Financial Flows

Illicit financial flows

Kouassi Yeboua and Jakkie Cilliers

Last updated 17 April 2024 using IFs v7.84

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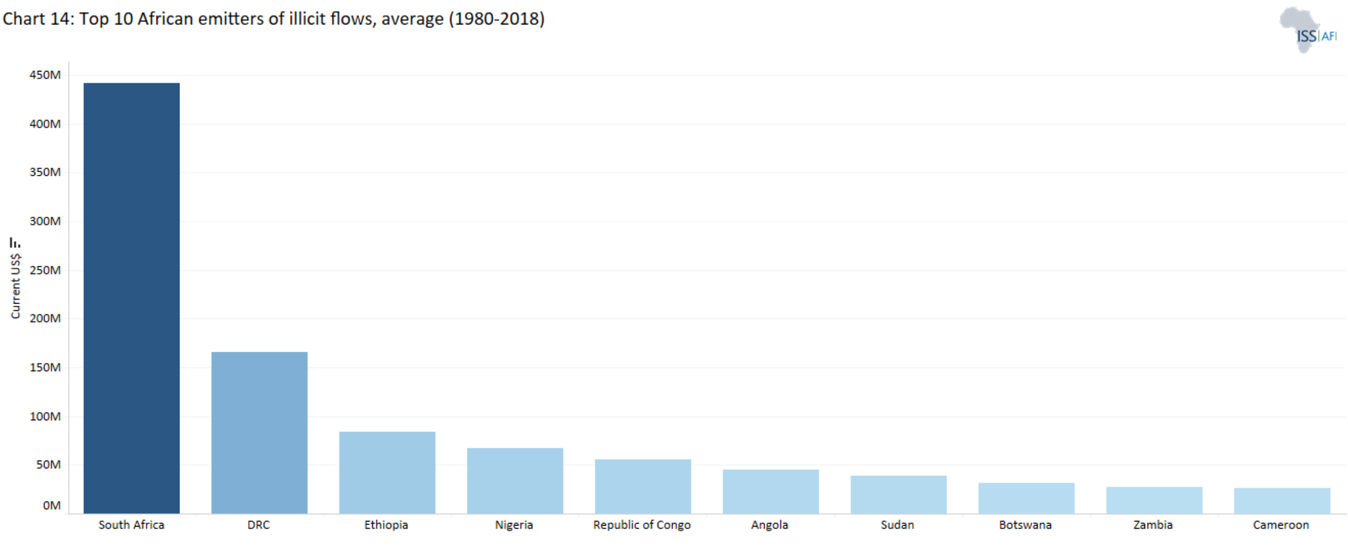
There are several definitions of which specific forms of capital movement constitute illicit financial flows. For instance, Global Financial Integrity defines illicit financial flows as 'the illegal movement of money or capital from one country to another.' This definition of illicit financial flows covers activities including hiding the proceeds of crime, channelling funds to criminal destinations, and evading tariffs and taxes through misreporting of transactions. Other definitions generally focus on actions that are not strictly illegal but are undesirable because they result in reduced tax revenues, including tax avoidance actions such as strategic transfer pricing.[1]

The 2015 Report of the High Level Panel on Illicit Financial Flows from Africa estimated that 65% of illicit flows from the continent originate from commercial activities of multinational companies through transfer mispricing, trade misinvoicing, misinvoicing of services and intangibles, tax treaty shopping and unequal contracts. The remaining 35% is linked to criminals and funds stolen by government officials.[2] Using the Global Financial Integrity methodology, a recent estimate by the Brookings Institute is that US$1.3 trillion left sub-Saharan Africa in the form of illicit money flows between 1980 and 2018.[3] The outflows are concentrated in a few countries (South Africa, DR Congo, Ethiopia and Nigeria) and in a few sectors, notably the extractive and mining industries (oil in particular), which present lucrative opportunities for misinvoicing. Chart 14 shows the top 10 emitters of illicit financial flows from Africa.

According to the 2020 UNCTAD Africa Report, an estimated US$88.6 billion leaves the continent as illicit capital flight every year, equivalent to 3.7% of Africa's GDP, and nearly as much as the combined annual inflows of aid and FDI.[4] The bulk of the money goes to China and the US. In the case of China, the increase in illicit financial flows has followed rapid increases in trade between most African countries and China. In response, Chinese President Xi Jinping launched an anti-corruption campaign in 2012, which appears to have contributed to a decline in illegal outflows from the peak in 2014.[5]

Chart 14: Top 10 African emitters of illicit flows, average (1980-2018)



Source: Authors elaboration using data from Signé et al.(2020)

In the case of the US, the problem is its status as a 'secrecy jurisdiction', which facilitates private offshore tax evasion. The US Foreign Account Tax Compliance Act requires foreign financial institutions and signatory governments to disclose information about US citizens' assets in their jurisdiction to the US government. But the US government is not providing reciprocal information to the 113 participating governments on the assets that are held in the US and has resisted joining the OECD Common Reporting Standard for the automatic exchange of information on foreigners' financial accounts with their home country governments. It is not surprising that, in 2020, the US ranked second only to the Cayman Islands on the Tax Justice Network's Financial Secrecy Index, surpassing Switzerland, Hong Kong and Singapore.[6]

Illegal capital flows from Africa pose a central challenge to development as they remove domestic resources which could have been crucial for the continent's economic development. A study[7] by Janvier D. Nkurunziza reports that illicit financial outflows have a strong and negative effect on investment rates, notably private investment. Studies have found several drivers of illicit financial outflows such as higher taxes and higher inflation, suggesting that firms seek out relatively more stable or favourable fiscal environments for their funds. Goal 16 of the SDGs specifically includes a target to reduce illicit financial and arms flows, strengthen the recovery and return of stolen assets and combat all forms of organised crime by 2030.

For example, African countries are estimated to lose about US$450 million to US$730 million in corporate income tax revenue every year from multinational mining enterprise tax avoidance,[8] with total tax losses, not just from mining, being estimated at US$17 118 million.[9]

Although several important agreements already underpin efforts to curb tax losses,[10] more is required. Support from the Biden administration for a global minimum tax on large multinational companies, based on sales regardless of the physical presence in a country, was an important step in this regard. Eventually, in October 2021, the G20 formally endorsed a global deal to impose a minimum corporate tax rate of 15% for companies with annual revenue over €750 million (US$865 million). It requires those with an annual turnover of €20 billion (US$23 billion) and profit margins above 10% to pay taxes in countries where they sell their products or services.[11] To date, the tax deal is lacking in implementation, however, as it is being blocked by Hungary in the EU and by the Congress in the US. Meanwhile, the amount of money lost to tax havens keeps growing. A recent WIDER Working Paper indicates that corporations shifted nearly US$1 trillion in profits earned outside of their home countries to tax havens in 2019, up from US$616 billion in 2015.[12] A more stable and equitable international tax system will contribute to national digital taxes and constrain tax avoidance and profit shifting.

In response, the African Development Bank and the Coalition for Dialogue on Africa has initiated a US$5.9 million project (the African Financial Integrity and Accountability Support Project) to stem illicit financial flows from Africa.[13] The project, launched in March 2023, aims to improve regional coordination of combating illicit financial flows from Africa. This will reduce illicit financial flows and improve domestic revenue mobilisation in African countries.

Endnotes

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Cite this research

Kouassi Yeboua and Jakkie Cilliers (2024) Financial Flows . Published online at futures.issafrica.org. Retrieved from https://futures.issafrica.org/thematic/10-financial-flows/ [Online Resource] Updated 17 April 2024.

About the authors

Dr Kouassi Yeboua is a senior researcher in African Futures and Innovation programme in Pretoria. He recently served as lead author on ISS studies on the long-term development prospects of the DR Congo, the Horn of Africa, Nigeria and Malawi. Kouassi has published on various issues relating to foreign direct investment in Africa and is interested in development economics, macroeconomics, international economics, and economic modelling. He has a PhD in Economics.

Dr Jakkie Cilliers is the ISS's founder and former executive director of the ISS. He currently serves as chair of the ISS Board of Trustees and head of the African Futures and Innovation (AFI) programme at the Pretoria oce of the ISS. His 2017 best-seller Fate of the Nation addresses South Africa's futures from political, economic and social perspectives. His three most recent books, Africa First! Igniting a Growth Revolution (March 2020), The Future of Africa: Challenges and Opportunities (April 2021), and Africa Tomorrow: Pathways to Prosperity (June 2022) take a rigorous look at the continent as a whole.

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