**Assessing the Human Impact of Illicit Financial Flows of Africa**

**BY**

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**Abstract**

This article assessed the impact of illicit financial flow on economic growth and development in Nigeria. This article contributes to the regulatory debate that is emerging in response to the financial crisis, as the accepted wisdom of deregulated global financial markets is being challenged. Illicit financial flows — cross-border capital movements for the purposes of concealing illegal activities and evading taxes — pose major challenges to developing countries. The study among others recommends that government of Nigeria and indeed other African countries must lobby developed nations to adopt control so that individuals who move funds out of Africa into tax havens and secrecy jurisdictions can be exposed. It was also recommended that African states and indeed Nigeria, in particular, must develop customs capacity in order to fight the massive outflows of capital through illicit practices.

**Introduction**

Illicit financial flows (IFFs) are illegal movements of money or capital from one country to another often involving Money Laundering, tax evasion, or bribery. It is a broader term that encompasses Money Laundering, Terrorism Financing illicit trade (such as contrabands, illegal arms and human trafficking), and other forms of illicit financial flows. IFFs are widely acknowledged to be among the most serious contemporary global threats. A joint study conducted by the AfDB (African Development Bank) and the Global Financial Integrity (GFI) found that between 2000 and 2009, some US$30.4 billion per annum flowed out of Africa, mostly in the form of IFFs. Over the longer period of 30 years calculated from 1980, the resource drain was between US$1.2 - 1.3 trillion. The UNECA High Level Panel on Illicit Financial Flows (The 4th Joint AU/ECA Conference of African Ministers of Finance, 2011) indicated that currently, Africa is estimated to be losing more than $50 billion annually in IFFs. Some reports estimate that for every dollar of development assistance that developing countries received over the 10 year period (2003-2012) 10 USD left in the form of illicit financial flows (GFI 2014). From my findings, I discovered that there are great estimates of illicit financial flows that confirm that the problem facing Africa is large, and has grown substantially.

The issue of illicit financial flows ranks top on the international agenda, affecting both industrialized and developing countries. Though, the current scale of IFFs originating in developing countries cannot be measured. Precisely, it is believed that the value has been worth more than official development assistance from Organization for Economic Cooperation and Development (OECD) donor countries according to Global financial integrity report. These practices occur in all countries and are quite damaging both to the social and economic life of the nations and much more severe to the developing countries whose resources are small. Consequently, the issue of IFFs occupies a prominent place in development policy discourse of nations calling for a higher quality of national regulations, proper implementation and compliance with international best practices.

**CONCEPTUAL FRAMEWORK OF ILLICIT FINANCIAL FLOW**

Generally, while economists and international organizations have analyzed and discussed capital flight for decades, interest in illicit financial flows is more recent. The term illicit financial flow is seen by some as being vague and imprecise and the content controversial.

Movement of funds across borders is imperative for world economies to grow but the flow of “dirty money” out of Africa from evidence deny the continent of the essential financial sources for the funding of infrastructural needs such as education and health facilities among other basic needs. The economic benefits of increased movement of funds across the globe are numerous. It enhances greater, the level of economic activities, which have the tendency to improve world employment opportunities, global welfare, reduction in income inequality and world peace.

IFFs in Africa are defined as illegally earned, transferred or used resources moved from Africa to the rest of the world in violation of the laws. Developed countries are often the final destinations of these flows. These financial flows are generally categorized in three groups (see Kar and Cartwright-Smith, 2010; AU/ECA, 2012 for more details). Kar and Catwright (2010), define illicit financial income as money that is obtained through extra-legal either by transfer or earnings without considering the type of transfer process. But Mevel, Siope and Karingi (2013) view that precise meaning and definition of illicit financial flow is scanty in the literature. This is partially due to, according to them, the controversy over how the “illicit” portion of the phenomenon and the “official” portion of financial flows are to be defined.

Illicit financial flows can be generated in a variety of ways that are not revealed in national accounts or [balance of payments](https://en.wikipedia.org/wiki/Balance_of_payments) figures, including [trade mispricing](https://en.wikipedia.org/wiki/Transfer_mispricing), bulk cash movements, [hawala](https://en.wikipedia.org/wiki/Hawala) transactions, and [smuggling](https://en.wikipedia.org/wiki/Smuggling). (CSIS and GFI Conference)

The World Bank has recently stated that the concept of IFFs:

“Now generally refers to cross-border movement of capital associated with illegal activity or more explicitly, money that is illegally earned, transferred or used that crosses borders.

This falls into three main areas:

1. The acts themselves are illegal (e.g., corruption, tax evasion);
2. The funds are the results of illegal acts (e.g., smuggling and tracking in minerals, wildlife, drugs, and people);

The funds are used for illegal purposes (e.g., financing of organized crime).” (World Bank, 2016)

In 2015 the OECD produced a thematic module on illicit financial flows10 which proposed the following definition:

“Illicit financial flows (IFFs) means all cross-border financial transfers which contravene national or international laws. This is a wide category which encompasses several different types of financial transfers, made for different of reasons. It can include:

1. Funds with criminal origin, such as the proceeds of crime (including corruption);
2. Funds with a criminal destination, such as bribery, terrorist financing or conflict financing;
3. Funds associated with tax evasion;
4. Transfers to, by, or for, entities subject to financial sanctions; and
5. Transfers which seek to evade anti-money laundering /counter-terrorist financing measures or other legal requirements (such as transparency or capital controls).” (OECD, 2015)

Kar and Freltas (2012) opine that IFFs are funds that are illegally earned, transferred or utilized, and cover all unrecorded private financial assets by a resident in contravention of applicable laws and regulatory frameworks. In Baker's (2005) view, illicit financial flows are termed as ‘dirty money' where dirty money is any money illegally earned, transferred or utilised. He argues that if it breaks any law in its origin, movement or use, then it is dirty money. In a seminar contribution to the dirty money literature, Reutter and Truman (2004) do not define dirty money explicitly instead they say it is the conversion of criminal income into assets that cannot be traced back to its underlying crime.

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**Components of Illicit Financial Outflows**

The definitions of illicit financial flows/transfers generally involved the following practices – money laundering, bribery, and tax evasion. The main components of illicit financial transfers are (ECA, 2013; AU/ECA/2015):

**Corruption**

The proceeds of bribery and embezzlement of national wealth or abuse of entrusted power by government officials. Combating corruption is a key element in improving governance in Africa and achieving structural transformation goals; since corruption leaves the door wide open for illicit financial flows.

**Criminal activities**

The proceeds of criminal activities such as drug trading, human trafficking, racketeering, counterfeiting, contraband, and terrorist financing.

**Commercial activities**

The proceeds of activities intended to hide wealth, avoid taxes, and dodge customs duties and levies. They include the proceeds of tax evasion and laundered commercial activities such as: abusive transfer pricing, trade mispricing, misinvoicing of services and intangibles, and unequal contracts.

According to Baker (2005), laundered commercial money through multinational companies constitutes the largest component of Illicit Financial Flows, IFFs (about 60%), followed by proceeds from criminal activities (about 35%). Proceeds of corruption account for only about 3-5% of IFFs. However, the components of illicit financial flows are not mutually exclusive. Some criminal activities of multinational companies are facilitated by corruption by government officials (bribery). Also, the proportions could vary between countries. Thus, corruption may account for higher proportions in some African countries where large sums are embezzled by government officials and transferred abroad.

According to the HLP Report (AU/ECA, 2015), reasons for engaging in illicit financial transfers through commercial activities include:

* Holding wealth;
* Evading or aggressively avoiding tax; and
* Dodging customs duties and domestic levies.

Some of these activities are described as “base erosion and profit shifting”. IFFs out of Africa take place through abusive transfer pricing, trade mispricing, misinvoicing of services and intangibles and using unequal contracts, all for purposes of tax evasion, aggressive tax avoidance and illegal export of foreign exchange (AU/ECA, 2015, p.24).

**Money Laundering**

Money laundering involves taking criminal proceeds and disguising their illegal source in anticipation of ultimately using the criminal proceeds to perform legal and illegal activities.

Simply put, money laundering is the process of making dirty money look clean.

The Financial Action Task Force (FATF) is a Paris-based multinational or inter-governmental body formed in 1989 by the Group of Seven industrialized nations to foster international action against money laundering. According to FATF, crimes such as illegal arms sales, narcotics trafficking, smuggling and other activities of organized crime can generate huge amounts of proceeds. Embezzlement, insider trading, bribery and computer fraud schemes can also produce large profits, creating the incentive to “legitimize” the ill-gotten gains through money laundering.

**Magnitude of Illicit Financial Transfers from Africa**

There are difficulties in estimating IFFs due to their hidden nature because they are illicit. There are also data challenges. The AU/ECA (2015) study examined gross outflows with focus on trade mispricing. However, most studies show that tax-related components – tax evasion and avoidance – in addition to transfer mispricing make up the bulk of illicit transfers out of developing countries (Ritter, 2015). Available evidence for the period 1970 to 2008 shows that Nigeria is a major source country for illicit financial transfers out of Africa.

**Drivers/Enablers of Illicit Financial Transfers from Africa**

Who and what are the drivers/enablers of illicit capital transfers out of Africa? The AU/ECA Report identified the following enablers and drivers of illicit financial flows out of Africa, most of which are relevant in Nigeria. Ghana loses a staggering $5.5 billion annually due to trade leakages, a development that is hampering the country's economic growth, Global Financial Integrity (GFI) says in its latest report.

Every year, Africa loses between $30 and $60 billion to [illicit financial flows](http://www.uneca.org/sites/default/files/PublicationFiles/iff_main_report_26feb_en.pdf) (pdf, p. 34), according to the United Nations Economic Commission for Africa (UNECA). A “major enabler” of these flows, UNECA says, are offshore tax havens like Panama, the British Virgin Islands, Seychelles, and other jurisdictions that happen to feature prominently in the “Panama Papers” leak

These are: poor governance, weak regulatory structures, tax incentives, the existence of financial secrecy jurisdictions and tax havens and beneficial ownership.

1. **Poor Governance**

Poor governance includes corruption and weak regulatory systems. The Transparency International’s Corruption Perception Index 2016 which assesses corruption in the public-sector ranks Nigeria as 136th out of 176 countries with a score of 28 out of 100. The ranking has however slipped down in 2017 where Nigeria was ranked 148th position with a score of 27, showing that corruption is still very widespread in Nigeria and manifests in different ways (Transparency International, 2018). Jose Ugaz, Chair of Transparency International highlighted the need to address issues of corruption urgent in a 2017 Report where he stated:

‘In too many countries, people are deprived of the most basic needs and go to bed hungry every night because of corruption, while the powerful and corrupt enjoy lavish lifestyles with impunity.’

1. **Tax Evasion/Avoidance/Payment of Royalties/compensation**

According to calculations by the International Monetary Fund (IMF, 2011, 12ff.), the average tax ratio (tax revenues as a percentage of GDP) of developing countries has risen slightly over the past 10‒15 years. The main factors behind this increase are the more widespread use of VAT, and the commodity boom, which led to a slight increase in corporate tax revenues. Despite this, the average tax ratio of developing countries continues to be too low — around 17 per cent (versus over 30 per cent in OECD countries). Countries such as Burundi, Ethiopia, and Guinea-Bissau recorded tax revenues of just over USD 35 per capita and year in 2009 (Atisophon et al., 2011, 19).

The reasons for these low tax revenues lie most of all within the countries concerned. Many developing countries lack the necessary financial, administrative, and human resource capabilities for building up and enforcing effective tax systems (Herkenrath et al., 2012, 4f.). But like industrialized countries, which have well-equipped tax authorities and sophisticated laws in this field, developing countries too suffer from the consequences of international tax evasion. In addition to income tax on natural persons, it also affects corporate profit taxes in particular.

The Federal and State Governments have had running battles with Shell and Chevron in particular over payment of taxes, and royalties. Multinational oil companies have bribed officials of the Federal Inland Revenue Service in order to pay less tax (Bakre, n.d)

A prime example of this is the Halliburton bribery scandal where a network of secret banks and offshore tax havens was used to siphon US$182 million in bribes to Nigerian officials for a project worth US$6 billion in engineering and construction works.

The Halliburton scandal dates back to 1994 when the Nigerian government launched the plan to build the Bonny Island Liquefied Gas Project. Part of the cash was moved to Nigeria and destined for the ruling party via the NNPC. One of the lawyers was jailed in the USA in 2012, although the Nigerians involved are yet to be prosecuted for money laundering and financial fraud (The Indian Express, 2015).

1. **Tax Waivers and Revenue Loss**

Studies have shown that Nigeria loses a lot of revenue from tax waivers every year. In a study by Oriakhi and Osemwengie (2013) they showed that tax incentives resulted in loss of revenue to the country. Tax incentives have operated under the following sub-heads in Nigeria (Oriakhi and Osemwengie, 2013; CBN, 2013): Tax holidays, investment allowance, rural investment allowance, tax free interest, deductible capital allowance, research and development, tax-free dividends, tax treaties, reliefs and allowances, and capital allowances. The objective of tax incentives is to attract, retain or increase investment in specific sectors of the economy to promote economic growth. It is expected that revenue sacrifice through tax incentives will eventually be compensated for by an increase in tax capacity of the favoured tax base as a result of increased tax compliance or capital formation thereby encouraging growth of the tax base (Oriakhi and Osemwengie, 2013).

However, it is reported that Nigeria lost billions of dollars due to indiscriminate granting of waivers to undeserving companies between 2010 and 2014, mainly on the recommendation of the Nigerian Investment Promotion Commission (NIPC). According to a NEITI report, Nigeria lost $1.17 billion between 2009 and 2014, and $1.56 billion between 2014 and 2016. It was reported that while oil companies were to be taxed 65% under the Petroleum Profits Tax Act, fraudulent officials of the NIPC listed these companies under the Industrial Development (Tax Relief) Act thereby qualifying them for Pioneer Status.

1. **Existence of Financial Secrecy Jurisdictions and Tax Havens**

The existence of secret financial jurisdictions and tax havens which make it easy for stolen funds and assets to be repatriated abroad has facilitated illicit transfers out of the country. Studies have shown that the elite in many developing countries, including Politically Exposed Persons (PEPs) in Nigeria have placed assets in offshore financial centres (Otusanya, 2012; Otusanya and Lauwo, 2012). The proceeds of embezzlement, fraud, and theft have also been laundered either as money or as foods. OFCs facilitate the transmission of illicit funds through the banking system. PEPs in Nigeria are known to have engaged in money laundering, purchasing private jets, luxury mansions and cars, yachts, and other luxury goods, and hiding them in the United States, United Kingdom, Switzerland, United Arab Emirates, South Africa, and other countries. In the Panama Papers which leaked over 11.1 million files of an offshore company, a number of wealthy Nigerians including businessmen, politicians, retired military personnel were listed as owning and hiding their wealth, some of it obtained through corruption, in offshore accounts (Ogbu, 2016).

1. **Beneficial ownership**

A NEITI report also showed that some of the oil companies operate shell companies. Section 2.5 of the Extractive Industries Transparency Initiative (EITI) Standard 2016 recommends that countries should maintain a register of the beneficial owners of corporate entities that bid for or operate or invest in extractive industries which should be available to the public. EITI defines a beneficial ownership as follows: “A beneficial owner in respect of a company means the natural persons(s) who directly or indirectly ultimately owns or controls the corporate entity”. NEITI has published a Road Map for beneficial ownership, outlining Nigeria’s strategy towards beneficial ownership. It demands public disclosure of the real owners of oil and gas and mining companies operating in Nigeria. In the 2015 Oil and Gas Report, NEITI tried to obtain the beneficial owners of oil and gas and mining companies operating in Nigeria, it was unable to obtain names of natural owners from publicly listed companies and wholly owned subsidiaries.

**Impacts of Illicit Financial Flows on Africa**

The economy of any society is like a roof on a house. It serve as a covering for every given society. If there are leakages in the roof, the house will be exposed to dangers. Illicit cash flows is greatly affecting the economy of any country. Having looked at the current trend in Africa and how much illicit financial flows have huge impacts, I came up with the following impacts made;

1. Contracts are inflated and masses shortchanged.
2. Corruption becomes a culture through all levels of society.
3. Foreign direct investments thin out.
4. The society lacks integrity.
5. The country becomes less competitive in its product as a result of infrastructure deficit example; Power.
6. The country becomes a dumping ground with resultant high level of unemployment.
7. Foreign exchange translation rate appalling leading to low purchasing power.
8. There are unmitigated high immigration rate.
9. Education, health and development are adversely affected.

IFFs pose a huge challenge to political and economic security around the world, particularly to developing countries. Corruption, organized crime, illegal exploitation of natural resources, fraud in international trade and tax evasion are as harmful as the diversion of money from public priorities. Drugs counterfeiting can have even more dire consequences, such as the thousands of preventable deaths from malaria and tuberculosis due to sub-standard counterfeit drugs.

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