MANIFESTATIONS OF ILLICIT FINANCIAL FLOWS IN ZIMBABWE MEASURES TO PLAGUE THE LEAKAGES.

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Outline

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Introduction

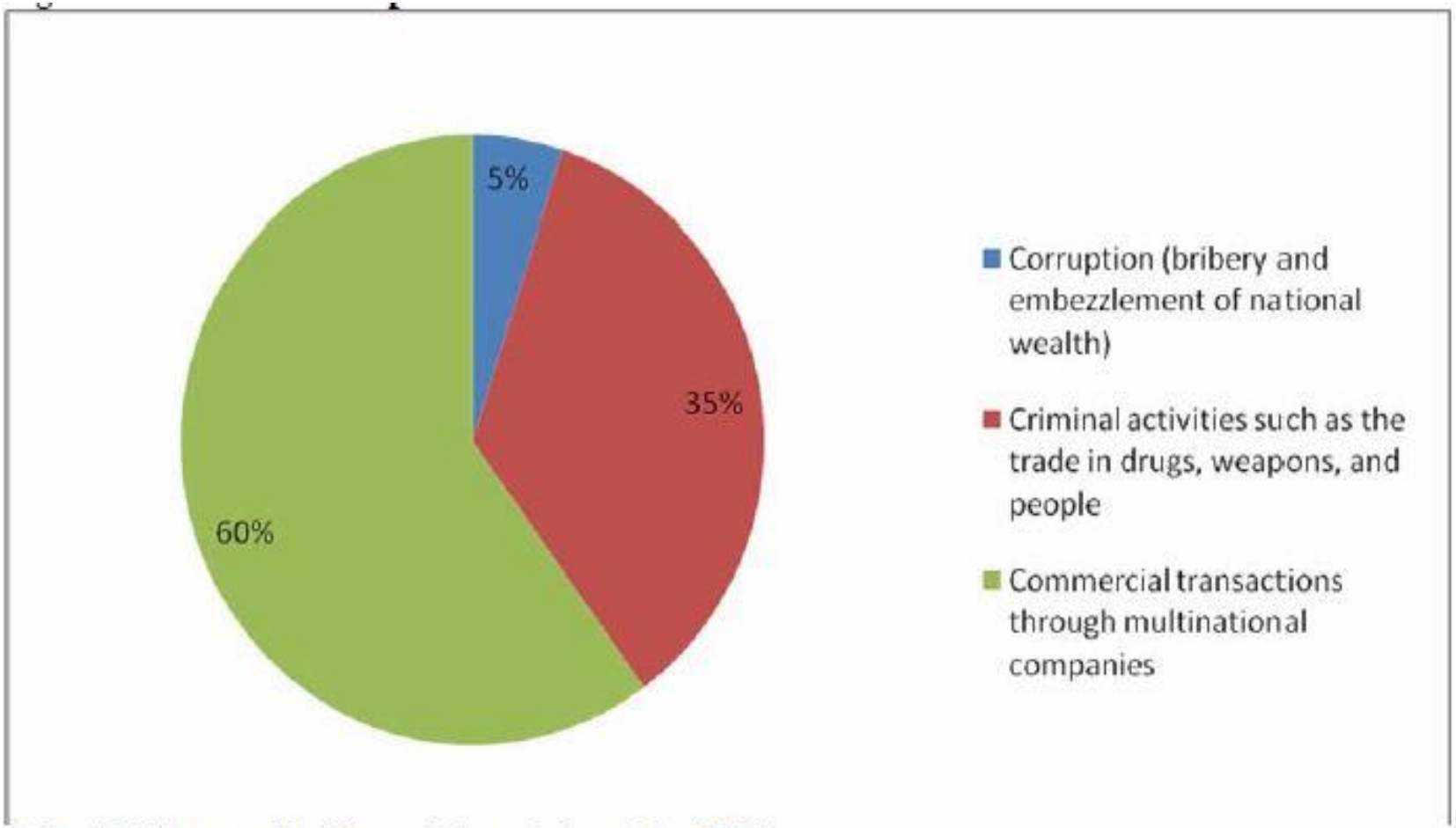
- Illicit financial flows occur when money is illegally earned, transferred or spent. Somewhere at its origin, movement or use, the $ broke laws, GFI.
- Include but not limited to cross border transfers of the proceeds of tax evasion, corruption, trade in contraband goods and criminal activities such as drug trafficking and counterfeiting UNDP.
- If one or more of the following conditions is fulfilled, then such funds are considered to be illicit:

1. The transfer itself is illegal;
2. The funds are proceeds of illegal activity;
3. Legal obligations relating to the funds, such as payment of tax, have not been observed

CHARACTERISTICS OF ILLICIT FINANCIAL FLOWS

- These flows are largely unrecorded (not captured by the BoP and other official statistics)
- These flows are often associated with active attempts to hide origin, destination & true ownership etc (they seek secrecy)
- These flows are usually associated with public loss and private gain because no (or little) tax is paid on them or because they may be comprised of bribes paid
- These flows constitute domestic wealth permanently put beyond the reach of domestic authorities in the source country
- These flows are not part of a 'fair value' transaction and would not stand up to public scrutiny if any
- refer to all unrecorded private financial out-flows that increase foreign assets of residents through contravention of National Laws and Regulations.

Forms of Illicit Financial Flows



Baker (2005) quoted by Kar and Cartwright-smith, (2010).

Facilitators

- Tax havens,
- Secrecy jurisdiction,
- Shell companies that cannot be traced back to their owners,
- Anonymous trust accounts,
- Bogus charitable foundations,

Mechanisms

The most commonly used methods to facilitate IFFs are...

- **Transfer Mis-pricing**
- **Trade Mis-invoicing**

Both account for 60% of all illicit financial flows out of developing countries .

Trade Mis-invoicing

- Occurs when businesses or individuals shift money abroad by falsifying trade documents (for example, prices in a customs invoice).
- A buyer and a seller may collude in a scheme in which the buyer only pays the standard market price for imported goods, but is billed for the goods at a higher price
- The seller then deposits the difference in a bank account in a secrecy jurisdiction on behalf of the buyer, thus siphoning funds abroad and preventing national authorities from collecting much needed taxes.

Transfer Mis-pricing

- Similar process which happens within multinational companies to evade taxes.
- 60% of international trade happens within, rather than between MNCs- across national boundaries but within the same corporate group.
- A subsidiary of a company avoids paying taxes in a high taxation country by selling its products at a loss to a subsidiary in a low tax country, which then sells the product to final customers at market price and yields the profit.

Transfer Mis-pricing cont…

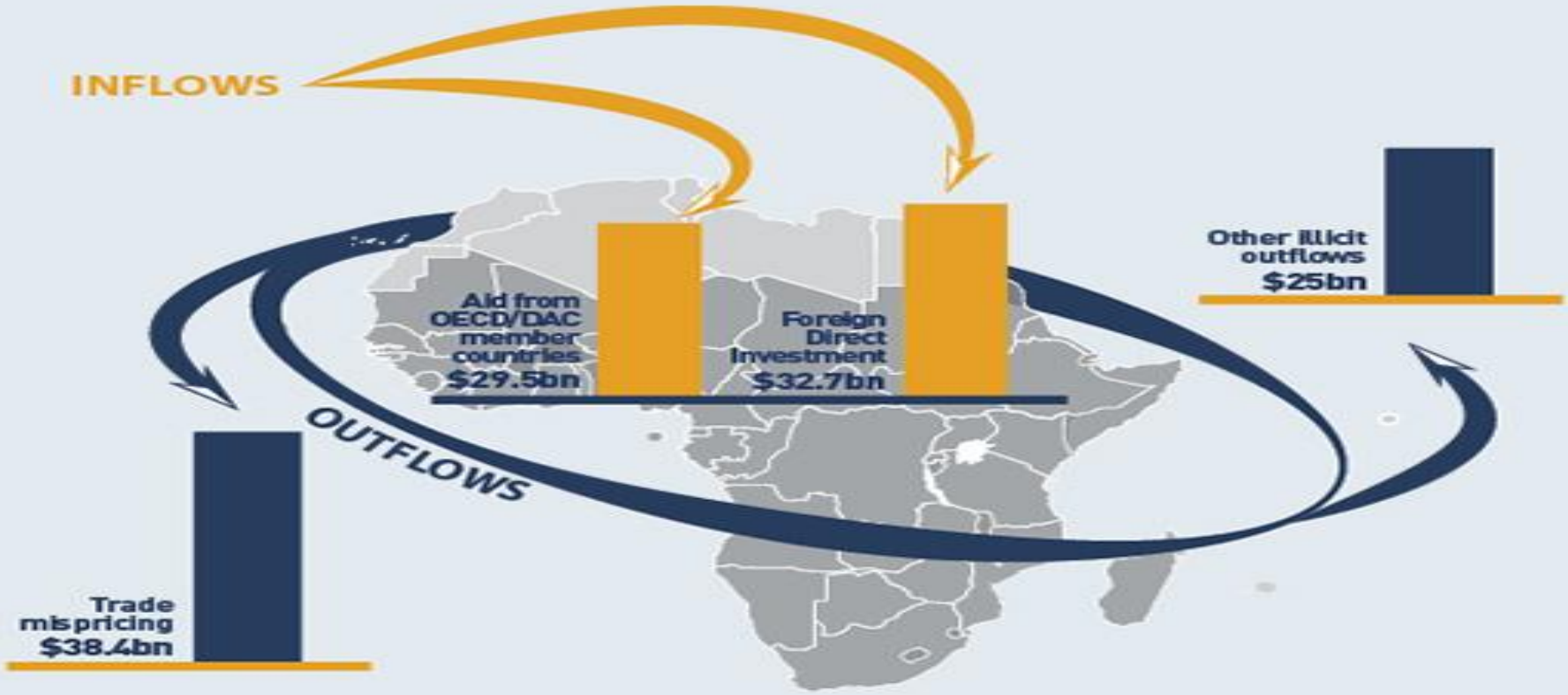
Scale of the Problem in Africa

- Africa lost over US$854 billion in illicit financial flows between 1970 and 2008 (GFI)
- Africa loses over USD 50 billion a year in illicit financial flows, far exceeding the amount of official development assistance the continent receives (High Level Panel)
- Zimbabwe alone lost about US$12 billion over the last three decades
- The illicit outflows are approximately 7-10 times the amount of official development assistance (ODA) going into developing countries (GFI).
- Some estimates show that if Africa were to repatriate illicit funds the capital stock would expand by more than 66%.
- Ancillary to this, is the fact that if illicit outflows of funds did not take place GDP per capita would have been higher than what it is in the current environment. (Ndikumana and Boyce 2008, 2011).

(Ndikumana and Boyce, 2010)

Africa's Illicit Outflows

Africa loses more through illicit outflows than it gets in aid and foreign direct investment



Trade mispricing: Losses associated with misrepresentation of export and import values

Other illicit flows: Funds that are illegally earned, transferred or utilized and include all unrecorded private financial outflows

[All figures are average annual 2008-2010 for Sub-Saharan Africa]

Sources: OECD (n.d.), OECD Stats Extracts.
Global Financial Integrity (2012), Illicit Financial Flows from Developing Countries 2001-2010.
World (2013), Global Economic Prospects – January 2013.

Impact

a) Stifle Africa's socio-economic progress,
b) Distort of consumption and investment
c) Promote of corruption and bribery in financial institutions and other sectors of the economy,
d) Undermines political institutions INCLUDING weakening public institutions and domestic private sector development
e) Loss of critical resources meant for development
f) Drains scarce foreign exchange resources,
g) Reduces government tax revenues,

Impact Cont…

h. Aggravates foreign debt and increases Africa's economic dependency

i. Exacerbates inequality by increasing private gains for a few at the expense of public gains.

i. It has its greatest impact on those at the bottom of income scales in their countries, removing resources that could otherwise be used for poverty alleviation and economic growth.

EI and Illicit Financial Flows

- Extractive industry generates about US$3.5 trillion in global annual gross revenue
- Corresponding to around 5% of global GDP
- Oil accounts for 65% of this figure
- Coal and natural gas represents 11% each
- Non fuel minerals 13%
- Much of this money is lost through illicit financial flows

Natural Resources and Illicit Financial Flows

- Extractive sectors are associated with high levels of IFFs

Mines minister, Chidhakwa offered bribes

November 17, 2013 in Local, News, Politics

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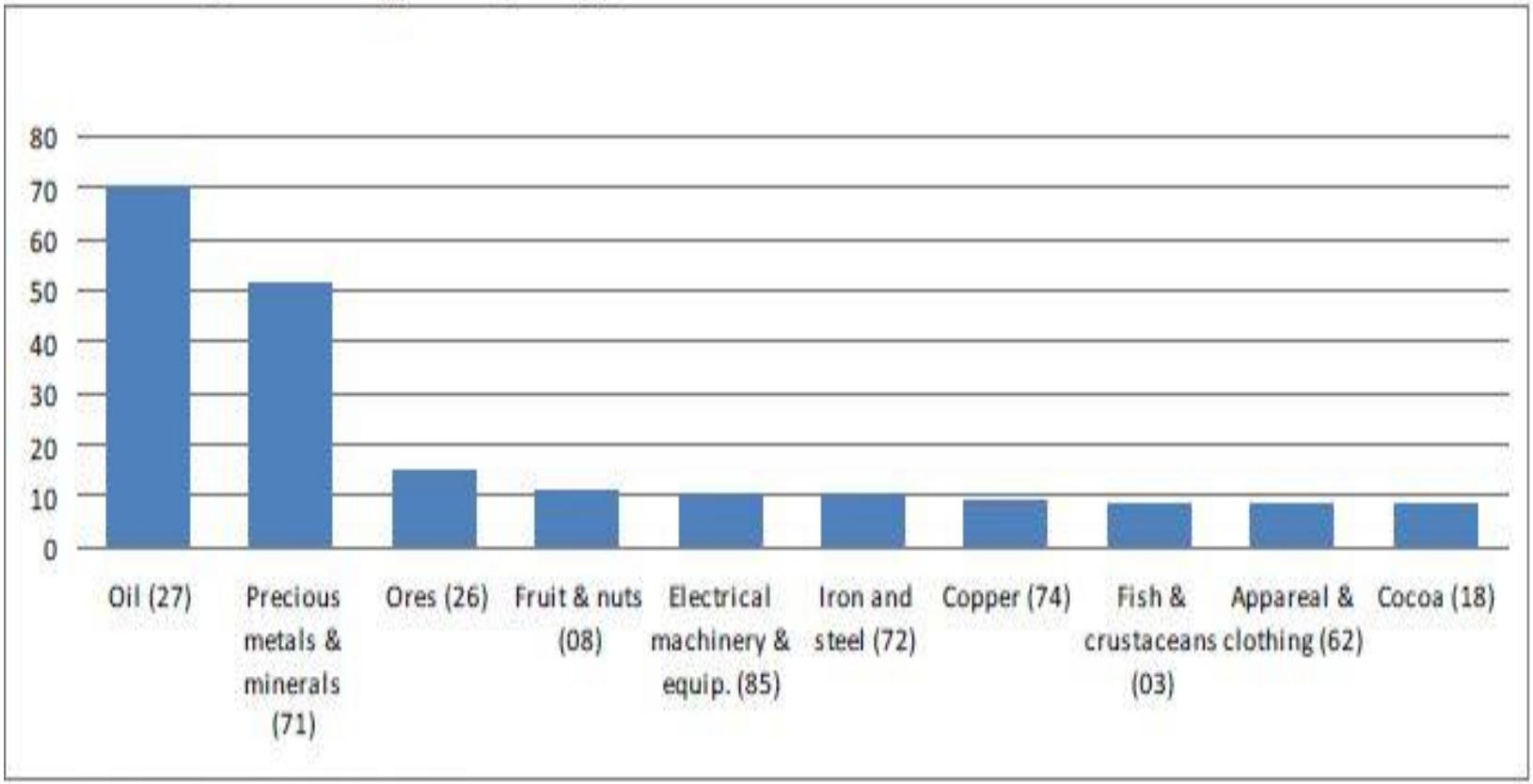
MINES and Mining Development Minister Walter Chidhakwa has revealed that he was approached by private sector players, including mining companies, offering him bribes to facilitate deals.

- 2000-2009, more than half (56%) of IFFs from the African continent arose from oil, precious metals and minerals, iron and steel and copper.
- Fuel exporters accounted for nearly half of IFFs from Africa between 1970-2008 (Baker and Kodi 2010,12)
- For each extra 1$ in oil exports, 11-26c leaves the country as IFF. Ndikumana and Boyce 2011.

Top 10 Sectors in Africa US$billion (trade mispricing only)



Source: UNECA's computations

Types of IFFs and Beneficiaries

Source: Anti-Corruption Resource centre

	Corruption	Illegal Exploitation	Tax Evasion
Main Financial Flows	Facilitation Payments (bribes) paid by companies, money embezzled from tax collection and budgetary allocation	Undeclared corporate revenues from illegal resource exploitation	Inflated costs deducted from taxable revenues, smuggling of resources
Main Beneficiaries	Corrupt gvnt officials and companies gaining undue advantage	Domestic companies, local subsidiaries of foreign companies	Parent and holding companies, exporting companies

AFRICAN FORUM AND NETWORK ON DEBT AND DEVELOPMENT

Corruption

- Abuse of public authority for personal interest at the expense of the broader community
- Of the top 10 corrupt political leaders in developing countries, 3 ruled in extractive sector dependent countries Nigeria, DRC and Indonesia (TI 2004)-.
- Corruption is linked to illegal resource exploitation and tax evasion
- Eg. The bribing of midlevel resource management officials, enables illegal resource exploitation outside of concession areas
- Corruption also facilitate tax evasion, with bribing undermining maximisation and collection of monetary revenues

Revenue Streams and Risks of IFFs

Revenue Stream	Illicit Flows Risks
Bonuses	Bribes and Payments outside central budget accounts, associated with embezzlement and political slush funds
Royalties	Underreporting of volume, underestimated value, price discount, benchmark or indexation
Fees	Petty corruption related
Corporate Income Tax	Transfer mispricing/over-invoicing, undue tax exemptions or rebates
Production Share	Misreporting on volume or quality by operating company, inflation of operational costs, embezzlement by state resource marketing entity

Source: Anti Corruption Resource Centre

Illegal Resource Exploitation

- Includes operating outside the confines of the licensed areas/concessions/contractual limitation
- Theft, eg 30t of gold were stolen from South African mines every year in the mid 1990s with gvt losing approx 13% of its potential revenues.
- Failure to respect environmental and social regulations
- Compliance is costly for companies and thus open to corruption, through compliance avoidance, lowering of standards or demand for “facilitation payments”
- Illegal gold panning in Zimbabwe-export without proper declarations

Tax Evasion

- Tax avoidance starts with the negotiation of contracts set within broader framework of EI taxation policy
- Overestimation of operating costs, underestimation of production volumes, transfer pricing manipulation and breach of the arms length principle
- Uneven and inadequate enforcement by tax authorities

Resource Value Chain and IFF Risk Level

	Risk level		
Activity	**Corruption**	**Illegal exploitation**	**Tax evasion**
Licensing	High, through award criteria, information access, and selection process	Low, except for overriding normally prohibited resource exploitation (e.g., in national park)	High, through setting fiscal framework
Exploration	Low, except for ensuring investment schedule and presentation of survey results	Low, except for medium- scale placer mining of high-value minerals	High, through expenditure inflation
Development	High, through contract amendments, cost-recovery and production-profile plans, and construction phase	High, through agreement on future production monitoring	High, through procurement over-invoicing
Production	High, through application of production regulations and contract amendments	High, including through fraudulent measurements and underreporting	High, through transfer mispricing and over-invoicing
Trading and transportation	High, through resource purchase contracts, shipment authorisation, and pipeline access	High, through diversion of resource flows and racketeering by transporters	High, through transfer mispricing and under-invoicing
Refining and marketing	Medium, through circumventing price controls and award of importing and retailing contracts	High, through diversion of refined resources and racketeering by transporters	Medium, through smuggling of untaxed or subsidised products
End phase	Low, except for decommissioning expenditures including environmental mitigation	Low, except for post-decommission "illegal" exploitation	High, through early exit or false bankruptcy
Revenue allocation	High, through embezzlement, "pork-barrelling," "white elephant" projects, and inefficient "populist" policies	Low, except through effect of low revenue allocation to regulation of extractive sectors	High, through under-invoicing of imports

Sources: McPherson and MacSearraigh (2007), Al-Kasim, Søreide, and Williams (2008), Kolstad and Søreide (2009); author.

IFF Risk levels for different EIs

	Risk level		
Sector	Corruption	Illegal exploitation	Tax evasion
Oil	High, due to confidentiality and concentration of decision making and monitoring	High, due to biased metering, siphoning, and bunkering	Medium, due to homogeneity of international prices according to oil quality
Gas	Medium, due to limited market options	Low, since gas theft is very difficult except at transit hubs between markets	High, as gas prices vary widely because of fragmented markets
Industrial mining	High, due to confidentiality and concentration of decision making and monitoring	Low, except in measurement and ore grading	High, due to transfer mispricing
Artisanal mining	Medium for grand corruption but high for petty corruption, due to diffuse resource flows except at official export channel	High, due to accessibility of deposits and difficulties in monitoring	High, due to smuggling

Recommendations and Key messages

Africa's common strategy to address the problem of IFFs which augments the AU High Level Panel on Illicit Financial Flows should include:-

1. **Fiscal Transparency**

- Increase transparency by implementing the different Financial Action Task Force standards
- e.g. obligations for banks and other institutions to conduct due diligence on customers.

2. **Country by country reporting**- All MNCs should be required publicly to report sales, profits and taxes paid in all jurisdictions where they operate in their audited annual reports and tax returns.

Recommendations and Key messages

3. **Transparency of Beneficial Ownership**-The Beneficial ownership, control and accounts of companies, Trusts and foundations should be available on public record in ach jurisdiction.

- A beneficial owner must be defined as a natural person or publicly listed corporation, not a nominee or trust.

4. **Automatic Exchange of Tax Information**-Gvts should collect data from financial institutions on the financial assets within their domain and automatically provide it to gvts where the non-resident individual or entity beneficially controlling the structure is located.

Recommendations and Key messages

5. **Harmonizing predicate offences for money laundering including tax evasion**-Require that predicate offenses for a money laundering charge include tax evasion, as well as crimes committed both at home and abroad.
6. **Unitary taxation**-Require uniform taxation to prevent funds being transferred to low tax jurisdiction.
7. **Capital Repatriation Schemes**- Recuperating lost resources and providing mechanisms and incentives for their return.

Conclusion

- Most existing initiatives to address governance issues in the extractives sector have not been designed with illicit financial flows in mind.
- They have generally contributed to increased levels of transparency in the sector but have not significantly influenced the likelihood of revenues not being misappropriated and illicitly transferred.
- Eg. KPCS and EITI

Conclusion

- The untouchable MNCs and the complicity of those in government positions makes it extremely difficult to enforce laws and standards.
- Best policies and practices can only do so little in Africa in the absence of global political will, a global regulator and robust legal and institutional frameworks that foster greater transparency and accountability for combating IFFs.
- An integrated international approach is therefore needed in order to combat IFFs and for taxation to contribute meaningfully to Africa's development.