How are IFFs affecting Africa's sustainable development

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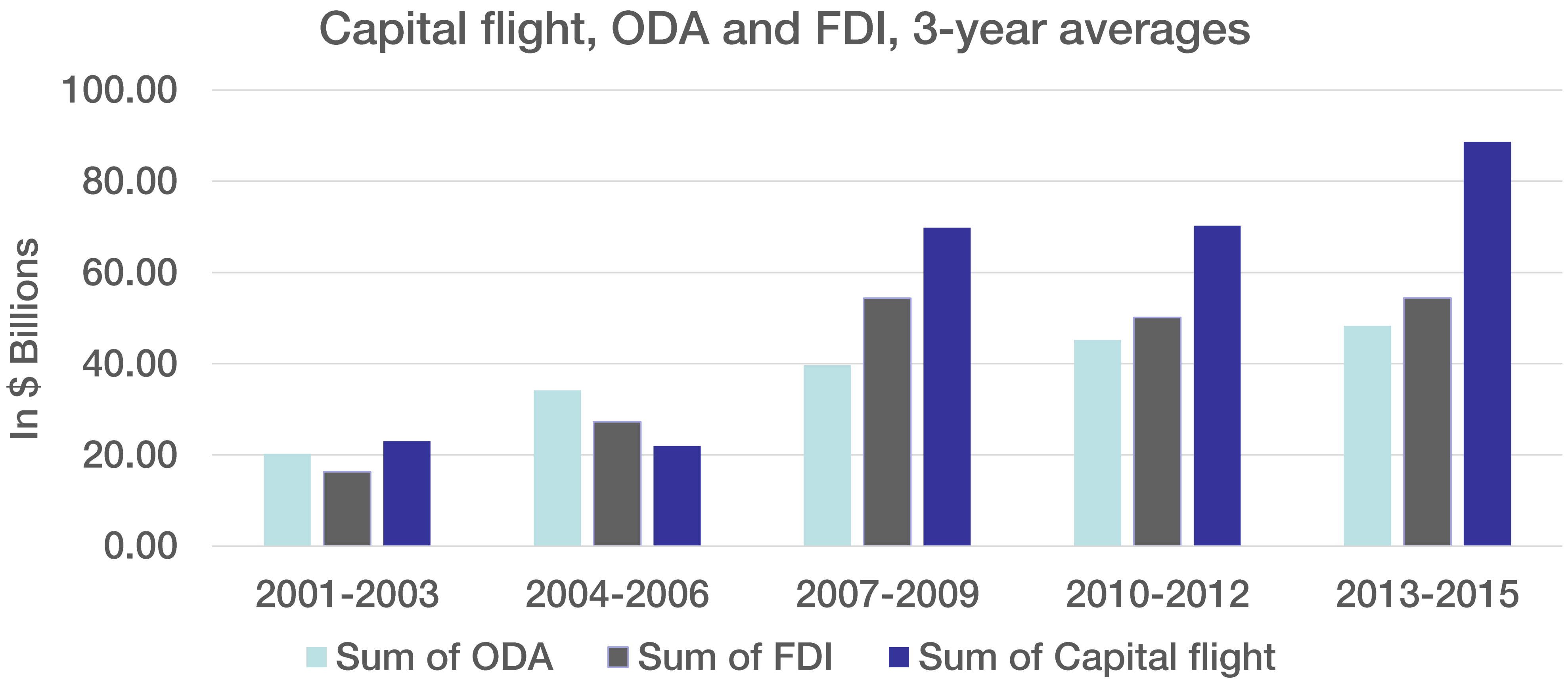
Economic Development in Africa Report 2020 briefing on Tackling illicit financial flows for sustainable development in Africa

OUTLINE

- Motivation and research questions
- Channels and empirical methodology
- Key findings
- Policy recommendations

MOTIVATION



Source: UNCTAD‘s calculation based on Peri data (Ndikumana and Boyce, 2019) and UNCTAD Statistics

RESEARCH QUESTION

- What is the relationship between IFFs and the economic, social and environmental dimensions of sustainable development in Africa?
  - What are the channels through which IFFs may have an impact on development?
  - Are some sectors more vulnerable to IFFs?
  - To what extent could curbing IFFs help in achieving SDGs and in mobilizing domestic resources in Africa?

CHANNELS

(1) Illicit financial flows lower the rate of capital accumulation through a reduction of private investment.

(2) Illicit financial flows can affect government revenues through lowering the tax base.

(3) Illicit financial flows through criminal activities, bribes and corruption, are likely to undermine the domestic rule of law and harm institutional quality.

(4) Illicit financial flows originate in the illicit exploitation of environmental resources.

METHODOLOGY

Indicators of IFFs:

- Capital flight
- Trade misinvoicing
- Estimates of tax avoidance

Indicators of sustainable development

- Labor productivity (and other indicators of structural transformation)
- Education, health outcome and gender equality
- Environmental indicators (Nordhaus approach)

Indicators of quality of institutions

- State fragility, Control of corruption, Financial sector rating, Number of suspicious transaction reports related to money-laundering

EMPIRICAL APPROACH

1) Panel-data model is estimated applying various specifications to identify heterogenous effects by sector and measurement of IFFs
2) Simple cross-country regressions of environmental performance and IFFs in extractive industries
3) Comparative analysis of IFFs with SDG indicators and climate-finance needs
4) IFFs and domestic resource mobilization in Africa

KEY FINDINGS

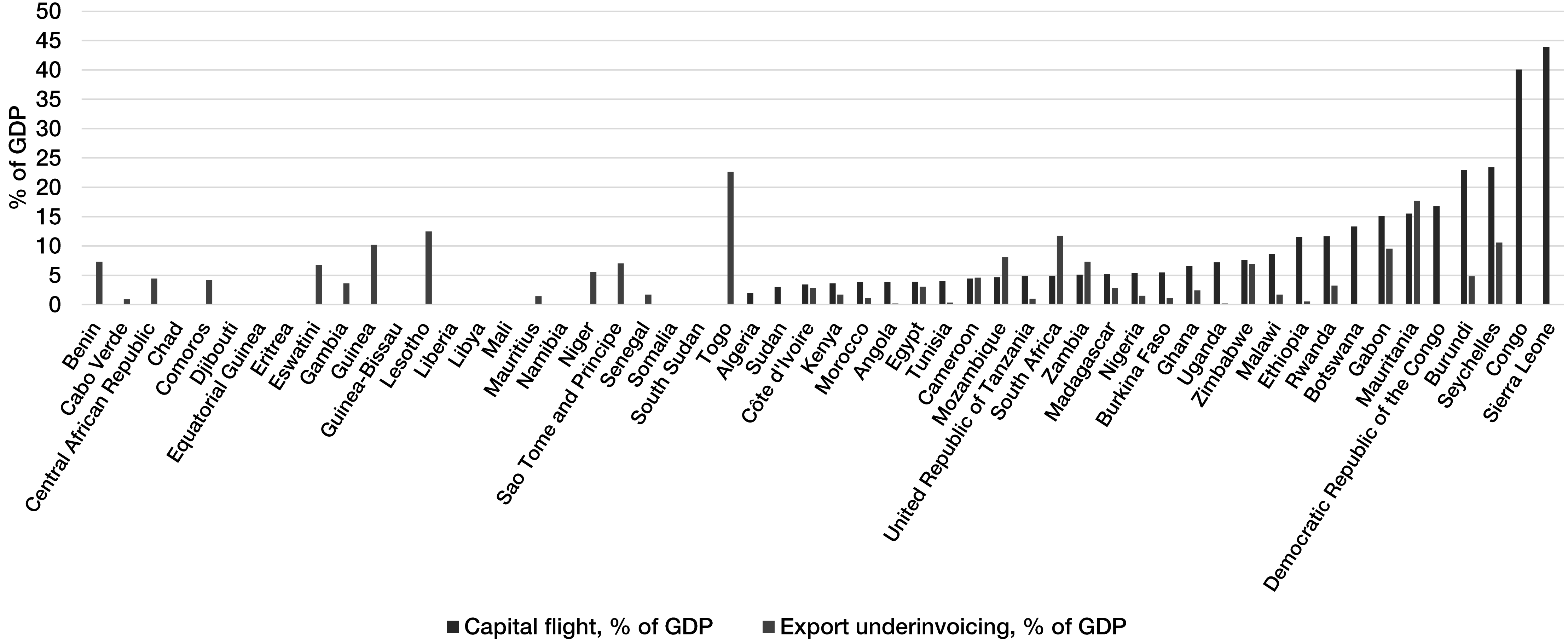
1) Panel-data model estimation:

- Illicit financial flows are negatively associated with SDG8 on achieving higher levels of economic productivity.
- Countries with higher institutional quality are less vulnerable to illicit financial outflows due to a business-friendly environment and alternative financial resources
- Low-productivity sectors are the most vulnerable to the lack of financial resources to increase productivity.

Identified challenges and future research areas:

- Selection bias from data limitations and heterogenous impacts of IFFs.

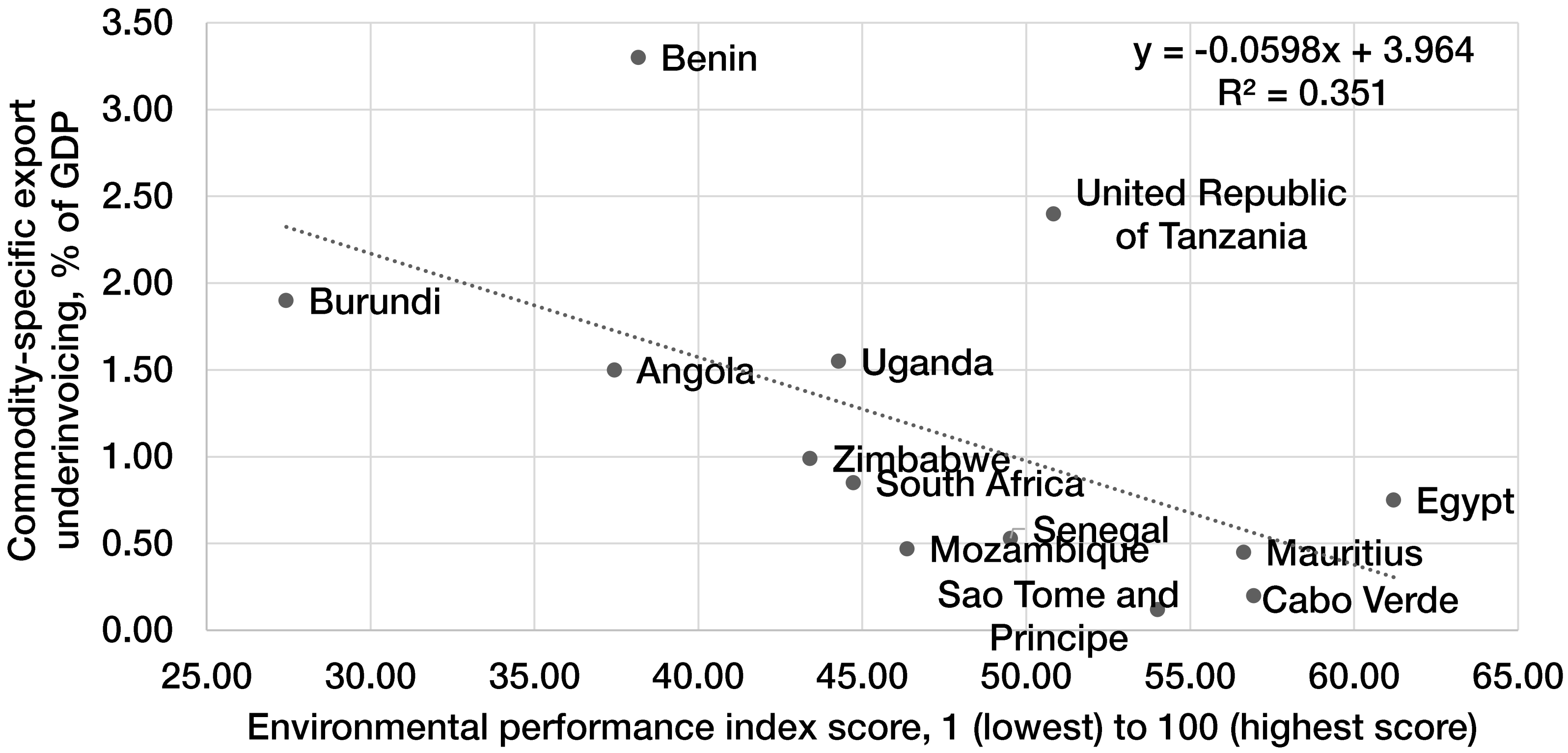
Fig.: Illicit capital flight and export underinvoicing, in % of GDP, 2000-2015 annual average



Source: Authors' graph based on capital flight data obtained from Ndikumana and Boyce (2018) and export underinvoicing estimates from Schuster and Davis (2020).

KEY FINDINGS

2) Environmental Performance Index and commodity-specific export underinvoicing (as percent of GDP), in 2018



Identified challenges and future research areas:

- Lack of theoretical background
- Value chain linkages
- Role of stricter environmental standards and requirements for compensation schemes in extractive industries

Source: Authors' calculation based on the Environmental Performance Index data

KEY FINDINGS

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3) Comparative analysis of IFFs with SDG indicators and financing needs

Fig.: Total health and education expenditure, median by level of capital flight

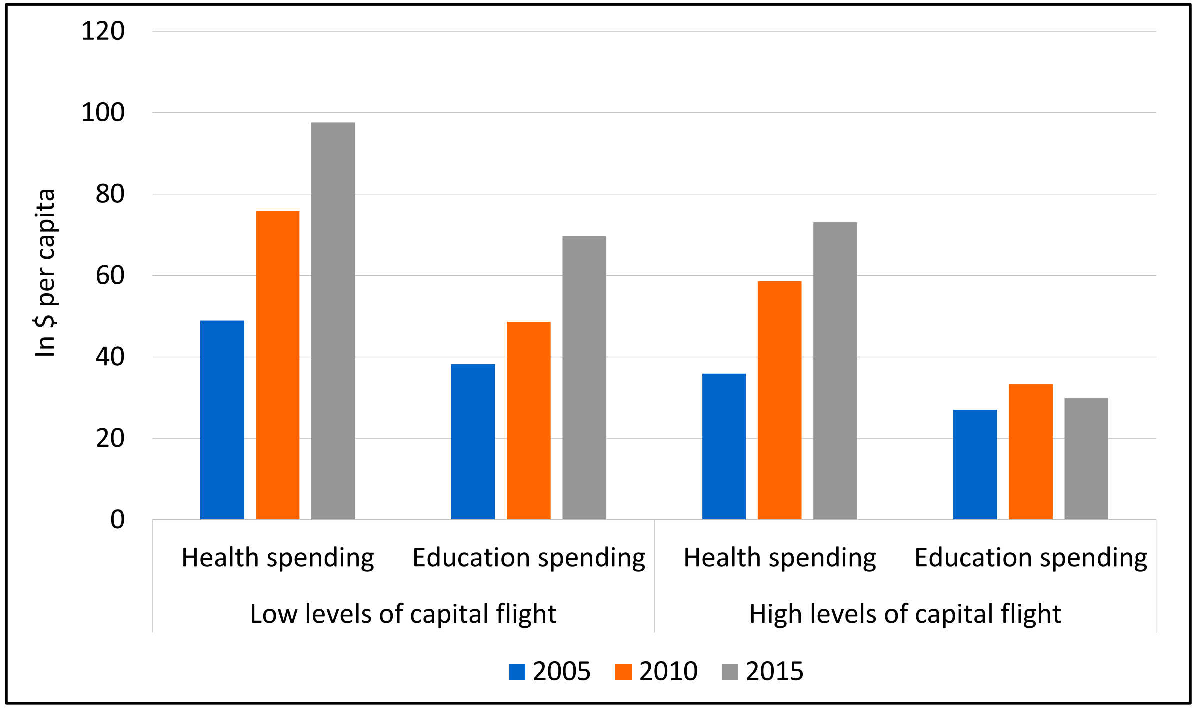
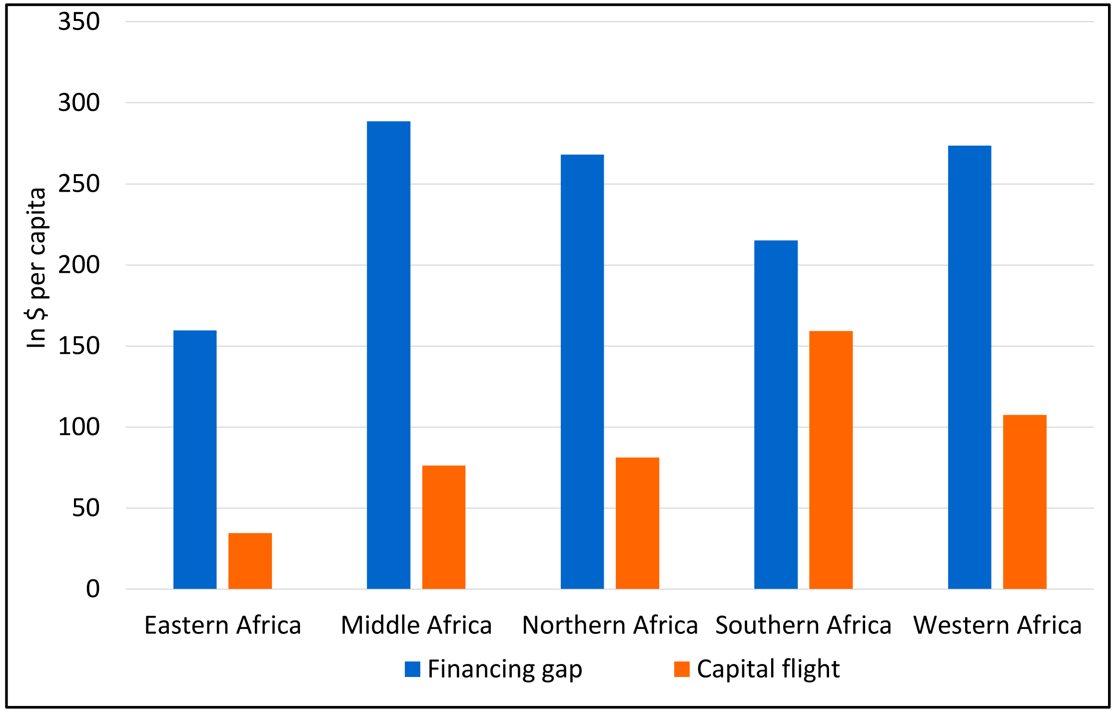


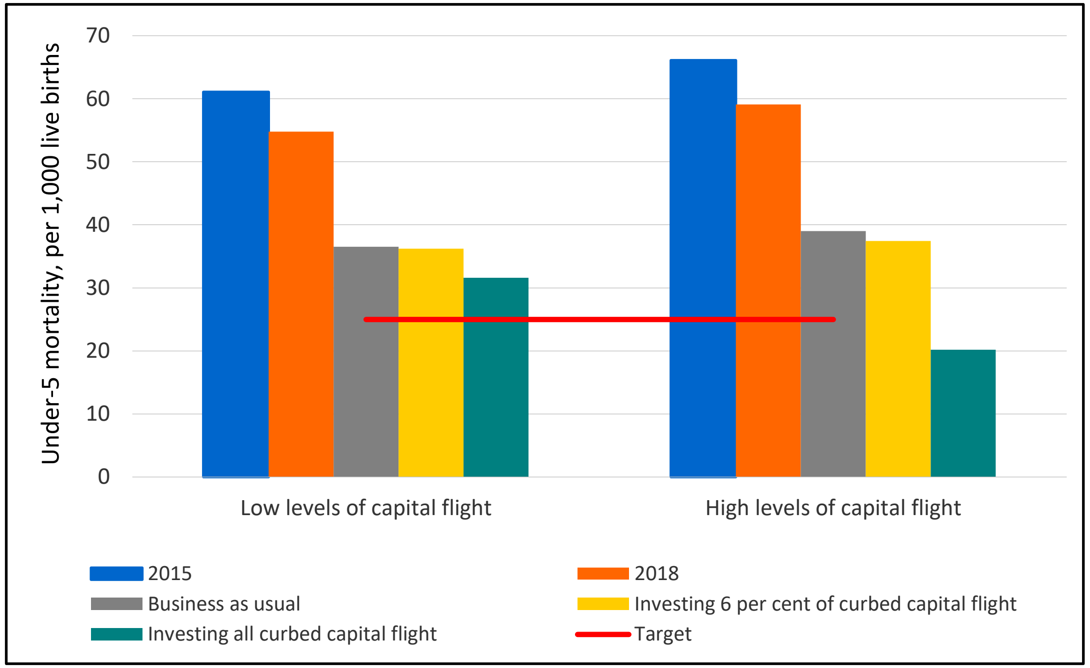
Fig.: Total financing gap and capital flight, by region, 2013–2015



Source: UNCTAD secretariat based on Peri dataset for annual capital flight, WDI data and Kharas and McArthur (2019) for financing needs gap.

KEY FINDINGS

Fig.: Projections on achieving target 3.2, by level of capital flight



Source: UNCTAD secretariat based on Peri dataset for annual capital flight, WDI data

Specific example of Sierra Leone:

- One of the highest under-5 mortality rates on the continent (105 per 1,000 live births in 2018)
- Curbing capital flight and investing a constant share of revenues in public health expenditures could bring down the under-5 mortality rate to 52 per 1,000 live births in 2030 (compared to 61 per 1,000 births in the 'business-as-usual' scenario)

Identified challenges and future research areas: Measuring SDG financing gap, identify gender-adverse impacts of IFFs and investment inefficiencies. What are the multiplier effects (e.g. from strengthening institutional capacity)?

KEY FINDINGS

4) IFFs and domestic resource mobilization in Africa

- The revenue losses from corporate tax avoidance are significant.
- Increasing the overall revenue raised will require efforts across a range of sources, including but not limited to corporate income tax.
- Improving tax efficiencies and closing this average tax gap of 20 per cent could raise tax revenue by 3.9 per cent of GDP.
- Improving governance through better control of corruption and higher accountability of policy laws would largely reduce inefficiencies and could help to raise an additional $110 billion a year (Coulibaly and Gandhi, 2018).
- Due to the StAR initiative a total of $1.53 billion has been recovered and returned to African countries

⇨ **Identified challenges and research areas:** Estimates of tax avoidance (lack of firm-level and transparent tax revenue data). What is the efficient tax rate?

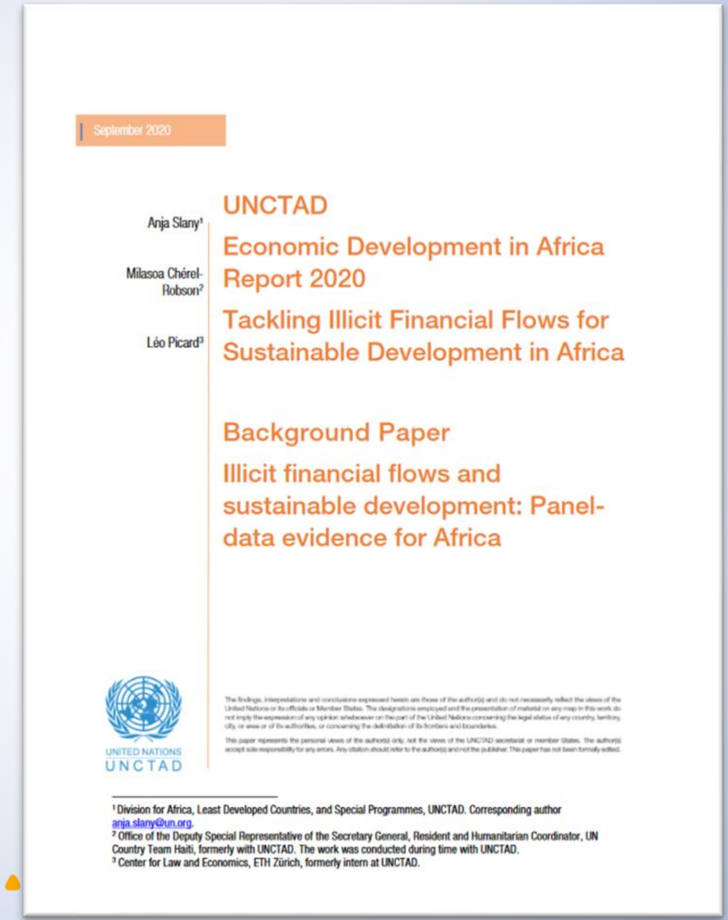
POLICY RECOMMENDATIONS

- Invest in data infrastructure and transparency (including gendered data)
- Join the Extractive Industries Transparency Initiative (EITI) and adopt policy recommendations by the EITI to increase transparency
- Engage in the work of the Africa Tax Administration Forum (ATAF)
- Join the global AML/CFT network: The Financial Action Task
- Engage in regional networks of fight corruption and money-laundering (e.g. Inter-Governmental Action Group against Money Laundering in West Africa (GIABA))

POLICY RECOMMENDATIONS (CONT.)

- Report cases to Stolen Asset Recovery Initiative (StAR) to measure progress towards target 16.4 of the SDGs
  - E.g. German Development Cooperation (GIZ) capacity building project “Combating Illicit Financial Flows”
- Engage in reporting standards initiatives to measure the environmental and social impacts of large-scale investments (e.g. through Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) at UNCTAD)
- Adopt Whistle-blower policy to uncover illegal practices and protect individual from retaliation
- Ratify the AfCFTA agreement to actively engage in tax initiatives

For more details, please find our background paper on our website: https://unctad.org/webflyer/economic-development-africa-report-2020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Economic Development in Africa Report 2020

Tackling Illicit Financial Flows for Sustainable Development in Africa

Background Paper

Illicit financial flows and sustainable development: Panel-data evidence for Africa

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