Executive Summary

This report, the latest in a series by Global Financial Integrity (GFI), provides a comparison of illicit financial flows from some of the world's poorest nations and compares those values to some traditional indicators of development including: GDP, total trade, Official Development Assistance plus foreign direct investment, public expenditures on education and health services, and total tax revenue, among others. The data used covers the period 2008–2012.

The study finds that, for close to one-quarter of the 82 countries studied, the **ratio of IFFs to GDP [see p. 6] is 10 percent or greater—for example, Honduras (21.7 percent), Zambia (18.1 percent), and Ethiopia (11.2 percent).** It would not be overstating the point to note that, if any other economic factor had such a double-digit impact on GDP, it would be front-page news. Unfortunately, this is often not the case when illicit flows are concerned.

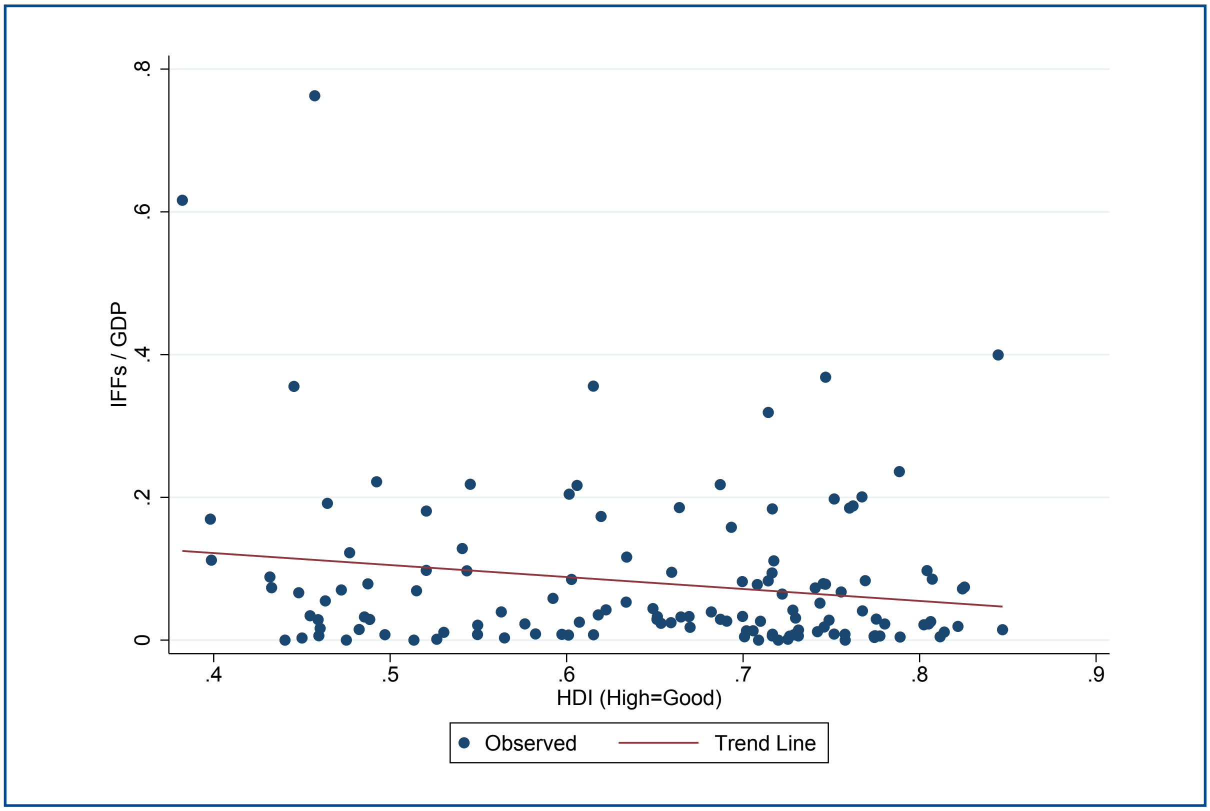
Additionally, we find that 40 percent of the countries examined had **illicit flows that were at least 10 percent of the country's total trade value [see pp. 30-33].** These include the notable cases of **Nicaragua (28.9 percent), Malawi (24.6 percent) and Nigeria (16.3 percent) [see p. 7].** This finding may be a reflection of the fact that, over the last 10 years, approximately 80 percent of all illicit outflows use trade misinvoicing (i.e. trade fraud) as the method to move funds offshore.

Most tellingly, we find that 20 of the nations analyzed had **illicit flows amounting to more than the combined total of Official Development Assistance (i.e. foreign aid) and foreign direct investment [see p. 10].** These include **Indonesia (184.5 percent), Chad (151.8 percent), and Cote d'Ivoire (109.9 percent).** There can be no clearer indication that a nation is suffering the ill-effects of a severe countervailing economic force than when two of the largest sources of foreign funds are swamped by illicit outflows. Similarly, the ratio of IFFs to a country's tax base demonstrates the opportunity cost of this phenomenon. While illicit capital outflows are not themselves directly analogous to lost government revenue, it is startling to note that **Liberia's levels of IFFs are 257.4 percent of its total tax revenue; in Nepal, it is 56.9 percent; and in Burkina Faso, it is 42.9 percent [see p. 13].**

Domestic spending on fundamental social needs, such as education and health, are often overwhelmed by the amount of illicit money flowing out of the economy, and, with it, domestic resources that could be mobilized to address basic human needs. Forty percent of the 82 countries had illicit outflows that exceeded spending on education. A similar percentage had IFFs that surpassed health expenditures. **In Paraguay, IFFs were equal to 361.0 percent of education spending during the period, and in Rwanda they were 147.1 percent [see p. 11]. In the Republic of Congo, illicit flows were almost five times (483.5 percent) what the government spent on the country's health system; in Malawi it was 200.1 percent [see p. 12].**

Our study also produces several **scatter plots** in which we compare illicit flows values for all developing and emerging market nations to key trade indicators [see pp. 15-18] and various development indices, such as human development, inequality, and poverty [see pp. 18-22], to determine if correlations exist between the two. Among our findings, we reveal **that there is a robust relationship between high tariff rates and high levels of IFFs [see p. 16].** One reason for this may be that high tariffs could spur importers and exporters to resort to trade fraud to avoid the tariff. **There is also a strong link between the efficiency of a country's customs department and the volume of its illicit outflows [see p. 17].** This may indicate that higher levels of performance (i.e. better enforcement of trade rules) will quell the urge to misinvoice trade.

Chart X1. Illicit Financial Outflows and the Human Development Index[a]



In the area of human development, there is an inverse relationship between IFFs and a country's ranking on the UN's annual Human Development Index [see Chart X1 or p. 18]. **When illicit flows are high, a country's development score tends to be low.** This negative relationship might be caused by a significant loss of domestic resources (i.e. tax that could have been collected by the government, or capital that could have been retained by the economy) if trade misinvoicing had not taken place. Last, there appears to be **a strong connection between high levels of IFFs and the poverty gap.** A plotting of illicit outflows against the number of people living on US$1.25 per day

a. "Human Development Reports," [Online Database], *United Nations Development Programme*, (n.d.), http://hdr.undp.org/en.

[see p. 21] and those living on US$2 per day [see p. 22] shows that, when IFFs are high, poverty rates are high at both poverty levels.

That illicit flows have an adverse impact on developing country economies is no longer a secret. Most international institutions focused on development have said as much.[b] The value of **this study** is that it **goes beyond "the big number"** of cumulative global illicit outflows and focuses instead on the impact of IFFs in the poorest of places. We find that, in many countries, the factors that are usually associated with budding economies—such as trade, foreign investment and development assistance, and tax revenue—are often times undermined by illicit flows. Concerted action is needed by the international community to assist not only nations that have high dollar levels of illicit flows, but also to help those countries that that have such huge percentages of their economic foundation eroded by IFFs.

As such, GFI recommends that world leaders focus on addressing trade misinvoicing, which accounts for the vast majority of measurable illicit outflows, as well as on curbing the opacity in the global financial system—comprising, among other things, tax haven secrecy, anonymous companies, and money laundering techniques—which facilitates these outflows. Specifically, GFI maintains that [see pp. 23-25]:

- The United Nations should adopt a clear and concise Sustainable Development Goal (SDG) to halve trade-related illicit financial flows by 2030 and similar language should be included in the outcome document of the Financing for Development Conference in July 2015;
- Governments—with assistance, as needed, from donors—should significantly boost their customs enforcement by equipping and training officers to better detect intentional misinvoicing of trade transactions;
- Trade transactions involving tax haven jurisdictions should be treated with the highest level of scrutiny by customs, tax, and law enforcement officials;
- Governments should establish public registries of meaningful beneficial ownership information on all legal entities;
- Financial regulators should require that all banks in their country know the true beneficial owner(s) of any account opened in their financial institution;
- Government authorities should adopt and fully implement all of the Financial Action Task Force's (FATF) anti-money laundering recommendations;
- Regulators and law enforcement authorities should ensure that all of the anti-money laundering regulations, which are already on the books, are strongly enforced;

b. The World Bank Group, Financing for Development: Post 2015 (Washington, DC: The World Bank, October 2013), http://www.worldbank.org/content/dam/Worldbank/document/Poverty%20documents/WB-PREM%20financing-for-development-pub-10-11-13web.pdf; UNTT Working Group on Sustainable Development Financing, *The Variety of National, Regional and International Public Sources for Development Finance* (New York: United Nations, October 2013), https://sustainabledevelopment.un.org/content/documents/2101Chapter%202-variety%20of%20public%20sources%20for%20development%20finance.pdf.

- Policymakers should require multinational companies to publicly disclose their revenues, profits, losses, sales, taxes paid, subsidiaries, and staff levels on a country-by-country basis; and
- All countries should actively participate in the worldwide movement towards the automatic exchange of tax information as endorsed by the OECD and the G20.