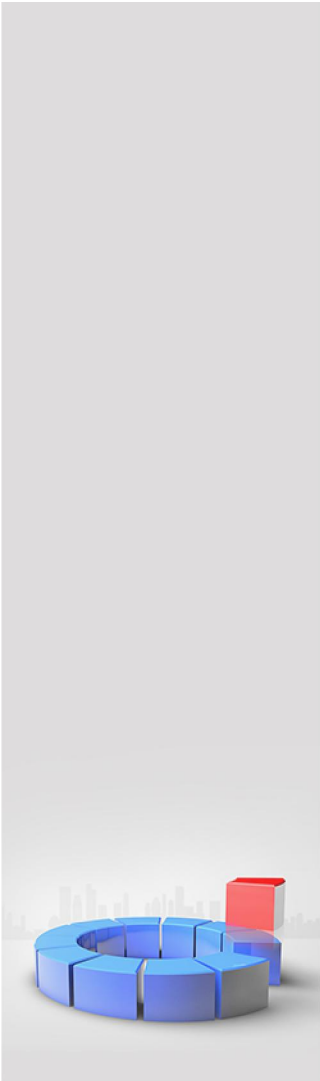
## Methodology extensions (1/2)

- More sectoral disaggregation for more precise sectoral picture.
- BUT too much disaggregation can be problematic due to same goods being systematically reported in different tariff lines by importer/exporter, & BACI dataset may not adjust some observations for reporting errors.
- Currently, since net flows estimated, valuable information lost about inflows & outflows that could be useful for policy. AND understates negative impacts – inflows do not (fully) compensate outflows



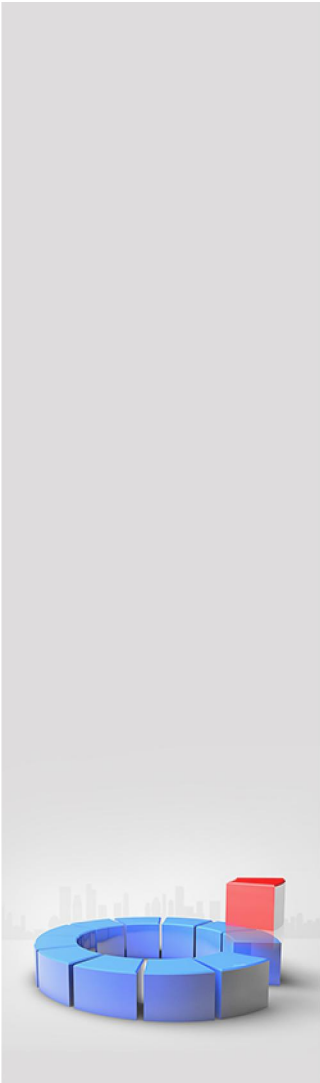
## Methodology extensions (2/2)

- Estimate IFFs through trade in services, data disaggregated by partner country
- African countries do not report trade in services data by partner country > estimate trade in services misinvoicing for countries with data by partner & build econometric model to explain services mis-invoicing to identify risk factors > see which African countries at risk
- Similar approach possible with investment (data also not available for all African countries)-CEPII dataset



## Follow-up to the HLP Report: Methodology

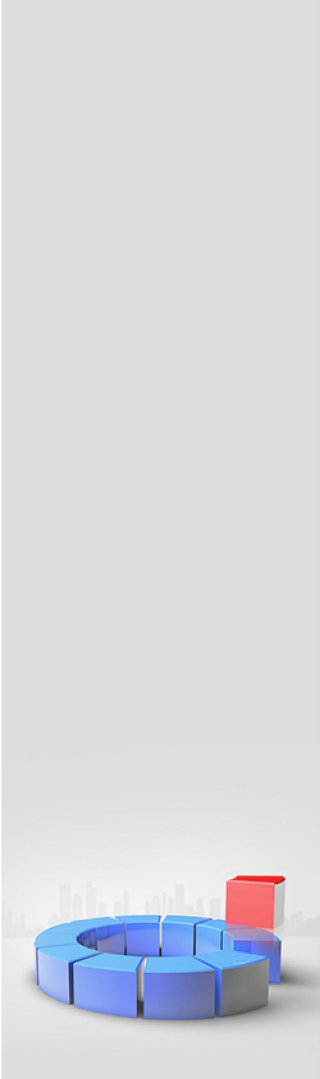
- Update the ECA estimates up to 2015.
- Work with other UN regional commissions on the trade-mispricing model (ECLAC, ESCAP and ESCWA)
- 3 year joint project with UNCTAD and UNODC: to address the disjointed international work on estimating IFFs and build towards the in-depth review expected for SDG 16 in the summer of 2019





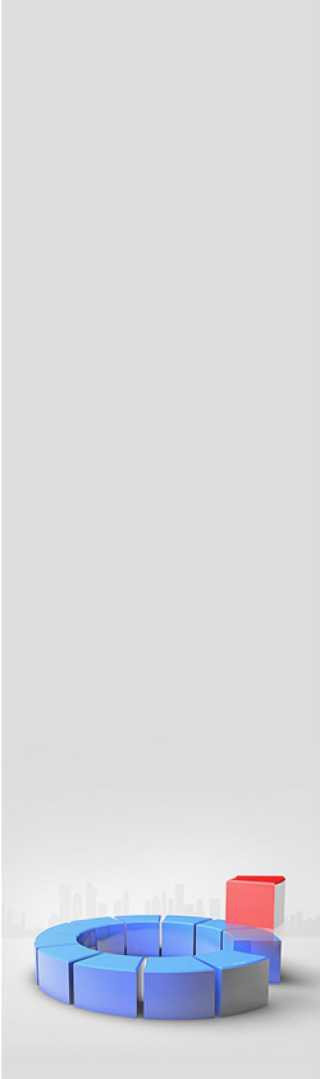
## HLP findings (1/2)

- Tackling IFF is a **political** and technical issue
- **Natural resource** sectors are particularly vulnerable
- Greater efforts needed to tackle **IFF through commercial channels**
- **Tax incentives** are often abused and not guided by cost-benefit analysis



## HLP findings (2/2)

- Weak **capacities** impede efforts to tackle IFFs
- **Global architecture** on IFFs is incomplete
- More action needed on **financial secrecy jurisdictions**
- **Development partners** have an important role



## Work under the Consortium to Stem IFFs from Africa



- Input to the annual report to the AU Heads of State and Government by H.E Thabo Mbeki, Chair of the IFF Consortium to Stem IFFs
- Research, capacity building and advocacy.
- Utilize the Consortium to enhance the participation of Africa in global dialogues on tax cooperation and illicit financial flows

**Thank you very much  
for  
your kind attention!**

