



Illicit Financial Flows and the Problem of Net Resource Transfers from Africa: 1980-2009



Joint Report by
**African Development Bank and
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Executive Summary

This report analyses the volume and pattern of recorded and unrecorded capital flows to and from Africa and its various regions and country groups over the period 1980-2009.

It also provides the main trends of resource transfers; it does not provide an analysis of the reasons underlying the flows. Further analysis on the dynamics of the flows will need to be based on in-depth, country-specific work. For the purposes of this study, recorded “capital flows” are financial and non-financial transactions recorded in the balance of payments, whereas unrecorded capital flows primarily involve the “flight” of capital. The report assumes that unrecorded capital flows are illicit in nature and involve the transfer of money earned through corruption, kickbacks, tax evasion, criminal activities, and transactions of certain contraband goods. Likewise, legal funds earned through legal business but transferred abroad in violation of exchange control regulations also become illicit. More specifically, **net recorded transfers (NRecT)** are based fully on recorded balance of payments items. The narrow version of this measure, NRecT Narrow, is simply equal to the Financial Account Balance, whereas the broad measure, NRecT Broad, is equal to the Financial Account Balance plus the sum of net current and net capital transfers. **Net resource transfers (NRT)** are calculated by the difference between NRecT and illicit financial flows (IFF), which also have two versions, normalized (conservative) and non-normalized (robust). Hence, there are four alternate measures of NRT, corresponding to the version of recorded transfers and outflows of illicit capital. These concepts are important as they enable a comparison of NRecT against unrecorded outflows of illicit capital.

Results indicate 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. While there were brief periods in the early 1980s and the 1990s, when Africa received small net resource transfers from the rest of the world, the continent has been a net provider of resources to the world with estimates of real NRT ranging from US\$597 billion to US\$1.4 trillion, depending on the definition used for the transfers (NRecT, Narrow or Broad, and IFF, normalized or non-normalized). The most optimistic estimate of NRT (or lowest negative NRT of US\$597 billion) involves broadly defined recorded transfers net of conservatively estimated illicit outflows (BroadNRTNorm), while the most pessimistic scenario (negative transfers amounting to US\$1.4 trillion) involves narrowly defined recorded transfers net of robust estimates of illicit outflows (NarrowNRTNon-norm).

If we focus on recorded transfers, that is, not taking account of illicit outflows, we find that, according to the NRecT Narrow measure, there were net inflows to Africa over the period 1980-1999 and a sharp reversal to net outflows in the period 2000-2009. The NRecT Narrow measure shows that African countries received resources amounting to 2.3 percent of GDP in the 1980s and just under 1.0 percent of GDP in the 1990s. However, the continent became a net lender of resources to the world over the decade ending 2009. This sharp reversal from net inflows over the earlier two decades to net outflows over the last decade was mainly due to outflows associated with reserve accumulation, reflecting African countries' desire to self-insure against financial crisis.

The recorded outflows from Africa in the past decade were not evenly distributed across regions. They were largely driven by outflows from North Africa. Considering the period 2000-2009 alone, some US\$30.4 billion per annum flowed out of Africa with 83 percent of such outflows originating from North Africa. **Within Sub-Saharan Africa, the results from the NRecT Narrow measure were mixed.** West and Central Africa experienced considerable outflows, which swamped resource transfers into other regions over the decade ending 2009. NRecT Narrow losses from the West and Central regions were mainly driven by outflows related to repayment of loans and trade credits, rather than reserve accumulation.

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 (NRecT Narrow) 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.

The broader measure of recorded transfers (NRecT Broad) alters the long-run developments in net recorded transfers owing to the impact of current and capital transfers (which principally include remittances and debt relief). Based on the broad measure, Africa's transfers (NRecT Broad) 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. The broad measure does not show that Africa swung from net debtor to net creditor to the 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.

Every region of Sub-Saharan Africa received resources on a net basis throughout the three decades, based on the broad measure of transfers, with the largest gains going to the West and Central Africa region. West and Central Africa received the most resources over the 30-year period, in terms of GDP, increasing from 5.2 percent of GDP per annum in the 1980s to 5.7 percent in the 1990s, before declining to 2.3 percent in the last decade. Recorded transfers were mainly driven by remittances and debt forgiveness, rather than net foreign direct investments.

Country resource endowment matters when transfers are measured on a broad basis.

For instance, non-fuel exporters came out ahead of fuel-exporters in attracting net recorded transfers measured on a broad basis. **Debt-relief also helped low-income countries to re-capture some of the resources.** Heavily Indebted Poor Countries (HIPC) experienced a modest increase in transfers over the three decades. On an average per annum inflation-adjusted basis, resource inflows to HIPC countries increased from US\$14.0 billion in the 1980s to US\$14.3 billion in the 1990s, before jumping to US\$20.8 billion over the last decade ending 2009. **North African countries dominated the top gainers over the 30-year period, based on broad categorization of net recorded transfers.** Egypt, Morocco, Tunisia, Kenya, and Ghana were the top five gainers of broad-based recorded resource transfers over the 30-year period 1980-2009; Libya, Algeria, Gabon, Botswana, and Angola were the top five losers of recorded transfers.

Illicit financial flows (IFFs) were the main driving force behind the net drain of resources from Africa of US\$1.2 - 1.3 trillion on an inflation-adjusted basis. IFFs grew at a much faster pace over the 30-year period 1980-2009 than net recorded transfers, even accounting for the net inflows arising from the broad net recorded transfers.

Illicit outflows were dominated by outflows from Sub-Saharan Africa, especially from West and Central Africa. Illicit outflows from Sub-Saharan Africa outstripped those from North Africa by over two times in nominal terms while in real terms, three African regions—West and Central Africa at US\$494.0 billion (37 percent), North Africa at US\$415.6 billion (31 percent), and Southern Africa at US\$370.0 billion (27 percent)—account for 95 percent of total cumulative illicit outflows from Africa over the 30-year period. (See Chart 4 and Table 1).

In terms of the volume of illicit financial flows, Nigeria, Egypt, and South Africa led the regional outflows. In West and Central Africa, outflows were largely driven by Nigeria, the Republic of Congo, and Cote d'Ivoire in that order of magnitude while North Africa outflows were dominated by Egypt, Algeria, and Libya respectively. Outflows from Southern Africa were mainly driven by South Africa, Mauritius, and Angola.

The study concludes by offering policy recommendations with respect to (i) initiatives to restrict the absorption of illicit financial flows, (ii) policies to curtail illicit financial outflows from Africa, and (iii) policies to boost net recorded transfers by improving the business climate. To ensure greater effectiveness, it is imperative that there is policy alignment between African countries and “absorbing” countries in addressing the issue of illicit financial flows. With regard to stemming the absorption of illicit financial flows, the following policy initiatives could be considered:

- *Promoting transparency in the financial system:* Banks and offshore financial centers (OFCs) should be required to regularly report to the Bank for International Settlements (BIS) detailed deposit data by sector, maturity, and country of residence of deposit holders. Moreover, the BIS

must be permitted to publicly disseminate the cross-border banking data for specific source and destination countries. Further, the obscurity of information on the beneficial ownership of companies, trusts, and other legal entities must be addressed. Domestic laws governing financial institutions should be strengthened to make it illegal to open accounts without knowledge of the natural person(s) owning the accounts (i.e., its beneficial owners).

- *Entering into automatic exchange of tax information agreements:* Tax evasion is at the heart of the world's shadow financial system and constitutes a significant component of illicit financial flows. One way to address the problem of tax evasion is for African countries to enter into automatic exchange of information (AEI) agreements with the destination countries where the proceeds of tax evasion are lodged. AEI agreements should be accompanied by double tax avoidance agreements, which set clear rules for countries' ability to assess taxes and monitor compliance according to international norms, making it more difficult for individuals and entities to shift income between countries.

With respect to policies aimed at curtailing illicit financial outflows from Africa, policy initiatives are geared to resource-rich and resource-poor countries and include the following:

- *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. These countries should promote transparency and accountability through the strengthening of civil society organizations and the implementation of open and transparent budgeting processes such as the Open Budget Initiative, the Collaborative Africa Budget Reform Initiative (CABRI), and the Extractive Industries Transparency Initiative (EITI). Countries will also need to look beyond the EITI to ensure that policies are in place to facilitate greater transparency and accountability over the entire resource value chain. Further, multinational companies operating in African countries should be required to publish annual financial reports that explicitly include their activities in Africa.
- *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. These countries should focus on strengthening legal institutions and anti-corruption laws and empowering regulatory agencies to exercise adequate oversight. Specifically:
 - *Undertaking tax reform to widen the tax base.* Tax reform applicable to a broad group of taxpayers is not only fair but will ensure greater tax compliance than a proliferation of indirect taxes that are unwieldy to manage, costly to administer, and have large built-in incentives for evasion.
 - *Creating a national authority for the regulation and management of public procurement to ensure greater transparency and accountability in the contracting process.* The procedures and rules for bidding on government contracts should be transparent, as should be information regarding the contracts awarded. African countries should follow international best practices in the area of government contracting so as to maximize public benefit.

- *Reforming customs service procedures to curtail trade mispricing.* This involves the removal of ad hoc exemptions from customs duties, streamlining clearance and document control procedures, and efficient computerization of payment and collection procedures in order to make procedures less cumbersome and more efficient. Additionally, capacity-building and training are needed to detect and investigate under- and over-invoicing of goods entering and leaving the country.
- *Strengthening anti-money-laundering initiatives and enforcement.* During the last decade, many African countries have set up anti-money-laundering programs under which financial institutions are required to report suspicious transactions to the relevant authorities. However, there is a need to strengthen the capacity of the relevant authorities to initiate appropriate legal actions on the basis of these reports.

Policies to boost net recorded transfers by improving the business climate generally involve measures that range from improving a country's political and economic stability to specific business-friendly measures to improve infrastructure, rationalize corporate taxation, and strengthen governance.



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