

***“ILLICIT FINANCIAL FLOWS: TRENDS, CAUSES, ECONOMIC
LINKS AND REMEDIES IN SADC”.***

**REGIONAL CONFERENCE ON "CORRUPTION AND THE
CHALLENGE OF ECONOMIC TRANSFORMATION IN
SOUTHERN AFRICA”.**

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Introduction

- ▶ Illicit financial flows - movement of illegally transferred assets or value, funds earned through illegal activity (e.g. corruption), or proceeds of tax evasion.
- ▶ Crises in Africa resulting from insufficient resources: quality education, improved health care, ensuring good infrastructure and provision of clean and safe drinking water.
- ▶ Africa lost more than US\$1.8tn to IFFs -1970 and 2008, and US\$60bn annually through IFFs.
- ▶ In general, drivers of IFFs: Commercial activities (60-65%), criminal activities (30%), corruption (5%)
- ▶ Facilitators of IFFs: tax havens, secrecy jurisdictions, disguised corporations, anonymous trust accounts, fake foundations, trade mispricing and money laundering techniques, Custom irregularities , outdated and unprofitable trade agreements

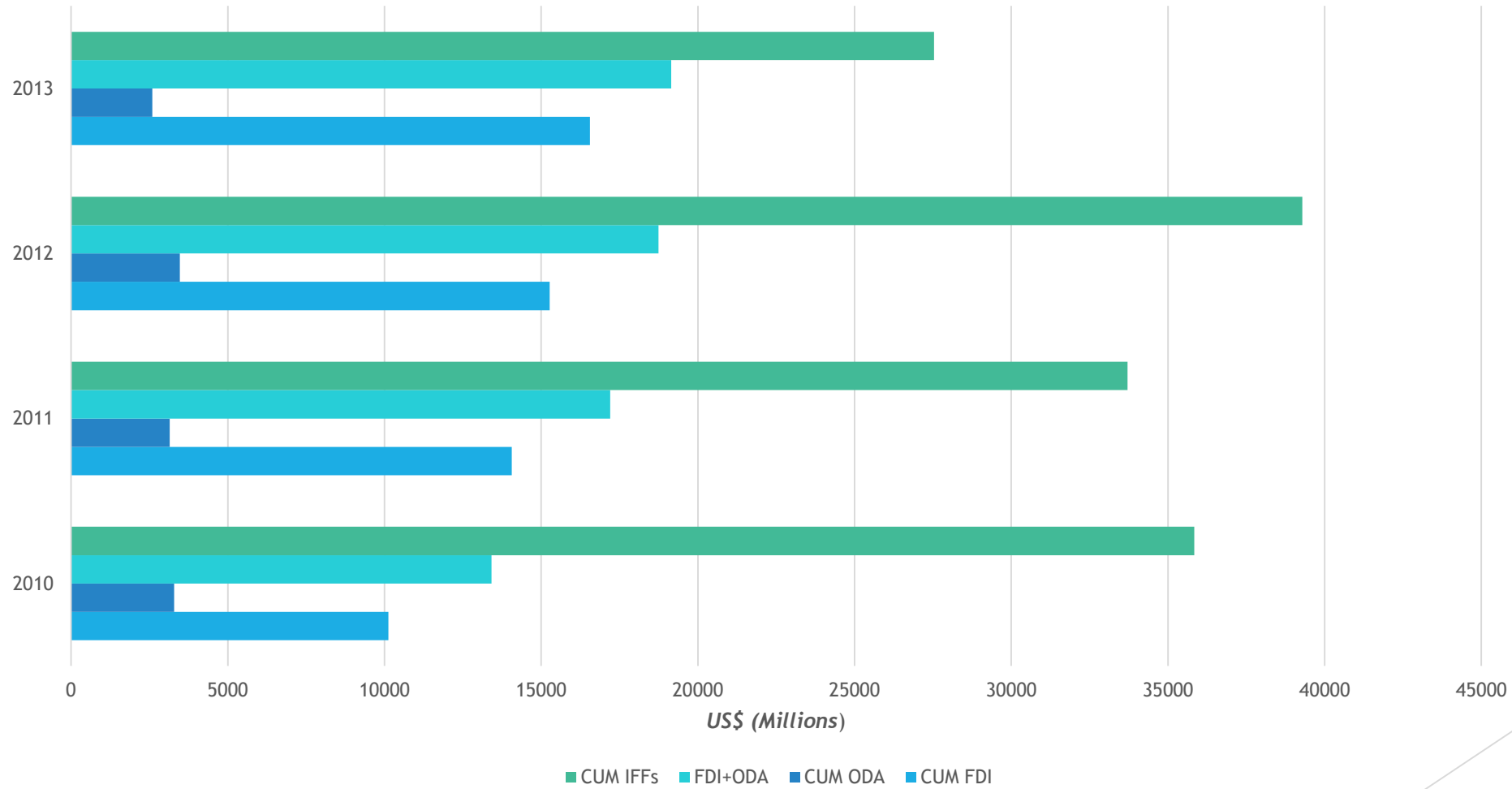
Background

- ▶ Top 15 countries that recorded the highest cumulative IFFs in SSA, 8 are from the SADC region.
- ▶ Cumulatively, SADC lost about US\$314 billion to IFFs in 10 years to 2013.
- ▶ Representing an equivalent ODA received by the region over the same period.
- ▶ This is in light of the widening infrastructure financing gap requirement of US\$500 billion.
- ▶ SA alone lost US\$209 billion and Seychelles, US\$458 million (GFI)
- ▶ All the 54 countries in Africa lost US\$860 billion within that period, SADC was 3rd, representing 13% of the loss.

Trends of Illicit Financial Flows in SADC

- ▶ According to GFI data, IFFs for SADC countries have been fluctuating annually, on an upward trend.
- ▶ Regarding absolute scale of IFFs from SADC, SA topped all the countries followed by Zambia, while Seychelles registered the least financial outflow
- ▶ The general increase in IFFs across all SADC countries show that these flows are a global phenomenon
- ▶ Intra-country differences show that country-specific factors also play a role in the creation of IFFs
- ▶ Illicit financial flows in SADC found to be correlated to imports, exports, total expenditure, FDI flows, current transfer, errors and omissions, capital account movements as well as external debt
- ▶ The amount that SADC received in ODA and FDI together fell short of the amount of IFFs during the period 2010-2013.

IFFs VS ODA+FDI in SADC



Empirical Literature on Causes of IFFs in SADC

- ▶ Weak financial management systems,
- ▶ Weak institutions and regulatory structures
- ▶ Political and macroeconomic instability
- ▶ Business relations between the government and multinational companies shrouded in secrecy
- ▶ Corruption, illegal exploitation, and tax evasion
- ▶ Double Taxation Agreements
- ▶ Tax incentives
- ▶ Trade mis-pricing

Economic links of IFFs in SADC

- ▶ Empirical evidence has proven that IFFs are not only negative, but of great economic consequence
- ▶ IFFs deprive countries of appreciable amounts of investment funds, hence widening funding deficits
- ▶ IFFs have a significant private investment-inhibiting effect, whereas the impact on public investment turns out to be insignificant,
- ▶ Ndikumana also concluded that there is a close connection between IFFs and the public debt ratio
- ▶ IFFs compound government indebtedness and hence dependence on foreign aid, together with its implicit and explicit policy conditionalities.
- ▶ IFFs lead to additional capital inflows into the country of origin, facilitating labour migration and ultimately increase in inflows of remittances.

Assessing impact of IFFs on GDP in SADC

- ▶ 14 SADC countries were chosen.
- ▶ GDP dependent variable, IFFs was independent variable of interest. Other control variables external debt, FDI, Trade as proxy for trade openness, Human Development Index, CPIA on Effective Revenue Management, CPIA on Debt Policy, CPIA on Quality of Public Administration.
- ▶ Secondary data from the 2004 – 2013, extracted from WDI and GFI.
- ▶ The period 2004-2013 chosen based on the availability of data on IFFs
- ▶ Model specification: $LGDP = \alpha + \beta * LIFFs + \varphi * X_{it} + \varepsilon$
- ▶ OLS, FE and RE methods.
- ▶ FE most suitable after running a hausman test
- ▶ Applying FE methods, IFFs found to have a significant effect on GDP @ 10% significance.

Impact of IFFs on GDP in SADC Cont'

- ▶ 3 Methods of estimation were used, namely OLS, FE and RE.
- ▶ Fixed effects was found to be the most suitable method after running a hausman test
- ▶ Applying fixed effects methods, IFFs found to have a significant effect on GDP.
- ▶ These findings are in line with those of other studies such as one by Amah Kalu Ogbonnaya, Okezie Stella Ogechuckwu and Kelly Agassiz.
- ▶ However, the direct economic impact of IFFs, may, however, be considered not only as negative but also of grave consequence

Model Results

	(Model 1)	(Model 2)	(Model 3)
VARIABLES	OLS	RE	FE
Log of Illicit Financial Flows	-0.0632 (0.113)	-0.0632 (0.0964)	-0.0280* (0.0137)
External debt (% of GNI)	-0.000424 (0.00284)	-0.000424 (0.00218)	-0.00342** (0.000937)
Foreign Direct Investment (% of GDP)	0.00690 (0.00512)	0.00690 (0.00474)	0.00637* (0.00267)
Trade (% of GDP)	-0.00540*** (0.000952)	-0.00540*** (0.00154)	-0.00286*** (0.000705)
CPIA of Transparency, Accountability and Corruption in Public Sector	-0.836*** (0.170)	-0.836*** (0.274)	-0.206*** (0.0470)
CPIA on Efficient Revenue Management	0.479*** (0.105)	0.479*** (0.155)	0.0286 (0.0635)
CPIA on Debt Policy	0.238 (0.207)	0.238 (0.265)	-0.165* (0.0712)
CPIA on Quality of Public Administration	-0.475*** (0.166)	-0.475** (0.187)	-0.0230 (0.0414)
Human Development Index	3.611*** (0.683)	3.611*** (0.975)	1.270* (0.623)
Constant	11.08*** (0.467)	11.08*** (0.529)	11.09*** (0.554)
Observations	49	49	49
R-squared	0.790		0.792
Number of Country		7	7

Remedies to IFFs in SADC

- ▶ Building responsive, effective institutions which deliver services to their population
- ▶ Measures to strengthen governance, transparency and regulatory oversight
- ▶ Collaboration in the generation and dissemination of knowledge on IFFs,
- ▶ Strengthening of institutional, regulatory and human capacity to counter IFFs,
- ▶ Closure of Tax Havens and Loopholes
- ▶ Review of Tax Incentives
- ▶ Review of Unprofitable Trade Agreements
- ▶ Anti-Money Laundering (Compliance with the Financial Action Task Force Recommendations to combat money laundering and terrorist financing)

Remedies to IFFs in SADC Cont'

- ▶ Beneficial Ownership of Legal Entities
- ▶ Automatic Exchange of Financial Information
- ▶ Country-by-Country Reporting
- ▶ Release of Annual Reports to Parliament
- ▶ Capacitation of the Respective Member States' Revenue and Regulating Authorities
- ▶ Curtailing Trade Mis-invoicing
- ▶ Working towards implementation of the Addis Tax Initiative (UN Sustainable Development Goal on Illicit Financial Flows).

Region Specific Policy Recommendations

- ▶ Countries must fully implement the agreed action plans.
- ▶ Establish and strengthen the independent institutions and agencies of government responsible for preventing IFFs
- ▶ Need for further capacitation through regional training of law enforcement agencies on investigations related to money laundering and financing for terrorism cases
- ▶ Review current and prospective double taxation conventions, particularly those in place with jurisdictions that are significant destinations of IFFs, to ensure that they do not provide opportunities for abuse
- ▶ Use regional integration arrangements to introduce accepted standards for tax incentives in order to prevent harmful competition in the effort to attract FDI
- ▶ Need for national and multilateral agencies to make fully and freely available, and in a timely manner, data on pricing of goods and services in international transactions

Region Specific Policy Recommendations Cont'

- ▶ Establish transfer pricing units
- ▶ Need to make it illegal, intentional or inaccurate stating of price, quantity, quality or other aspects of trade in goods and services to manipulate or evade taxation
- ▶ Collection of trade transaction data
- ▶ Customs departments must use available databases to compare prices
- ▶ There must be a requirement that beneficial ownership information be provided when companies are incorporated or trusts are registered

Conclusion

- ▶ Mobilisation and proper utilisation of domestic resources lie at the heart of the process of sustainable development and growth
- ▶ Illicit financial flow undermines both
- ▶ The resource drain on SADC over the past thirty years is almost equivalent to its current GDP
- ▶ Need for active involvement of all concerned stakeholders, including the beneficiaries of IFFs.
- ▶ Actually stopping IFFs comes down to enforcement
- ▶ Regulators and law enforcement officials must strongly condemn and enforce all illegal financial laws and regulations already in place
- ▶ Includes prosecuting criminal charges against and imposing appropriate penalties to the perpetrators of illicit financial outflows

Limitations

▶ The study was not without limitations:-

- ❖ 2004 – 2013, would have wanted to extend the analysis to 2016.....2017. However, data unavailability on IFFs from 2013...
- ❖ Inclusion of more variables, impossible due to data gaps in most SADC countries.

END!!!

Zikomo

Obrigado

Natotela

Ngiyabonga

Ke a Leboga

I Thank You!!!