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Illicit Financial Flows from Africa: South Africa, Nigeria and Zambia

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In 2013, the then South African Revenue Services Commissioner, Oupa Magashula said:

> "In part because of our world-class financial systems, along with the large extractive industry of mining and resources, the presence of large multinational corporations, and our open economy and tradable currency, South Africa is at very high risk of [illicit financial flows]"[1]

The SARS Commissioner is referring here to cross-border flows of financial capital that bypass formal financial record and so evade due taxation, but illicit financial flows (IFFs)[2] are also motivated by the desire to avoid import tariffs, exploit export incentive schemes and shift capital offshore outside of the regulatory strictures (capital flight).

The primary mechanism for these IFFs in the context of extractives exporters (such as South Africa) is '*trade mis-invoicing'* – referring to the deliberate over or under invoicing of exports and imports. A previous tralac brief covered the issue from the perspective of how to account for it: the definition, measurement and estimation of IFFs. This briefing provides an overview of the state of IFFs in three of Africa's important extractives exporters – South Africa, Nigeria and Zambia.

The South African economy is relatively diversified when compared with other African economies, nevertheless it is an important exporter of precious minerals gold, silver and platinum group metals (PGMs) as well as other minerals such as iron ore and concentrates. These exports together make up more than 23% of its total exports. In the case of PGM and silver exports, export mis-invoicing began to increase in the late 90's and has averaged around 10% of total exports. However, the extent of mis-invoicing with respect to China in particular, is very large at more than 700% of SA reported exports.

Non-monetary gold exports are SA's third most important export and represent a significant source of IFFs. Exports are concentrated geographically with India (35%), China (17%), Italy (13%) and the UK (12%) making up the top four destinations, and 77% overall of gold exports. For the decade of the 2000s, export under-invoicing (outflows) amounted to nearly 2000% of SA's reported exports[3]. This is a *substantial illicit capital outflow*, from a country that requires investment capital to diversify and future-proof its economy.

By contrast with PGM exports, SA's iron exports to China, which is by far its major trading partner in this commodity, amount to less than 10% of SA's reported exports. Overall, trade mis-invoicing of iron ore exports is not at the scale of mis-invoicing of the two major precious metals export groups, but nevertheless presents something of a puzzle because since 2010 the pattern has shifted from export under invoicing (outflows) to export over invoicing (inflows).

IFFs do not just rob a developing economy of needed financial capital (export under invoicing), they also rob the fiscus via import under-invoicing. The quantum of the loss of revenue to the SA fiscus due to recent IFFs has been estimated at more than $35b, or enough to completely redeem all of SA electricity parastatal Eskom's outstanding debt.

The Nigerian economy is the largest by absolute size in Africa, and not undiversified. However, as an exporter it is highly dependent on fuels products – crude oils and gas, which comprise more than 90% of its total exports. It is also a significant importer of oils, which it processes through its refineries. Nigeria's trade (both directions) is more prone to import under-invoicing than to export under-invoicing, although the latter does take place. In the case of its oil exports, there is export under-invoicing with five out of 17 trade partners and export-over-invoicing with the balance.

Nigerian oil import under-invoicing totals to similar values as that for export mis-invoicing, with the Netherlands standing out as a trade partner engaged in IFFs both on oil exports from and oil imports to Nigeria[4]. A large quantum of Nigeria's exports to the Netherlands are not recorded by the Netherlands, and similarly for the Netherland's export of oil to Nigeria.

More 'traditional' IFFs that result in capital outlflows from Nigeria are observed with trading partners in the EU (Germany, Spain and the UK) and significantly, with the US. The quantum of the loss of revenue to the Nigerian fiscus due to IFFs in 2014 has been estimated at more than $2.2b, or approximately 4% of total government revenue.

The Zambian economy is heavily based on copper, of which it is a major exporter (about 65% of total exports) and upon which its economy is heavily based. Trade misinvoicing in Zambia is dominated by export under-invoicing (outflows), with the exception of South Africa, the UK and Switzerland, with the latter being responsible for zero recorded copper imports from Zambia. This is despite Zambia invoicing for exports to Switzerland to the tune of more than 50% of its total copper exports.

Zambia also shows significant copper export under-invoicing, led by its trade with China, which has grown strongly as an importer of Zambian copper since the mid-2000s. The value of Zambia's copper exports to this country as well as to Korea are significantly under recorded, resulting in illicit financial outflows.

Switzerland as a trading partner presents a special case of IFFs with several of its African trading partners. In the case of Nigeria's oil exports to Switzerland, there is evidence of substantial export under-invoicing or even non-reporting. This represents an illicit flow of capital from Nigeria to Switzerland. The opposite case applied to Zambia's copper exports to Switzerland, which are substantially export over-invoiced or simply not recorded by Switzerland[5].

Whether they are export or import-based, IFFs represent a diversion of resources away from the very countries that need them the most. While domestic economic and social conditions in some developing countries sometimes lead to 'push' factors for corporates operating there, not all IFFs can be simply ascribed to investment aversion. Appropriate policy interventions, that focus on effective auditing and reconciliation of domestic and foreign transaction values, combined with a system of penalties and fines, could help to staunch the flow of IFFs from Africa's extractive economies. That, in combination with an investor-friendly environment and with streamlined business regulations in all sectors, could help kick start a virtuous cycle of reinvestment and growth.

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[1] IOL 2013. *Tax evasion remains a risk*. https://www.iol.co.za/business-report/economy/tax-evasion-remains-a-risk-says-sars-1515785#.Uu4hXfmvVyU

[2] Data used in this report has been drawn from UNCTAD and Global Financial Integrity (GFI) sources.

[3] Since 2011 it has not been possible to make comparable calculations of IFFs because South Africa began to combine monetary and non-monetary gold exports. Even with this adjustment, there was still a discrepancy equivalent to export under invoicing of nearly 45% of mirror data reported values.

[4] One consideration when evaluating IFFs in respect of the Netherlands, is that some part of this total could represent legitimate trade that is simply passing through the Rotterdam trade hub en route to a different trade partner.

[5] In 2017 Switzerland updated aspects of its reporting methods for gold trade, resulting in less apparent discrepancies. It remains to be seen if similar steps will elucidate the situation as regards its copper and oil trade.