

## Chapter 1

# Illicit financial flows and sustainable development: Definitions and conceptual framework

This chapter aims to provide a background to the report and a narrative thread of the rationale behind the focus of its analytical chapters. It is structured as follows. Section 1.1 underlines the report's anchoring in the development approach to IFFs. Section 1.1 also aims to provide a better understanding of the state of play on the measurement of IFFs for the monitoring of Sustainable Development Goal indicator 16.4.1. Section 1.2 examines a selected set of sources of IFFs that are of particular relevance to the study. Section 1.3 discusses some of the main enablers of IFFs. Section 1.4 follows with an exposé of the report's approach to the analysis of the relationship between IFFs and the economic, social and environmental dimensions of sustainable development. The overall conceptual framework of the report is summarized in figure 1.

**EACH YEAR ON  
THE AFRICAN CONTINENT**



trade misinvoicing  
between

**\$30 and  
\$52 billion**

contributes  
to



capital flight

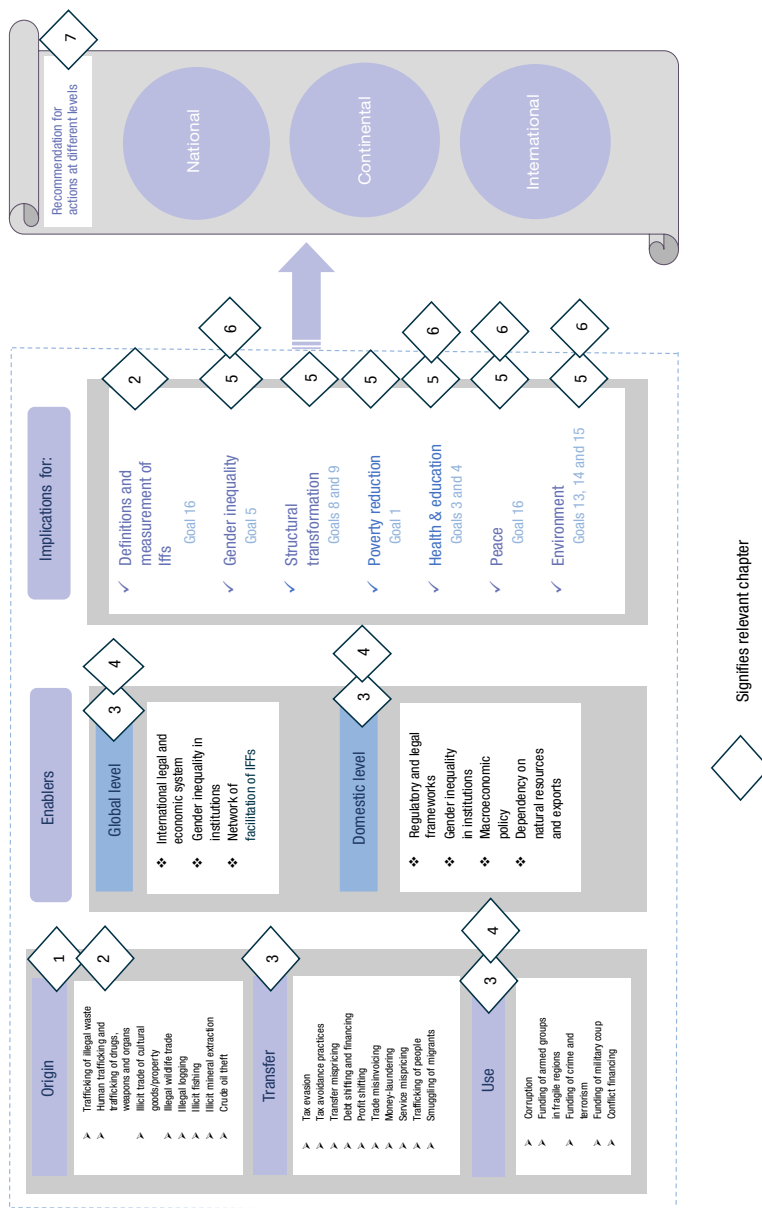
**\$88.6 billion**

**CURBING IFFs  
is part of SDG target 16.4**

in support of peace, justice and strong institutions



Figure 1  
Conceptual framework of the Economic Development in Africa 2020



Source: UNCTAD secretariat.

## 1.1 Illicit financial flows in the report

### *The development approach to illicit financial flows*

The present report adopts a development approach to IFFs, informed by insights from the legal literature highlighted in the introductory chapter. The development approach to IFFs is explicit in the concern expressed in General Assembly resolution 71/213 for the impact of such flows on “economic, social and political stability and development of societies”.<sup>6</sup> In doing so, the resolution is in line with the strand of the literature on IFFs that accounts for their direct and indirect effects, and ultimately, their net negative impact on development (Blankenburg and Khan, 2012; Myandazi and Ronceray, 2018). In these studies, developmentally harmful IFFs include lawful transactions (“until proven unlawful”), such as aggressive tax planning and profit-shifting schemes, that result in government revenue losses (Musseli and Bürgi Bonanomi, 2020). This categorization comes with nuances on the understanding of the impact of IFFs on development. The use of bribes or profit shifting, for instance, can be motivated by the need to make investment viable and as such are not considered to be developmentally harmful (Blankenburg and Khan, 2012). When further elaborated upon, Musseli and Bürgi Bonanomi (2020) argue that this purposive approach also implies that all practices that erode the tax base of developing countries are developmentally harmful. The list would then include business tax incentives and tax-related contract provisions. The purposive approach also complicates the consideration of flows from artisanal and small-scale mining. In addition to formal small-scale and artisanal commercial mining entities, artisanal and small-scale mining includes individual miners operating outside formal legal and economic structures and who depend on the sector for their survival (Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development, 2017). However, the overall economic, social and environmental impacts of artisanal and small-scale mining are likely to be more nuanced. In Sierra Leone, for example, although estimated to generate substantial economic value, small-scale gold mining is a major source of money-laundering and IFFs with little taxation revenue for the Government (Hunter and Smith, 2017).

Given these layers of complexity, a purposive definition of IFFs risks making the assessment of their effects on development even more difficult. Instead, for policy purposes, this report subscribes to the contention that a better anchoring of the definition of IFFs in law is needed, in addition to striving for “granularity”, “spelling out what is or is not within scope in terms of actors, transfer mechanisms, or origin” (Musseli and Bürgi

<sup>6</sup> United Nations, General Assembly, 2017, Promotion of international cooperation to combat illicit financial flows in order to foster sustainable development, A/RES/71/213, New York, 18 January.

Bonanomi, 2020:15) while also building on the literature on economic transformation and social development.

### ***Multilateral efforts in the measurement of illicit financial flows***

The large array of literature on estimating IFFs from commercial activities showcases major differences in methods, sample sizes and data sets. Main findings from these studies are presented in the annex to this chapter. These studies have played a critical role in raising awareness about the scale of IFFs. However, such estimates are not comparable and there is a lack of consensus. With regard to trade misinvoicing in particular, there are variants across analytical traditions on the treatment of inward IFFs. Some researchers, for instance, measure IFFs at a regional level and subtract outflows from inflows to determine net IFFs (Reuter, 2012). Others estimate the total sum of inflows and outflows. This latter approach is based on the belief that inflows and outflows cause development harm and hence must be added together to gauge the full impact (Global Financial Integrity, 2019).

By 2017, further to the adoption of indicator 16.4.1 on “Total value of inward and outward illicit financial flows”, considering the complexity of the multiple dimensions of IFFs, development of the measurement of the indicator had been entrusted to two custodians: UNODC on crime-related IFFs and UNCTAD on the tax and trade components. Subsequently, an international Task Force on Statistical Methodologies for Measuring Illicit Financial Flows was established composed of country representatives and experts from international organizations such as IMF, OECD, the United Nations Department of Economic and Social Affairs, UNECA and Eurostat. The exercise has encountered a number of difficulties. First, efforts are constrained by the lack of statistics due to the hidden nature of IFFs and the diversity of what they mean across countries and regions. Second, many of the activities that lead to IFFs are intertwined, further compounding challenges in disaggregating between the different categories. Trade misinvoicing practices, for example, can hide tax-avoidance schemes, and while a stand-alone category, bribery and corruption also permeate most illicit and illegal activities. Third, innovation by perpetrators of illicit activities and facilitators of illicit financial transfers results in a constantly evolving field that is difficult to capture in statistics. Fourth, the treatment of the informal economy and how it relates to IFFs differs across countries. Fifth, statistical definitions of IFFs should be comparable across countries to allow for the ranking of their prevalence and for the design of a common set of solutions at the multilateral level.

In addition to these preliminary challenges, the international statistical Task Force underlined the need for the statistical definitions to be separated from legal definitions.

According to the Task Force, differences in legal frameworks across jurisdictions imply that it is empirically infeasible to separate illegal (for example, tax evasion) from illicit and licit practices (for example, aggressive tax avoidance) and lawful tax planning. The Task Force findings further show that this has implications for the development of Sustainable Development Goal indicator 16.4.1 by underlining the need to move away from a legal/illegal split in the definition (UNCTAD and UNODC, forthcoming). The Task Force states that the primary objective of the statistical exercise is to measure certain behaviours and activities and indicate the size of the phenomenon and steer away from definitions of what is illegal. This approach resonates with the findings from the legal strand of research on IFFs discussed in the introduction.

Expert meetings held during 2017–2019 further underscored difficulties in gathering data for the measurement of IFFs, given that such information is scattered across a range of institutions at the country level: from national accounts and balance of payments data from central banks; information from financial intelligence units and ministries of justice; tax-related data from national revenue authorities; and merchandise trade data from customs. Furthermore, although trade in services is a main conveyor of aggressive tax-avoidance practices mostly through the relocation of financial service flows and intellectual property, there is no single data source from which to derive relevant statistics.

By July 2019, the efforts of the UNCTAD–UNODC Task Force had led to a consensus on an agreed statistical definition of IFFs for indicator 16.4.1 as well as on a typology and methodology to measure them. By October 2019, the Inter-agency and Expert Group on Sustainable Development Goal Indicators had upgraded the classification of the methodology for classifying indicator 16.4.1 from tier III to tier II, thereby underlining that “the indicator is conceptually clear and has an internationally established methodology and standards are available, but data are not regularly produced by countries”.<sup>7</sup> Core elements of the definition of IFFs, for statistical purposes, were underscored as follows:

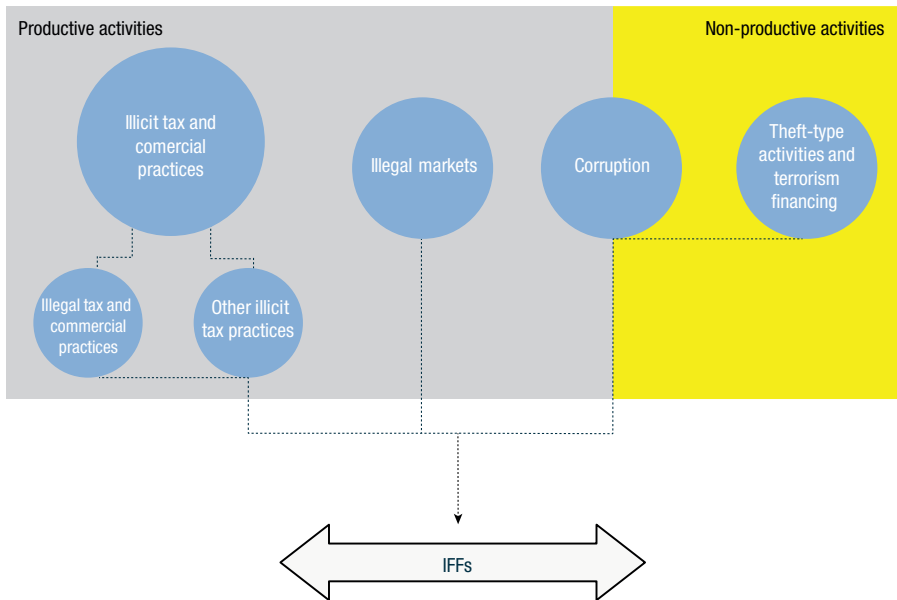
- Illicit in origin, transfer or use;
- Exchange of a value (rather than purely financial flows);
- A flow of value over time (as opposed to a stock measure);
- Flows that cross a border.

<sup>7</sup> For further information on the classification of global Sustainable Development Goal indicators, see <https://unstats.un.org/sdgs/iaeg-sdgs/tier-classification/>.

Figure 2 and box 1 present a more detailed account of the categories of IFFs as endorsed by the Inter-Agency and Expert Group on Sustainable Development Goal Indicators. Data collection in a sample of pilot countries is under way to test the methodology. In this regard, the Task Force acknowledges at the outset that data related to corruption or commercial and tax-related IFFs will be more difficult to obtain due to the variety of channels used by MNEs across a number of related activities: transfer pricing, the relocation of intangible assets, royalty payments, and the like.

**Figure 2**

**Categories of illicit financial flows**



Source: UNCTAD and UNODC (forthcoming).

## Box 1

### **The measurement of illicit financial flows for Sustainable Development Goal indicator 16.4.1**

The UNCTAD–UNODC Task Force identified four main categories of activities that can lead to IFFs.

#### *Tax and commercial IFFs*

These include illegal practices such as tariff, duty and revenue offences, tax evasion, corporate offences, market manipulation and other selected practices. Some activities that are non-observed, hidden or informal, or part of the so-called shadow, underground or grey economy may also generate IFFs. The practices are typically motivated by increasing profits and avoiding taxes. Related activities included in the International Classification of Crime for Statistical Purposes comprise tax evasion, tariff, duty and revenue offences, competition offences, import/export offences, acts against trade regulations, restrictions or embargoes and investment or stock/shares offences. Also included are tax-avoidance practices, including transfer mispricing, debt shifting, relocation of intellectual property, tax treaty shopping, tax deferral, changes in corporate structure or economic residence and other profit-shifting schemes. When these activities directly or indirectly generate flows crossing country borders, they generate IFFs.

#### *IFFs from corruption*

The United Nations Convention against Corruption defines acts considered as corruption and these are consistently defined in the International Classification of Crime for Statistical Purposes. They include bribery, embezzlement, abuse of functions, trading in influence, illicit enrichment and other acts. When these acts, directly or indirectly, generate cross-border flows, they are counted as IFFs.

#### *Theft-type activities and financing of crime and terrorism*

Theft-type activities are non-productive activities that entail a forced, involuntary and illicit transfer of economic resources between two actors. Examples include theft, extortion, illicit enrichment and kidnapping. In addition, the financing of terrorism or crime involves the illicit, voluntary transfer of funds between two actors with the purpose of funding criminal or terrorist actions. When the related financial flows cross country borders, these activities constitute IFFs.

#### *IFFs from illegal markets*

These include domestic and international trade in illicit goods and services. Such processes often involve a degree of criminal organization and are aimed at creating profit. They include any type of illegal trafficking of goods, such as drugs and firearms, or services, such as smuggling of migrants. IFFs are generated by the flows related to the international trade of illicit goods and services, as well as by cross-border flows from managing the illicit income from such activities.

Sources: UNCTAD and UNODC (forthcoming).



The present report abides by the definitions issued by the UNCTAD–UNODC Task Force as highlighted in box 1. It further asserts that differences in patterns of intra-African and extracontinental trade and changing trade dynamics due to rising trade volumes between Africa and large emerging developing countries warrants a new examination of IFFs in Africa along these lines (chapter 2).

## 1.2 Selected sources of illicit financial flows

As per the definition of IFFs used in this report, illicitness comes from the activities from which flows originate and from the cross-border characteristic of the movements. Although an exhaustive review of the sources of IFFs is beyond the scope of the report, some of these activities are discussed below.

### *Tax avoidance*

Tax avoidance is a global problem that affects both developed and developing countries. Estimates of revenue losses related to global corporate taxation range from \$500 billion to \$650 billion annually depending on the variables under study (Crivelli et al., 2015; Cobham and Janský, 2018). Calculations of corporate tax avoidance in the European Union, for instance, vary from €50 billion to €190 billion per year (Murphy, 2019). Analyses of recent data show that all European Union member States have tax gaps that might considerably exceed their health-care spending, with Italy, France and Germany topping the list in absolute terms.

In developing countries, losses due to global corporate taxation are estimated to range from 6 to 13 per cent of total tax revenue, versus 2 to 3 per cent in OECD countries (Crivelli et al., 2015). Research findings for India, for example, show losses of an average of \$16 billion per year during 2002–2006 (Kar and Cartwright-Smith, 2009). The 2008 global financial crisis played a role in raising awareness of the scale of tax evasion and other commercial dimensions of IFFs. The political urgency of addressing global corporate taxation led to the establishment of the BEPS initiative at OECD (the Inclusive Framework on BEPS is discussed in chapter 3). Estimates by UNCTAD show that the magnitude of revenue losses due to MNE tax avoidance in developing countries was approximately \$100 billion annually in 2012, comparable to the total annual amount of official development assistance (ODA) to developing countries computed at \$115 billion the same year (UNCTAD, 2015a).

With regard to Africa, one sixth of the continent's aggregate government revenue comes from corporate taxation (\$67 billion in 2015) and most estimates suggest that the cost

of tax avoidance is of the order of a tenth of this figure (Hearson, 2018). Corporate taxation is a more important share of government revenue in African countries than in OECD countries, mainly because African countries are unable to raise as much revenue from payroll taxes.

### *Corruption and offshore accounts*

Estimates from the African Development Bank (AfDB) show that Africa loses about \$148 billion to corruption every year (AfDB, 2015). Conservative estimates by the Stolen Asset Recovery Initiative (StAR) based on 2007 data also show that between \$20 billion and \$40 billion per year are stolen by public officials from jurisdictions in developing countries and countries with economies in transition (van der Does de Willebois et al., 2011). More recently, publications by investigative journalists have uncovered the magnitude of African private wealth in offshore accounts. In 2015, for example, an investigation provided details on almost 5,000 individuals from 41 African countries with assets of about \$6.5 billion (Moore et al., 2018).

Global-level analyses show that from 20 to 30 per cent of private wealth in many African countries is held in tax havens (Global Financial Integrity, 2017; Zucman, 2014; Johannesen et al., 2016). This is higher than the global country average of 8 per cent (Zucman, 2013).

### *Illicit flows from other criminal activities*

Recent estimates suggest that, on a global scale, revenues generated from 11 crimes (trafficking in drugs, weapons, humans, human organs and cultural property; counterfeiting; illegal wildlife trade, fishing trade, logging and mining; and crude oil theft) range from \$1.6 trillion to \$2.2 trillion per year (May, 2017). However, these estimates must be treated with caution as they cannot always be equated with IFFs, given the difficulty of determining the value that moves across borders. Human trafficking contributes to a significant part of these flows. Aggregating information on what is known and reported, UNODC (2018), for example, found that in 2016 along selected routes, 2.5 million migrants worldwide were smuggled for an economic return of at least \$5.5 billion to \$7 billion.

Most of these illegal activities have an impact on prospects for achieving economic, social and environmental goals and account for the findings detailed in chapters 5 and 6 of the present report on the relationship between IFFs and social and environmental sustainability. With regard to the illegal trade of counterfeit products, for instance, according to the World Economic Forum, substandard malaria medicines were

responsible for the deaths of over 100,000 children in sub-Saharan Africa in 2013 alone. Further, the global numbers associated with counterfeit malaria and tuberculosis medicines are significantly higher (World Economic Forum, 2015).

Similarly, illegal waste trafficking is a little-known source of illicit flows that has significant consequences for human health and the environment. Waste trade is regulated by a number of international environmental agreements some of which, such as the Basel Convention on the Control of Transboundary Movements of Hazardous Waste and their Disposal, the Bamako Convention on the Ban of the Import into Africa and the Control of Transboundary Movement and Management of Hazardous Wastes within Africa (Bamako Convention) and the Convention to Ban the Importation into Forum Island Countries of Hazardous and Radioactive Wastes and to Control the Transboundary Movement and Management of Hazardous Wastes within the South Pacific Region (Waigani Convention), define an illegal activity under these Conventions as a crime (World Customs Organization (WCO), 2018). Although a lack of appropriate data makes it difficult to measure the actual extent of the problem, a recent study shows that, globally, the volume of waste traded grew by more than 500 per cent, from 45.6 million to 222.6 million tons during 1992–2012 (WCO, 2018). As part of this trend, the share of the world's waste being exported to developing countries grew by 40 per cent during the period 1998–2009. Africa and the Asia and Pacific regions are among the world's key destinations for large shipments of electronic waste, plastics and various scrap metals. In addition to the official data being recorded, illegal activities are thriving through different means. The most prominent channels are the sale of waste on the black market, the fraudulent declaration of hazardous waste as non-hazardous and the classification of waste as second-hand goods in order to avoid abiding by international waste regulations and allowing them to be traded with developing countries.

Globally, the trafficking of cultural property from all origins contributes to money-laundering and the funding of terrorism (United Nations Educational, Scientific and Cultural Organization (UNESCO), 2018). With regard to Africa, it is estimated that about 90 per cent of sub-Saharan African historical items are to be found in major world museums, private collections or missionary museums (Godonou, 2007).<sup>8</sup> Most of these items have been either the result of pillaging or unfair acquisitions during wars and colonial domination, and as such have been sources of illicit flows. The resulting paucity

<sup>8</sup> "From the British Museum (69,000 objects from sub-Saharan Africa) to the Weltmuseum of Vienna (37,000), to the Musée Royal de l'Afrique Centrale in Belgium (180,000) to the Future Humboldt Forum (75,000) to the Vatican Museums and those of the Musée du quai Branly-Jacques Chirac (70,000): the history of the African collections is a European history that has indeed been a shared history" (Sarr and Savoy, 2018:15).

of remaining historical cultural items across the continent is developmentally harmful for two main reasons. First, cultural goods shape historical narratives and collective values that contribute to the education and social culture of society. The trafficking of cultural goods robs people of their identity, of their place in the world and affects their ability to build a collective future (see foreword by Lehoundou Assomo, UNESCO, 2018). Second, past and contemporary trafficking of cultural goods represents missed opportunities for Africa to benefit from greater revenue from tourism. Indeed, cultural heritage represents “a basic prerequisite” for a thriving tourist industry.<sup>9</sup> The present report is published in a context of renewed impetus for the restitution of African cultural heritage held abroad. This trend and the dynamism of pan-Africanism has led many scholars working on Africa to argue that “the decolonizing project is back on the agenda worldwide” (Mbembe, 2015:18). For many African countries celebrating their sixtieth year of independence in 2020, the agenda for reclaiming IFFs is likely to be situated within this wider project.

### 1.3 Enablers of illicit financial flows

Studies on IFFs have identified a number of drivers at the domestic level. They include inadequate regulation of the financial system and capital account; trade openness in the context of weak regulation and poor governance; and poor institutional quality and excessive dependence on commodity exports (Ndikumana et al., 2014). These drivers act as channels for the economic, institutional, environmental and social harm caused by IFFs. In addition to these, the discussion that follows is based on a selected set of enablers of IFFs.

#### *Capital account liberalization*

Following the dissolution of communist rule in the 1980s, diminishing levels of ODA and large investment needs across African countries exposed the limited role that domestic savings were able to play in addressing such gaps. The expansion of global capital markets further contributed to policy choices in favour of a more open capital account to access much needed resources. Capital account liberalization and heavy reliance on foreign savings became the norm across African countries. Such liberalization was expected to promote growth through financial deepening and better allocation of resources (Kose et al., 2009).

<sup>9</sup> See [http://archives.icom.museum/cultural\\_tourism.html](http://archives.icom.museum/cultural_tourism.html).

Policymakers often consider financial liberalization as part of financial resource mobilization, a key part of the engine for economic growth and development (Cardoso and Dornbusch, 1989). However, part of the economic literature argues that the continent's struggle with substantial outflows of capital originates in macroeconomic reforms initiated in the 1980s and intensified in the 1990s in most African countries (Ndikumana, 2003). This led many Governments to move towards greater capital account openness by abolishing or relaxing existing capital controls. Liberalization measures also generally included a relaxation or an abolition of restrictions on non-residents' ability to repatriate dividends, interest income, and proceeds of sales or liquidation of investments. Similarly, the lack of restrictions meant that by the late 1990s, for the group of severely indebted low-income countries, private assets held abroad, as measured by capital flight, exceeded total liabilities, as measured by the stock of debt, thus leading to the continent being labelled a "net creditor to the world" (Ndikumana, 2003). The capital flight to gross domestic product (GDP) ratio even exceeded 200 per cent for nine countries in the group. As a result of these trends, capital account liberalization coupled with severe macroeconomic imbalances has been associated with the provision of "legal" channels of capital flight (Ariyoshi et al., 2000), including for transfers associated with IFFs.



Though African economies are generally credited to have opted for capital account liberalization, a study by AfDB researchers (Bicaba et al., 2015) shows that there is an important gap between the desire of policymakers for capital openness and the level actually observed. As of 2012, 18 African countries had liberalized their capital accounts. These countries are also those that are among the most integrated into global financial markets. The speed of liberalization also varied across countries: Mauritius and Zambia fully liberalized their capital accounts in the early 1990s; and Angola, Tunisia and the United Republic of Tanzania, for example, had major restrictions in place until 2005. Similarly, members of the West African Economic and Monetary Union eliminated capital controls on inward foreign direct investment (FDI) as well as foreign borrowing by residents in 1999, but kept controls on capital outflows to non-member countries (IMF, 2008).

### *The international legal and economic system*

The distribution of taxation rights between countries of establishment and source countries has deep historical roots. These, in turn, have shaped contemporary patterns of opportunities and gains across global value chains. This report takes stock of the theoretical and empirical literature on the tax-motivated behaviour of MNEs. The latter is limited and is characterized by several “unresolved puzzles and blind spots” (IMF, 2020). Such limitations are mostly due to the highly technical nature of international taxation issues, to the paucity of suitable data partly for technical reasons, as well as the result of confidentiality clauses and lack of transparency. Despite these limitations, there is evidence of aggressive forms of tax-optimization strategies (Wei, 2015; IMF, 2020). This report examines risk factors along value chains that may be conducive to IFFs (chapter 3).

Countries with a high level of dependency on oil are more prone to higher levels of IFFs (UNECA, 2015). Yet, during the period 2013–2017, two out of five commodity-dependent countries were in sub-Saharan Africa and 89 per cent and 65 per cent of all countries in the Middle East and North Africa, respectively, were commodity dependent (UNCTAD, 2019a). In light of the persistent prevalence of commodity dependence in Africa, the present report examines the roots of international law and the historical configuration of the global governance of commodities and how these causes of IFFs contribute to creating distortions in market incentives (chapter 4).

### *Domestic institutions*

The negative implications of IFFs for development are channelled through two main streams. On one hand, IFFs originating in commercial activities reduce government revenue. Enabling factors include policy and regulatory inconsistencies, limited oversight, entrenched vested interests and limited transparency in economic and financial processes. On the other hand, IFFs contribute to the weakening of governance and institutional systems, including the rule of law, hinder transparency and accountability, and ultimately undermine the foundations of democracy and progress.

The primacy of institutions is highlighted in Goal 16 (“Peace, justice and strong institutions”) on promoting peaceful and inclusive societies for sustainable development, as well as providing accountable and inclusive institutions at all levels. The inclusion of IFFs in Goal 16 illustrates the relevance of institutions as a critical channel in their occurrence. Building on this, the present report posits that institutions are the primary channel through which IFFs negatively impact prospects for social and environmental sustainability (chapters 5 and 6).

### *Global actors*

IFFs are enabled by transfers facilitated by global-level financial mechanisms. Covering major cases of corruption across different jurisdictions, the World Bank and UNODC publication *The Puppet Masters: How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About It* (van der Does de Willebois et al., 2011) reveals the mechanics through which money-laundering operates. It uncovers billions in corrupt assets, shell companies and other spurious legal structures that constitute the complex web of subterfuge in corruption cases. The study also acknowledges that linking the beneficial owner to the proceeds of corruption is difficult because of the transnational constructions used, due to their sizeable wealth and resources; all rely on corporate vehicles – legal structures such as companies, foundations and trusts – to hide the ownership and control of “tainted assets”.

The present report provides an overview of the role of global actors in facilitating IFFs (chapter 3). It also critically examines policy and regulatory loopholes at the international level and the extent to which they increase risks of exposure to IFFs (chapter 4).

## 1.4 Illicit financial flows and the 2030 Agenda for Sustainable Development

In the absence of an established theoretical literature for conducting such an analysis, the conceptual framework of this report draws on the guiding principles of the 2030 Agenda for Sustainable Development, and different strands of the literature on structural transformation and economic and social development. The report’s operationalization of the relationship between IFFs and sustainable development is inspired by the capabilities framework (Sen, 1992). The report’s joint analysis of structural transformation and social development as the foundation of the analysis of economic and social sustainability aligns with Sen’s assertion that economic prosperity must go hand in hand with social development. Production and prosperity are merely the means, whereas the ultimate objective is people’s well-being. As Sen contends, lack of education or good health limits a person’s ability to make the most of opportunities offered by a well-functioning market, whereas the right human capital endowments would be of little use without access to economic opportunities.

This report is also aligned with the emphasis of General Assembly resolution 71/313 on associating the target related to combating IFFs with the indivisibility of the Sustainable Development Goals (United Nations, 2017a:2). Chapters 5 and 6 analyse the relationship

between IFFs and the economic, social and environmental dimensions of sustainable development. It derives its working hypotheses from the conceptual framework of the 2030 Agenda for Sustainable Development, that is, that curbing IFFs in Africa will contribute to the achievement of the following:

- (a) Greater benefits for people through poverty reduction;
- (b) More protection for the planet thanks to more protection from degradation and sustainable management of natural resources;
- (c) Higher levels of investment for prosperity;
- (d) Contribution to peace through just and inclusive societies;
- (e) More solidarity-based partnership thanks to a revitalized Global Partnership for Sustainable Development, based on a spirit of strengthened global solidarity.

The report underlines that curbing IFFs is not a panacea for achieving the Sustainable Development Goals. However, considering their significant magnitude by all accounts, efforts in curbing them and in the recovery of stolen assets are likely to contribute to much additional financing for the Goals.

### *For people: Poverty reduction and gender equality*

Far from being mere exaggerations, the perceptions of unfairness referred to in the introductory paragraphs of this report are validated by research findings (OECD, 2019a). The findings also underline the specific vulnerability of women and children to the detrimental effects of limited financing for development. In OECD countries, for example, strong feelings of unfairness and injustice prevail from low-income to high-income groups, with women and older people among the most dissatisfied with government social policy. In some countries, these feelings have fuelled street politics, the rise of national populist movements and an increasing share of voters drawn to the political far right. In countries in other parts of the world, for example Malaysia and the Republic of Korea, high-profile cases of corruption, bribery and the magnitude of IFFs have led to public outrage. In the former, for example, a scandal involving a \$6.5 billion bond offering for 1Malaysia Development Berhad, the country's State-owned fund, has led to investigations of corruption and money-laundering across six countries.<sup>10</sup>

With regard to gender, despite some progress, gender-based discrimination is still prevalent in both developed and developing countries (World Economic Forum, 2020).

<sup>10</sup> See <https://www.reuters.com/article/us-malaysia-politics-1mdb-goldman/malaysia-files-criminal-charges-against-17-goldman-sachs-executives-idUSKCN1UZODI>.



In this regard, the report is aligned with the centrality given to gender equality in the achievement of the Sustainable Development Goals (United Nations Entity for Gender Equality and the Empowerment of Women (UN-Women), 2018). The report also subscribes to Sen's (1999) contention that "nothing, arguably, is as important today, in the political economy of development as an adequate recognition of political, economic and social participation and leadership of women. This is indeed a crucial aspect of 'development as freedom'". The report addresses IFFs and gender issues in two ways. First, it considers women as agents of development and change. Many studies have underlined the low level of representation of women in senior corporate management across countries and industries (Elborgh-Woytek et al., 2013; International Labour Organization, 2019; Crédit Suisse, 2019). As a consequence, there is substantial and growing evidence concerning the business case for gender diversity in senior leadership positions across the public and private sectors (McKinsey Global Institute, 2015). This report subscribes to target 16.7 of "responsive, inclusive, participatory and representative decision-making at all levels" in institutions to turn them into critical enablers of equity. In this regard, chapter 4 investigates the status of gender diversity and inclusion in the management and leadership of key institutions from whose ranks facilitators and regulators of IFFs operate. And second, in chapter 5, the report reviews existing findings on the impact of IFFs on women and considers the implications of injecting finance from curbing or reclaiming IFFs on labour force allocation.

The capabilities framework provided the foundations for the United Nations Human Development Index, leading it to become one of the most authoritative international sources of welfare comparisons between countries (Fukuda-Parr, 2003; Fukuda-Parr and Kumar, 2006). More recently, greater consideration for the role of human capital in poverty alleviation has led to the adoption of a multidimensional measure of poverty in the World Bank report *Poverty and Shared Prosperity 2018* (World Bank, 2018). When considering this measure, which includes consumption, education and access to basic infrastructure, poverty levels are 50 per cent higher than when relying solely on monetary poverty. In sub-Saharan Africa, 28.2 per cent out of a total of 64.3 per cent multidimensionally poor experience shortfalls in consumption levels. Studies have also shown that education is a game changer in the economic history of developed countries (Piketty, 2019).

### ***For the planet: Environmental sustainability and climate change***

Climate change intensifies the occurrence and the manifestation of natural disasters (see, for example, Eckstein et al., 2019) and the climate crisis negatively affects the path towards achieving the Sustainable Development Goals. From Mozambique to countries

in the Caribbean, cyclones and tropical storms have resulted in the loss of life and have crippled economies. Floods destroy agricultural produce. Droughts in the Sahel and Horn of Africa contribute to the rise of the number of hungry on the continent and are a threat to peace and instability in the two regions (World Food Programme, United States of America, 2017). Some sources of IFFs, such as illegal logging, fishing and mineral extraction are closely connected with substantial environmental costs, as well as the impoverishment of individuals and communities that rely on those resources to sustain their existence. In addition, it is estimated that globally, countries forego an estimated \$7 billion to \$12 billion in potential fiscal revenue each year as well as reduced tourism activity (World Bank, 2019). This report attempts to capture some of the implications of IFFs for environmental sustainability and with regard to climate change in Africa (chapter 5). The analysis also confronts the magnitude of IFFs with that of climate finance related to the Paris Agreement under the United Nations Framework Convention on Climate Change (Paris Agreement). The Paris Agreement, signed by 195 countries in December 2015, was a landmark achievement as it set out a framework to combat climate change and set the target of holding temperature increases to “well below 2°C” with efforts to hold the increase to 1.5°C (United Nations Framework Convention on Climate Change (UNFCCC), 2015). In 2009, at the fifteenth Conference of the Parties to the UNFCCC in Copenhagen, developed countries committed to a goal of mobilizing jointly \$100 billion per year by 2020 to support climate change mitigation actions in developing countries. Six years later, this goal remained unfulfilled, and the twenty-first Conference of the Parties extended the goal of mobilizing jointly \$100 billion per year through 2025 (UNFCCC, 2019). The present report investigates the state of climate change-related factors across countries with different exposures to IFFs (chapter 5). It considers institutional and government revenue channels, both key elements in building climate-related resilience. The findings are then used to argue that considering the slow pace of progress in efforts to curb and reclaim IFFs, a bridge should be made between negotiations on IFFs and negotiations on climate finance.

### *For peace: Illicit trade and the financing of conflict*

Challenges to peace and security in Africa are “increasingly complex” (United Nations, Security Council, 2019:4). In this regard, it is difficult to capture the extent to which the flows estimated in chapter 2 originate in illicit activities aimed at conflict or terrorism financing. Similarly, the integration of peace and development perspectives in the analysis of the relationship between IFFs and sustainable development is limited by data constraints. Rather, this report begins with the premise that peace and security are prerequisites for sustainable development, as emphasized in the African Union

theme for 2020, “Silencing the guns”. A 2018 policy brief by the Oslo Peace Centre on conflicts in Africa during 1946–2018 showed that the number of conflict-affected countries on the continent increased from 14 in 2017 to 17 in 2018, the second highest number since 1946. Altogether, the number of battle-related deaths were estimated to be about 15,000 in 2018. Concerns for peace and security and the need to address components of IFFs as part of such efforts are frequently expressed in multilateral gatherings. In September 2019, for example, in its statement following the adoption of General Assembly resolution 71/315 on the implementation of the recommendations contained in the report of the Secretary-General on the causes of conflict in Africa and the promotion of durable peace and sustainable development in Africa, the Group of 77 and China called for taking concrete steps to address the root causes of conflict in Africa. The statement listed among such causes “illicit trade in and proliferation of arms, especially small arms and light weapons, as well as the illicit exploitation, trafficking and trade of high-value natural resources”.<sup>11</sup>

IFFs contribute to the financing of terrorism in Africa. International Criminal Police Organization et al. (2018) states that terrorists and armed insurgents’ activities in Africa are highly suspected to be funded by financial proceeds originating from transnational organized crime activities. These include, but are not limited to, trafficking of humans, drugs, cultural artefacts, stolen motor vehicles and various illicit goods, and illegal poaching. Taken together, the illicit exploitation of natural and environmental resources, including gold, diamonds, oil, charcoal, other minerals, timber and wildlife, and illegal taxation, confiscation and looting, account for 64 per cent of finance linked to security threats and conflicts (International Criminal Police Organization et al., 2018). It is further estimated that of the \$31.5 billion in IFFs generated annually in conflict areas, 96 per cent is used by organized criminal groups, including to fuel violent conflict. *The World Atlas of Illicit Flows* further identifies more than 1,000 routes used for smuggling and illicit flows, including in Africa.

This report’s examination of the specific case of mining (chapter 3) is motivated both by the sector’s prominence as a source of IFFs and by its continued association with conflict situations. As of September 2019, for example, the Security Council report of the United Nations Secretary-General – Strengthening the partnership between the United Nations and the African Union on issues of peace and security in Africa, including on the work of the United Nations Office to the African Union – highlights situations in the Central African Republic, the Democratic Republic of the Congo, Libya, South Sudan and the Sudan, and the Sahel and Horn of Africa (United Nations, Security Council, 2019). Most of these countries or regions are rich in natural resources. In Middle Africa, protracted armed conflict, including activities by non-State armed groups, is associated with significant transborder

<sup>11</sup> See <https://www.g77.org/statement/getstatement.php?id=190910>.

dimensions and terrorism. Transborder dimensions are also critical in the Sahel. In South Sudan, the United Nations Panel of Experts on South Sudan identified lack of oversight in defence spending and the practice of bypassing accountability mechanisms to procure arms before the war through mismanagement of the country's oil resources as playing key roles in enabling the illicit financing of weapons. The experts underlined violation of international human rights law and of international humanitarian law by all parties (United Nations Security Council, 2016). However, although oil, gold and other minerals have a stronger association with conflict financing, other natural resources, such as timber from illegal logging, also play a role in fuelling instability (UNECA, 2015).

### ***For prosperity: Implications of illicit financial flows on inequality, economic growth and structural transformation***

The primary motivation to tackle IFFs also comes from human rights considerations. IFFs are considered violations of human rights (United Nations, General Assembly, 2017). The second motivation comes from the association of IFFs with inequality and the impact this has on growth and poverty reduction. Although not the main determinant of inequality, IFFs add fuel to wealth concentration at the global level. The World Bank, for example, states that IFFs “are a symptom of problems that institutionalize inequality and constrain prosperity... Addressing the causes of illicit financial flows and restricting the illicit movement of capital out of developing countries undoubtedly support economic development and growth” (World Bank, 2016:3).

Tax evasion and aggressive tax avoidance are likely to be among the main channels of the impact of IFFs on inequality. However, available evidence points to a complex web of association between tax and inequality. On one hand, aggressive tax optimization strategies are disproportionately more prevalent among the richest groups and large corporations. In Denmark, Norway and Sweden, for example, tax avoidance represented about 25 per cent of the tax of the top 0.01 per cent of households, whereas it was estimated to affect an average of 2.8 per cent of the taxes of the remainder of the population (Alstadsæter et al., 2018). Additional analysis based on the *Crédit Suisse Global Wealth Databook* and the annual *Forbes* billionaires list also shows that there is increasing wealth concentration. The number of billionaires owning as much wealth as half the world's population fell from 43 in 2017 to 26 in 2018 (Oxfam, 2018). In contrast to these trends, there was a new billionaire every two days over the years 2017 and 2018, yet the wealth of the poorest half of the world's population dropped by 11 per cent during the same period. On the other hand, taxpayers at the top of the wealth or income scale are also those who make the most significant contributions to total income tax in many countries. In the United Kingdom of Great Britain and Northern Ireland, for instance, policy reforms contributed to making the tax system more progressive. As a result, the top 1 per cent earners now contribute a third

of the country's income tax, a reflection of an increase of their share of total income tax payments from 25 to 30 per cent since 2010 (Adam, 2019).

Recently, concerns about high levels of inequality and their effects on poverty reduction have returned to the fore. Research shows that it takes two to three generations in Nordic countries and nine generations in emerging economies for a child born into a poor family to reach the average income (OECD, 2018a). The share of global wealth owned by the world's richest 1 per cent rose from 42.5 per cent in 2008, at the time of the financial crisis, to 50.1 per cent in 2017, a value of \$140 trillion (Crédit Suisse, 2017). The Crédit Suisse report also estimates that the number of millionaires fell after the 2008 crisis but recovered fast and increased to 36 million, three times the 2000 level. Most of these millionaires were in the United States, followed by Europe, and 22 per cent were in emerging economies such as China. In contrast, 70 per cent of the world's working-age population, 3.5 billion adults, accounted for just 2.7 per cent of global wealth. Most of this population are in African countries and India.

In Africa, at the aggregate continental level, inequality indicators have followed a downward decline. However, 10 out of the 19 most unequal countries in the world are in Africa (United Nations Development Programme (UNDP), 2017). Reasons for such high levels of inequality include the highly dualistic economic structure of some countries, such as higher income levels in multinational companies, especially in the extractive sector, a main conduit for IFFs, and where linkages with other sectors of the economy are limited (UNCTAD, 2017). The latest available data show that poverty reduction and distributional issues remain critical in Africa. The causal factors include insufficient levels of economic growth, weak institutions and limited success in channelling growth into poverty reduction due to heavy reliance on extractive industries (World Bank, 2018). Findings from Nkurunziza (2014) also reveal that in the absence of capital flight, income per capita would have been 1.5 per cent higher and the poverty rate nearly 2 percentage points lower than they were at the time of the analysis.

More generally, the worse the distribution of income is, the lower the share of current and additional income that goes to the poor, and therefore the smaller the poverty-reducing effect of growth. High levels of initial income inequality reduce future growth even after controlling for initial levels of GDP and human capital (Birdsall et al., 1995; Knowles, 2001). Analysis of data over the period 1987–1998 also shows that developing countries with rising incomes and improving distributions reduced poverty seven times as fast as growing economies with increasing inequality (Ravallion, 2001). There is also evidence that a highly unequal distribution of human capital, that is, unequal access to health and education, is a major constraint to poverty reduction in Latin America and sub-Saharan Africa (Birdsall et al., 1995; Birdsall and Londono, 1997). This concern is

of great relevance to Africa as the average continental poverty rate stands at 40 per cent and is on the rise in several countries in sub-Saharan Africa, including in fragile and conflict-affected situations (World Bank, 2018). The number of people living in extreme poverty in sub-Saharan Africa, for instance, increased from an estimated 278 million in 1990 to 413 million in 2015. With regard to distributional aspects, in 12 African countries the living standard of the poorest 40 per cent is worsening rather than improving (World Bank, 2018). At this pace, the World Bank 2018 report estimates that extreme poverty in sub-Saharan Africa will still be at double-digit levels in 2030. To reverse this trend, African countries need to realize historically unprecedented and sustained economic growth rates while making sure that such growth is highly inclusive.

In addition to the inequality, growth and poverty reduction channel, IFFs might also impact negatively on many economies subject to rising debt. Indeed, there is empirical evidence of the close connection between IFFs and a rising public debt ratio (Ndikumana, 2003; Beja, 2006; Ndikumana and Boyce, 2011). On one hand, IFFs can lead to flight-driven external borrowing. On the other hand, foreign loans can trigger debt-fuelled capital flight, thereby compounding government indebtedness. These concerns are motivated by the previous occurrence of a debt crisis in the history of many African countries. High levels of poverty and unsustainable debt burdens made these countries eligible for special assistance from IMF and the World Bank and led them to be part of the group of “heavily indebted poor countries” established in 1996.

The present report examines the relationship between IFFs and structural transformation (chapter 5). Structural transformation is broadly defined as the reallocation of economic activity across agriculture, manufacturing and services. More specifically, the drivers of the reallocation of resources towards the non-agricultural sector are increases in agricultural productivity that relax a subsistence food consumption constraint, a reduction in constraints to labour mobility between sectors and increases in capital formation. Structural transformation is generally analysed through the following measures of economic activity at the sectoral level: employment shares and value-added shares on the production side, and final consumption expenditure shares on the consumption side. Stylized facts on structural transformation based on long-term historical series from developed countries show that increases in GDP per capita have been associated with decreases in both the employment share and the nominal value-added share in agriculture and increases in both the employment share and the nominal value-added share in services. Technological factors, policies, regulations and institutional as well as cultural factors that influence labour retention in traditional sectors such as agriculture can act as barriers to labour mobility and slow down the expected shift of labour towards services (Messina, 2006; Hayashi and Prescott, 2008).

However, it should be born in mind that this report's quantitative analysis of IFFs and structural transformation should be considered for illustrative purposes only, rather than definitive. Indeed, IFFs affect the integrity of many key economic indicators. At a recent expert meeting on measurement of IFFs in the context of the UNCTAD–UNODC Task Force, for instance, participants raised concerns about whether GDP and associated economic statistics could still constitute valid indicators of the economic dynamism of the domestic economy if such indicators reflected the international arrangements of MNEs rather than a country's real economy. Furthermore, in a context of high dependency on MNE activities, national accounts are vulnerable to “even minor organizational change by large multinational enterprises”.<sup>12</sup> Similarly, the report discusses the opacity of data across many global value chains due to the dominance of MNEs in global trade in goods and services (chapter 4). This limits any attempt to better collect data to understand productivity shifts across sectors.

This report does not set out to analyse the impact of IFFs on capital accumulation and investment, yet it must be emphasized that IFFs also negatively impact the economy through the domestic investment channel. Past research on the impact of capital flight on domestic investment has found that as of 1990, Africa had incurred an estimated 16 per cent loss in output due to the resulting financial leakages (Collier et al., 2001) and that it lowered the annual rate of productive capital accumulation in sub-Saharan Africa by about 1 per cent (Nkurunziza, 2014).

### ***Estimating the extent of asset recovery and what it could mean for the Sustainable Development Goals at the local level***

This report considers the magnitude of African wealth stored in offshore accounts and the missed opportunities that this generates (chapter 6). However, the report distances itself from perceptions of Africa being a special case in this regard. Indeed, studies on the distribution of the source of offshore wealth find that “offshore wealth is not easily explained by tax, financial or institutional factors” (Alstadsæter et al., 2018). In this regard, official data from the Switzerland National Bank, for example, shows that African countries do not feature in the top 10 of countries that own a greater share of wealth stored in banks in Switzerland than their share of world GDP. The list of countries is heterogeneous and includes countries with highly developed domestic financial industries, as well as countries with poorly developed financial institutions. The most prominent are Saudi Arabia, the United Arab Emirates, Spain, France, Belgium, Argentina, the Bolivarian Republic of Venezuela, Egypt and Jordan (Alstadsæter et al., 2018).

<sup>12</sup> See <https://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=2206>.

The experience of both developed and developing countries shows that reclaiming IFFs is a worthwhile exercise. France, for example, recovered €372 million of taxes and penalties between 2013 and 2019 due to the revelations in the papers leaked from a law firm in Panama. If earmarked, it is estimated that these funds could make it possible to build 24 primary schools of 20 pupils per class, or two large public hospitals, based on rates for a large metropolis in France (France, Assemblée Nationale, 2019). Despite slow progress overall, some African countries have been successful in establishing the ground for capital repatriation. By 2018, the OECD-supported Africa Initiative helped African members to identify more than €90 million in additional tax revenues.<sup>13</sup> Nigeria successfully recovered \$0.5 billion from Swiss banks in 2005 (UNODC and World Bank, 2007).

This report uses data from the UNODC–World Bank StAR and the International Centre for Tax and Development (ICTD) and United Nations University World Institute for Development Economics Research (UNU-WIDER) government revenue database to chart the state of play of government revenue across Africa and how IFFs feature in domestic resource mobilization efforts (chapter 6). The analysis is situated in the context of a growing number of cases of fund repatriation being allocated to development projects. There is increasing interest in showcasing the extent to which the repatriation of funds to Africa could result in major investments on the continent’s journey to economic and social transformation. AfDB, for example, estimates that the annual value of corruption in Africa far exceeds the investment needed to achieve universal electricity access for the continent by 2025, which will range between \$60 billion and \$90 billion per year (AfDB, 2017). With regard to IFFs, corruption is only accounted for if it implies a cross-border transfer of funds. Some cases of fund repatriation underline specific efforts to earmark funds for specific projects. In 2004 and 2012, for example, following criminal investigations into allegations of corruption and money-laundering from Angola, Angola and Switzerland allocated the recovered funds to the establishment of a hospital, infrastructure, water supply and local capacity-building for reintegration of displaced persons. In a similar initiative, the United Kingdom and the United Republic of Tanzania used recovered funds for primary schools in the country, including the financing of teaching materials and school desks in remote rural areas. The present report builds on these insights as well as on earlier studies on the dynamics of socioeconomic indicators and oil policies and regulations in a case study from Nigeria (UNCTAD, 2017; Chérel-Robson, 2017).

<sup>13</sup> See <https://www.oecd.org/tax/transparency/international-community-has-achieved-unprecedented-success-fighting-offshore-tax-evasion.htm>.



## Chapter 1 annex

**Estimates of the cost of illicit financial flows from Africa and worldwide (various years)**

Africa	Cost, billions of dollars
<b>Trade misinvoicing<sup>a</sup></b>	
High-level Panel on Illicit Financial Flows from Africa (UNECA, 2015)	40.2 (2010)
Ndikumana and Boyce (2018)	30 (2015)
Global Financial Integrity (2019)	45 <sup>b</sup> or 131 <sup>c</sup> (2015)
Kar and Cartwright-Smith (2009)	52.9 (2008)
<b>Transfer pricing manipulation</b>	
Lower-end estimates, median: OECD (2015), Janský and Palanský (2018), Tørsløv et al. (2018)	4.8 (2015)
Higher-end estimates, median: Crivelli et al. (2015), Cobham and Janský (2018)	55.4 (2015)
Treaty shopping: Beer and Loeprick (2018), all countries	3.4 (2015)
Personal tax evasion by high net worth individuals: Zucman (2014)	9.6 (2014)
IFFs related to corruption: AfDB (2015)	148 (per annum)
IFFs related to corruption: Yikona et al. (2011), estimates for Malawi	0.44 (over 10 years)
<b>Domestic tax losses (defined as domestic tax gap)</b>	
Yikona et al. (2011), estimates for Malawi	0.42 (2009)
Yikona et al. (2011), estimates for Namibia	0.84 (2009)
<b>Worldwide</b>	
<b>Estimated global annual IFFs</b>	
Cobham and Janský (2018), globally per year	500 (per annum)
Tørsløv et al. (2018), globally per year	200 (per annum)
International tax avoidance: UNCTAD (2014), global estimate	70–120 (per annum)
<b>Transnational organized crime</b>	
May (2017), global estimate of value 11 criminal activities	1 600–2 200 (per annum)
UNODC (2011), global estimate of transnational organized crime activities	650 (per annum)
UNODC (2018), global estimate of migrant trafficking	5.5 - 7.0 (2016)
<b>Estimates of global money-laundering</b>	
Schneider and Buehn (2013)	603 (2006 per annum)
UNODC <sup>d</sup>	800–2 000 (per annum)

Source: UNCTAD compilation of estimates from various publicly available reports and publications.

<sup>a</sup> The main difference between the Global Financial Integrity and Ndikumana and Boyce (2018) methodologies is that the latter authors' methodology allows for the possibility of reverse flows of capital flight and that net import misinvoicing (and net trade misinvoicing overall) can result in a downward adjustment of capital flight estimates (Boyce and Ndikumana, 2012).

<sup>b</sup> Global Financial Integrity (2019) based on United Nations International Trade Statistics Database (United Nations Comtrade) data, reflecting estimates for 2015.

<sup>c</sup> Global Financial Integrity (2019) based on the IMF Direction of Trade Statistics (DOTS), reflecting estimates for 2015. IMF DOTS includes a larger sample of African countries than United Nations Comtrade.

<sup>d</sup> See <https://www.unodc.org/unodc/en/money-laundering/globalization.html>.