



GLOBAL FINANCIAL INTEGRITY

Illicit Financial Flows

Analytical Methodologies Utilized By Global Financial Integrity

Global Financial Integrity (GFI) estimates that nearly US\$1 trillion of unrecorded money shifts out of emerging market and developing countries annually. This is a staggering sum, causing great harm to the economies of nations across the globe.

There are three forms of unrecorded money moving across borders:

- Corrupt: Proceeds of bribery and theft by government officials.
- Criminal: Proceeds of drug trading, human trafficking, counterfeiting, contraband, and myriad forms of additional activities.
- Commercial: Proceeds arising from import and export transactions conducted so as to manipulate customs duties, VAT taxes, income taxes, excise taxes, or other sources of government revenues.

GFI accepts that by far the greater part of money moving across borders in an unrecorded, undetected manner has an illicit component, intentionally violating the letter or the intention of laws and regulations of countries out of which the money comes, through which the money passes, or into which the money arrives. Thus we define illicit money as money that is illegally earned, transferred, or utilized. If it violates laws or regulations in its origin, movement, or use, it merits the label.

In analyzing illicit financial flows (IFFs), GFI utilizes sources of data and analytical methodologies that have been used by international institutions, governments, and economists for decades. Basically, these data sources and methodologies are providing information on gaps—gaps in balance of payments data and gaps in trade data. Where recorded sources and uses of funds in balance of payments data do not match, the difference is net errors and omissions, indicating an inflow or outflow that was not recorded. Where bilateral trade data does not match (after adjusting for freight and insurance in the data of the importing country) this indicates re invoicing of transactions between export from one country and import into another country.

GFI undertakes macroeconomic analyses of IFFs and detailed analyses of trade misinvoicing by commodity groups. For our annual analysis of illicit financial flows out of developing countries—the source of the current US\$1 trillion figure—we consistently use the following:

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IMF	a) Balance of payments data, contributing to the analysis of net errors and omissions.
	b) Direction of Trade Statistics (DOTS), enabling analyses of discrepancies in trade between pairs of reporting countries.

For other economic and trade analyses, we draw from a selection of sources including the following:

World Bank	Providing data on debt, contributing to the analysis of broad capital flight.
UN COMTRADE	Providing data on bilateral trade in commodity groups.
US Dept. of Commerce	Providing data on trade transactions by Harmonized System coding categories.
European Statistics	Providing data on trade transactions by Harmonized System coding categories.

GFI believes that the estimates arising from these data sources and analytical methodologies are very conservative, for several reasons:

- DOTS data records trade in merchandise only. It does not include trade in intangibles, services, licenses, royalties, etc., now estimated to comprise more than 25 percent of all global trade.
- DOTS data reveals only transactions that have been re-invoiced between export and import. It does not reveal transactions where price manipulations have been included in the same invoice exchanged between exporters and importers.
- None of the data sources adequately reveal cash transactions across borders, particularly those used in criminal pursuits.

Some reviewers of GFI's data sources and analytical methodologies have raised questions, which we are pleased to address as follows:

- GFI well recognizes that statistics can be flawed, due to errors in collection, recording, or conveying. Precisely the same point can be made about virtually every other economic analysis ever undertaken. We use the best data available, data that has been collected, reported, and recorded by governments for decades according to international guidelines issued by the IMF. Balance of payments data and global trade data provide the basis on which national governments measure their investment, trade, tax positions, and economic policies and international institutions, bankers, and corporations determine key decisions on capital transfers, interest rates, exchange rates, and more. Quite simply, balance of payments data and trade data are the basis on which the economic and financial worlds work.

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- The reliability and accuracy of trade statistics of developing countries are regularly assessed through the IMF’s Data Quality Assessment Framework under the Data component of the Reports on Standards and Codes. These ratings show that for all developing countries for which the IMF has carried out an assessment of balance of payments statistics (about 72) the quality of these statistics, which includes the main data on goods trade, is “very high” or “high” in accordance with the international guidelines issued by the IMF.
- GFI does not suggest that every single unrecorded transaction is illicit; however, the vast majority of unrecorded transactions are illicit given that, apart from entry errors, there is not often a reason why legitimate transactions should go unseen.
- GFI does not net illicit outflows and illicit inflows. In countries where unrecorded outflows and unrecorded inflows roughly balance, it would be a mistake to consider that such a country has no problem with unrecorded flows. There is no such concept as “net crime.” Indeed, in GFI’s view, illicit outflows and illicit inflows should be added, since both sides of the equation generally produce harm to the economies of the countries so affected.
- GFI does not suggest that illicit outflows and tax evasion are the same thing. If, for example, US\$100 million of illicit outflows from a country is evident, does this mean that if that US\$100 million stayed in the country that the total would accrue as tax revenues? No. If the US\$100 million stayed in the country, a portion of it would accrue as tax revenues, perhaps 10 to 30 percent, and most of the rest would remain in the economy for investment, consumption, or savings. Indeed, the private component of these flows is more important to the economy than the tax evading component of these flows.
- GFI makes no estimate as to how much of IFFs arising from trade misinvoicing are attributable to multinational corporations or locally owned businesses. None of our data sources reveal such information.

There has been a serious flaw in development economics for a half century—studying only one side of the financial equation for development – the money going into developing countries – while almost completely ignoring the other side of the financial equation for development – the money coming out of developing countries. GFI very firmly believes that both sides of the development equation must be analyzed. This requires that we work with orders of magnitude. While there is no perfection in the data that we utilize, the data and the methodologies have been very solidly established for decades and very clearly point to a major problem that must be addressed in development economics—*the vital need to focus on both sides of the financial equation for development.*

GFI welcomes carefully considered contributions to our ongoing efforts to improve sources of data and analytical methodologies on the crucial issue of illicit financial flows impacting emerging market and developing economies.

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