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# List of abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>AML</td>
<td>anti-money laundering</td>
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<tr>
<td>AML/CFT</td>
<td>anti-money laundering/combatting the financing of terrorism</td>
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<td>BEPS</td>
<td>base erosion and profit shifting</td>
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<td>CDD</td>
<td>consumer due diligence</td>
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<td>CSO</td>
<td>civil society organisation</td>
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<td>DNFBP</td>
<td>Designated Non-Financial Business Profession</td>
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<td>EDD</td>
<td>enhanced due diligence</td>
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<td>ESAAMLG</td>
<td>Eastern and Southern Africa Anti-Money Laundering Group</td>
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<td>FATF</td>
<td>Financial Action Task Force</td>
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<td>FDI</td>
<td>foreign direct investment</td>
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<td>FIA</td>
<td>financial intelligence authority</td>
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<td>FIC</td>
<td>financial intelligence centre</td>
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<td>FIU</td>
<td>financial intelligence unit</td>
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<td>FSDA</td>
<td>Financial Sector Deepening Africa</td>
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<td>FSP</td>
<td>financial service provider</td>
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<td>TF</td>
<td>terrorist financing</td>
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<td>GDP</td>
<td>gross domestic product</td>
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<td>GFI</td>
<td>Global Financial Integrity</td>
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<td>GIABA</td>
<td>The Inter-Governmental Action Group against Money Laundering in West Africa</td>
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<td>HDI</td>
<td>Human Development Index</td>
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<td>IFF</td>
<td>illicit financial flow</td>
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<td>MER</td>
<td>mutual evaluation report</td>
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<td>ML</td>
<td>money laundering</td>
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<td>MNC</td>
<td>multinational corporation</td>
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<td>ODA</td>
<td>official development assistance</td>
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<td>PEP</td>
<td>politically exposed person</td>
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<tr>
<td>SDG</td>
<td>Sustainable Development Goal</td>
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<td>UNECA</td>
<td>United Nations Economic Commission for Africa</td>
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Illicit financial flows (IFFs) are most commonly understood as financial flows that involve capital that is illegal in nature, either by the way it is earned, how the transfer happens or what the money is used for. Although definitions vary and there is an ongoing debate on the most appropriate definition, IFFs are widely understood to have a negative impact on countries, as they drain them of resources that could have been utilised by governments for social spending and other important functions. However, IFFs remain an enigma for policymakers from both developing countries and developed countries alike. This is mostly due to their illegal nature, which makes them difficult to track and address. Thus, the nature, scope, impact and solution to this problem are yet to fully unravel.

IFFs are of particular interest and concern to Africa due to its high opportunity cost in terms of growth and development. The availability of capital is critical for the private and public sectors to seize economic opportunities in a country. This is more so for sub-Saharan Africa (SSA), which is one of the most capital-scarce regions in the world. The importance of addressing IFFs for development is recognised in the Sustainable Development Goals (SDGs) as a key target under SDG16. Addressing IFFs is also key in achieving and attaining other SDGs. It is therefore important as an international development agenda item.

To date, the work of the High-Level Panel on Illicit Financial Flows of the United Nations Economic Commission for Africa (UNECA), Global Financial Integrity (GFI), as well as civil society organisations (CSOs) such as Action Aid, Tax Justice Network and Oxfam, has pioneered the general understanding and magnitude of this phenomenon. In general, efforts to enhance the understanding of IFFs have depended on the particular interest and focus of the institutions that are looking at IFFs. This has led to a disparate and fragmented debate.

- **Understanding the key drivers, channels and components of IFFs.** This work has focused on understanding the mechanisms through which IFFs arise. UNECA, Ndikumana and the above CSOs have been prominent in this area. Research questions typically look to understand which sectors IFFs emanate from, which legal environments enable them and which geographic locations are more prone to IFFs.

- **Estimating the value being lost through IFFs.** This work has focused on quantifying IFFs. Some, such as Global Financial Integrity, have focused on gaining a macroeconomic perspective of the size of IFFs by providing regional and world estimates, while others have focused on understanding the scale of IFFs at more granular levels. For example, a recent study by UNCTAD (2016) looked at the extent of IFFs within particular industries in a few African countries.

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1 This will be explored in more detail in subsequent sections.
Efforts to combat IFFs. A number of global and cross-country initiatives have been initiated to combat IFFs. However, most of these do not directly focus on IFFs but rather on elements of IFFs, such as money laundering and tax evasion. For example, the Tax Inspectors Without Borders initiative, spearheaded by OECD and UNDP, is aimed at helping developing countries improve their tax and audit capacities. An overview of some of the major initiatives can be found in Annexure 1.

While the above and related works have explored the link between IFFs, growth and development, the link between IFFs and financial integrity remains underexplored. Financial integrity is typically only understood in the context of money laundering and terror financing. However, as we argue in more detail in Section 5, IFFs significantly compromise financial integrity. To date, efforts of the Financial Action Task Force (FATF) have focused mostly on money laundering (ML) and terrorist financing (TF) standards as a way of promoting financial integrity. While such efforts are commendable, much more needs to be done to locate financial integrity within the broader IFF challenge.

Financial integrity is typically only understood in the context of money laundering and terror financing. However, as we argue in more detail in Section 5, IFFs significantly compromise financial integrity. To date, efforts of the Financial Action Task Force (FATF) have focused mostly on money laundering (ML) and terrorist financing (TF) standards as a way of promoting financial integrity.
Although they have been defined differently according to different institutions, illicit financial flows (IFFs) are generally understood to refer to illegal financial flows between countries which negatively affect the socio-economic development outcomes of those countries. These can refer to illegal outflows (illegal movement of funds out of a country) or illegal inflows (the illegal movement of funds into a country). This section outlines the major means through which IFFs are detrimental.

**IFFs reducing public resources.** The most fundamental impact of IFFs is the fact that they deprive governments of tax revenue. The loss of resources through IFF significantly affects the public sector’s ability to extract revenue from the tax base (UNECA, 2016). This affects the ability of the public sector to fund its debts and pay for social spending programmes. With fewer resources, governments are forced to cut spending in certain areas. This may lead to reduced spending on important societal needs, such as human capital, infrastructure development, and key public services like health and security. Furthermore, the erosion of tax bases (which are generally already quite small) may force the public sector to tax those inside the tax net even heavier (Ajayi, 2014).

**IFFs destabilising the monetary sector.** Through IFFs, specifically trade mispricing and transfer pricing, corporations can move funds in and out of an economic jurisdiction without the central bank receiving the benefit of increased foreign reserves. This has a direct bearing on the stock of available foreign reserves to address the above. As such, it increases a country’s financial liquidity risk, and it impedes the economy’s ability to compete in the international market and to seize the opportunities for economic development (Nicolaou-Manias, 2015).

**IFFs weakening governance, making institutions susceptible to more IFFs.** In a globalised economy, corporations take advantage of economies that have weak and inconsistent regulatory capacity, especially where corruption is present, as it is easier to avoid tax controls and environmental standards in such economies. Weak governance therefore presents an opportunity for IFFs. However, as noted by Reed and Fontana (2011), the relationship between illicit flows and corruption is symbiotic. That is, illicit flows perpetrators corrupt officials or, at the very least, present significant opportunities for corruption. As such, corruption and illicit flows do not only co-occur, but they tend to cause each other to increase. The weakening of governance through corruption and IFFs has an extended negative impact on developmental outcomes.

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2 Transfer pricing and trade mispricing are elements of IFFs that are described in more detail in the following section.
IFFs increasing the relative returns of rent-seeking economic activities. The ability of firms or entrepreneurs to avoid paying taxes or enrich themselves by transferring income illicitly to a different jurisdiction necessarily alters the relative returns of some economic opportunities versus others. Economic activities in which it is easier to evade tax and transfer money illicitly will be relatively more attractive than those in which it is harder. Furthermore, economic opportunities in which it is relatively easier to transfer money illicitly reside in the less productive extractive industries. The implication is that IFFs skew incentives towards the shorter-term, lower productive sectors, which allow economic agents to extract rents.

IFFs correlated with criminal activity. The above applies to criminal industries as well, which are linked to IFFs. The transnational crime sector relies on the ability to move money in and out of countries illicitly to fund activity and launder profits. Therefore, illegal economic activity such as illegal mining, forestry, narcotics and wildlife trafficking industries are correlated with IFFs. In Colombia for example, the drug trade is highly dependent on the ability to illicitly move money into the country for the sale of drugs and to fund operational activity (Reuter, 2012). Criminal industries such as the illicit narcotics trade have been shown to have a negative impact on long-term economic development (Villa et al., 2016). The link between IFFs and these types of economic activity affects the long-term development and stability of countries.

Stealing the fruit of growth. The existence of extensive illicit flows in economies therefore negatively affects economic incentives, reinforces corruption, and limits state resources to address development concerns. This all has the effect of destabilising societies and creating unsustainable growth paths. An economy with high GDP growth rates but high levels of illicit flows may not be developing as expected because many of its resources are transferred illicitly offshore. As a result, there is little reinvestment into the economy and the people of the society. It is therefore vital to tackle illicit flows so that countries be able to achieve sustainable development pathways and that governments be able to extract adequate tax revenue to support this development.

Economic activities in which it is easier to evade tax and transfer money illicitly will be relatively more attractive than those in which it is harder. Furthermore, economic opportunities in which it is relatively easier to transfer money illicitly reside in the less productive extractive industries.
Defining illicit flows

The purpose of this section is to outline the major definitions of illicit financial flows (IFFs) and their implications on our understanding of illicit flows. The definition of IFFs has largely been constrained or influenced by what can be measured as well as the particular focus of the defining organisation.

Defining IFFs from a legality perspective. IFFs are most commonly understood as illegal flows of money across borders. For example, Global Financial Integrity (GFI) defines flows as illicit if the funds that are crossing borders are “illegally earned, transferred or utilised”. If the flow breaks a law at any point, it is illicit (Global Financial Integrity, 2017). The UNECA High-Level Panel on Illicit Flows, headed by Thabo Mbeki, used this definition in its work that positioned illicit flows as a key issue that requires attention of African and global policy-makers at both the African Union and United Nations levels. The World Bank (2017), Nicolaou-Manias & Wu (2016) of Global Economic Governance Africa (GEG) use a similar definition. These definitions focus on the legality/illegality aspect of flows in determining whether they are illicit.

Expanding the legal definition. In an attempt to recognise the full scale of IFFs while staying within the legal realm, others such as UNCTAD (2014) and Cobham (2015) have broadened the legal definition to include tax avoidance and other legally ambiguous activities such as Base Erosion Profit Shifting (BEPS). The definition therefore includes illegal flows as well as flows that are legal but contravene with the spirit of the law. These flows may only be legal because they have not yet been tried in court or because the legal frameworks for prosecution within affected jurisdictions are underdeveloped. This definition recognises that the problem of IFFs cannot adequately be captured by restricting to what is explicitly illegal, because corporations are able to manipulate countries with weak regulatory capacity to exploit loopholes in legal systems.

Defining IFFs from an impact perspective. Other perspectives address the issue from a different angle. Blackenberg & Khan (2012) define an illicit flow as a “flow that has a negative impact on an economy if all direct and indirect effects in the context of the specific political economy of the society are taken into account”. As such, a flow that is legal but that has a damaging effect on the development of the country is termed illicit. This includes consideration of direct and indirect negative impacts. For example, IFFs may directly

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3 BEPS refers to the process whereby multi-national companies utilise highly trained lawyers to strategically exploit tax “loopholes” and legally shift profits to avoid tax in host jurisdictions.
lead to lowered government revenue, but they may also indirectly lead to reduced political stability. Moreover, flows that are illegal but benign in nature would not be defined as illicit. For example, remitting money through an illegal system would not be defined as illicit because it serves a positive socio-economic service. This definition therefore focuses on the outcomes of the flows rather than their legality.

The scope and focus of definitions differ. In light of the above, it is useful to distinguish between “broad” and “narrow” definitions of IFFs. Under narrow definitions, only explicitly illegal flows are regarded as illicit, while broad definitions may expand to cover legally ambiguous flows or may view illicit flows from an impact perspective in an effort to cover IFFs more comprehensively. The problem with narrow definitions is that they restrict focus to what is legal, thus ignoring other elements of IFFs that do need attention if the problem is to be addressed holistically. However, under broad definitions, what is termed illicit could vary depending on the defining organisation’s view on what constitutes “within the spirit of the law” or whether or not a flow had a damaging effect on economic development. Moreover, it is more difficult to measure and illustrate scale under the broad definitions. There are also slight differences between the various narrow and broad definitions respectively. For example, when defining IFFs, GFI describes the movement of “financial” flows, whereas OECD describes the movement of “capital” (Forstater, 2018).

Important to consider all types of illicit flows. While it is not easy to financially track and quantify non-monetary illicit flows, these types of flows are becoming much more common. Examples include commodity smuggling, wildlife smuggling and human trafficking. Although most of this ends up being converted into some financial form through the sale of the commodities, much of the value of these resources do not end up re-entering the formal financial system. Moreover, it is important to understand that commodity smuggling forms a major part of the illicit flows “value-chain” and therefore should be incorporated formally as part of the definition. Understanding commodity smuggling as part of IFFs highlights the need to track and monitor this to gain further insights into the scale and nature of IFFs.

Considering the above, we adopt a broad definition and a narrow definition. The broad definition of illicit financial flows is as follows:

“Capital, financial and resource flows that are earned, transferred, intermediated and/or used illegally or where illegality is questioned subject to the interpretation of legislation and development of case law”

A holistic definition of IFFs. This definition is a broad legal definition. We do not opt for an impact-based definition, nor do we recognise flows as “illicit” if they contravene the spirit of the law, because these introduce ambiguity and subjectivity around what is termed as illicit. However, we expand the legal definition to include flows where legality or illegality have yet to be tested or where there is unclear or insufficient legislation that prohibits certain defined activities. The definition therefore recognises the inadequacy of the binary nature of illegality/legality in some jurisdictions. The definition also recognises capital and resource flows in addition to financial flows, thus capturing the movement of resources such as gold and drugs, as well as the movement of financial capital and physical capital. It also explicitly recognises the intermediation of funds, because the role of intermediaries in facilitating IFFs is important and should be highlighted. Under the narrow definition, we define IFFs in line with GFI’s definition:

“Capital, financial and resource flows that are earned, transferred, intermediated and/or used illegally.”

This definition restricts application to only those flows that are explicitly illegal and that are the proceeds of crime of defined predicate offences.

Adopting the narrow definition because it is more measurable and actionable. We adopt the narrow definition going forward, because it is difficult to measure IFFs under the broad definition, and differences in interpretation of the definition could lead to reduced effectiveness of initiatives aimed at reducing IFFs. Moreover, given that it is in the interest of multinational enterprises to shift profits, a definition based on unclear legislation may not be able to effectively shift behaviour.
Box 1: High-level breakdown of the components of illicit flows

a) Monetised flows

• **Transfer mispricing and trade mispricing**
  Transfer mispricing occurs when related entities from the same Multinational Corporation (MNC) do business and trade with one another at prices that are way below or above market prices (or prices that could not have been obtained, had the transaction taken place via the market). This leads to the evasion of tax and other related levies due to government, as well as the unlawful transfer of value or facilitation of unlawful enterprises. Trade mispricing is similar to transfer pricing, but it involves entities that are not part of the same corporation. It essentially involves the distortion of transactions to avoid and secretly move money into countries illegally. Kar and Freitas (2012) estimate that trade and transfer mispricing are responsible for some 80% of IFFs. Nicolaou-Manias & Wu (2016) suggest that policy implementations, such as real-time online pricing tools and improved vetting controls, can be effective at curtailing transfer and trade mispricing.

• **Money laundering**
  Money laundering is the process of legitimising the proceeds of illegally generated money by facilitating its incorporation into the formal financial system. Examples of illegally obtained money include: proceeds from the sale of drugs and endangered wildlife, cash obtained from robbery and other related activities (such as car-jacking and bribes), or the money generated from any illegal activity. Money laundering forms an important part of illicit financial flows, as the laundered money generally exits the country in which the activity is taking place. Indeed, money laundering and transfer mispricing are linked, because the latter is often used to facilitate the proceeds of money laundering or to conduct illegal activity at its origin. Money laundering also includes “trade-based money laundering”. This refers to the use of the global trade system in order to facilitate integration of illegally earned money into the formal financial system. It is not necessarily the same thing as trade mispricing but is normally the result of trade mispricing.

• **Corruption**
  Corruption is a major medium through which IFFs are facilitated. Corrupt officials accept bribes from corporations and ignore suspicious activity, thus opening the channels through which the system can operate.

• **Financing of terrorism**
  Ultimately, the proceeds of corruption, money laundering and their facilitation through international transfer results in the financing of illegal activities, including terrorism. This is especially important for illicit financial inflows, which are often used to fund war criminals, civil insurrections, coups d’état, civil war drug trades and terrorist groups.

b) Non-monetised flows

In some cases, illicit flows take the form of physically moving or smuggling resources from one jurisdiction to the other. Although these flows may remain non-monetised (including from country of exit as well as across the value chain), in most cases they ultimately get converted into cash at some point.

• **Commodity smuggling**
  The smuggling of commodities is a major source of IFFs. The illegal trade of commodities (such as gold, diamonds and other resources) represent a major challenge for African countries in particular and are identified in the Mutual Evaluation Reports as one of the major sources of illicit flows in Uganda and Zimbabwe (2016). In addition, the smuggling of banned or illicit commodities (such as drugs, alcohol and other legal or illegal substances) constitutes the outflow of resources from one country to another and ultimately contributes towards IFFs.

• **Human trafficking**
  Human trafficking/smuggling is also identified as a major source of illicit flows in Africa. Money crosses borders in exchange for humans who are destined for exploitative activities such as sexual and other forms of slavery. Moreover, movement of humans deprives human capital in the source jurisdiction. These activities generate IFFs and are also a challenge due to the nature of this transnational crime.

• **Patent arbitrage**
  The illegal outflow of new technologies and patents to economies that have better regulatory systems and would earn greater return constitutes flows out of developing countries. This presents a major challenge, as new ideas and IPs would otherwise contribute towards development in the source country.
To understand the propensity and nature of illicit financial flows (IFFs), it is important to have an idea of the scale of the problem. However, given that IFFs are illegal, they are by their nature difficult to measure. Despite this, some efforts have been made to measure IFFs by various organisations and academics. The purpose of this section is twofold. Firstly, it explores the various methodologies available for quantifying IFFs and analyses the extent to which these are appropriate. Secondly, an appropriate methodology is then employed to indicate the risk of illicit flows in SSA.

4.1. Data and methodology

Due to the difficulty associated with measuring IFFs as discussed above, methodologies are unable to measure the full extent of IFFs. Rather, they can measure certain elements of the IFFs, such as trade mispricing or transfer pricing. There are two main methodologies for estimating IFFs. The first is a methodology that attempts to quantify trade mispricing by analysing trade data. The second attempts to quantify the illegal flow of financial capital by analysing country balance of payments (BOP) data.

4.1.1. Overview of methodologies for estimating IFFs

Attempts to quantify IFFs most commonly involving the analysis of global trade data. The analysis of trade data has the potential to reveal insights into the possible extent of trade mispricing through two primary mechanisms:

• Transactional data

Transactional trade data is non-publicly available data collected by Customs during the import and export process. It contains explicit details of the nature of the trade, including country of origin or destination, value of goods, quantity of goods, trading codes, and information on the exporter or importer. By analysing this data, researchers can assess the extent to which a trade deal might be mispriced, by analysing the extent to which the traded price reflects (or deviates from) normal market prices. For example, if a shipment of gold worth USD500 was priced at USD5,000, then the price of the trade was manipulated to create an illicit flow of USD4,500. Because Customs data is relatively granular and sophisticated, it is reliable in identifying price discrepancies (Financial Transparency Coalition, 2015). However, the fact that the data is not publicly available makes it difficult to obtain. This type of analysis is also time-consuming and therefore more appropriate for country case studies.

“...

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...”

4 By using publicly available free market values for goods, it is possible to estimate the normal market price of those goods. Large deviations from these prices can be deemed as trade mispricing or transfer pricing.
Another method of assessing trade mispricing is to use publicly available aggregated data that is bilaterally reported. Examples of this include the Comtrade database and the IMF Direction of Trade Statistics (DOTS). Comtrade data is aggregated by year, country and commodity, whereas DOTS is aggregated by year and country. In this case, trade mispricing can be quantified by assessing discrepancies in reported trade between two partner countries or between one country and the rest of the world. For example, if a country reports exporting USD10 million worth of goods to other countries, but those countries report importing collectively USD5 million worth of goods from the exporting country, there has been an illicit flow of USD5 million. Bilaterally reported trade is advantageous over transactional data, because it contains information from each trading partner and can thus identify the extent to which the trade was mispriced without relying on estimates of what constitutes a normal market price. The problem with aggregated databases is that they are aggregated over time and therefore may not reveal specific instances of large-scale pricing manipulation, but rather multiple small instances of price discrepancies that could be explained by other factors (Forstater, 2018).

There are a number of additional concerns with the above methodologies as holistic measurements of IFFs. These have been identified by GFI (2017), Nitsch (2016), Forstater (2018) and others.

Not measuring the full extent of IFFs. Such methodologies can only measure the extent of trade mispricing and should therefore not be interpreted as measurements of the full extent of illicit flows. Other flows such as smuggling and cash-based criminal activity would not be revealed in this analysis. Moreover, the extent of trade mispricing is not completely revealed, because many trades are mispriced at both the import and export country. These trades do not leave a discrepancy in bilateral trade statistics and appear legitimate despite being mispriced.

Discrepancies in trade data possibly reflecting statistical errors, not illicit flows. Indeed, the above analysis is an indirect measurement of IFFs, because it is based on the key assumption that discrepancies in trade data are instances of IFFs. In reality, these discrepancies could be explained by reporting errors. However, as noted by GFI and Ndikumana, it is unlikely that large, consistent discrepancies in trade data can be explained entirely by errors in reporting. Moreover, large inconsistencies and errors in reporting of statistics and methodologies for reporting do raise questions regarding the legitimacy of trades and the risk of IFFs. There are clear reporting standards provided by IMF to guide countries.

Global trading hubs making legitimate trade seem illicit. It is also possible that trade hubs, such as those in Singapore and Rotterdam, could create discrepancies in bilateral trade data despite representing legitimate, non-illicit trade. This happens because goods often pass through major ports on their shipping route and get classified as completed trades during the process despite not yet arriving at their final destination. For example, if South Africa exports gold to China, but the gold passes through Singapore before going to China, the trade statistics may show that China imported gold from Singapore, not South Africa. As such, South Africa’s recorded export of gold to China will not be corroborated by an import of South African gold in China’s reports. This would appear as a trade gap in the databases, thus overestimating the extent of IFFs.

Explaining differences in trade values by differences in reporting formats. There is also the problem of insurance and other transport costs having an impact on the data. This is because some trade data is reported inclusive of the cost of insurance, known as “cost, insurance and freight” or CIF, whereas other trade data is reported “free on board” or FOB (in other words: excluding insurance costs). As such, export and import data reported in different formats will not match (GFI, 2017). Although most methodologies employ corrections to the data to account for this, they are not always completely accurate, because different
commodities often have different freight costs, thus leading to perceived illicit flows that could be explained by differences in shipping costs.

**Using balance-of-payments data to analyse illicit flows.** The other major method for calculating IFFs is to analyse BOPS data to calculate finance-based IFFs. There are two ways in which this is generally done:

- **World Bank Residual Model**
  The World Bank Residual (WBR) model calculates IFFs by analysing a country’s recorded use of funds against the amount that actually flows into the country. That is: the increase in foreign debt and Foreign Direct Investment (FDI) should equal funding of the current account deficit plus additions to foreign reserves. If use of funds differs from source of funds, this indicates illicit flows. A criticism of this model is that it is not necessarily appropriate for measuring illicit flows, as much of what it captures is deemed to be “licit” capital flows (Kar and Freitas, 2012).

- **The Hot Money Narrow (HMN) method**
  The HMN method is a scaled-down version of the WBR model. Instead of analysing the difference between the source and use of funds, this method analyses the Net Errors and Omissions (NEO) line on a country’s balance of payments, and it attributes this to IFFs. According to Kar and Freitas (2012), this is a conservative balance of payments methodology for estimating IFFs which only captures illicit flows and does not include licit capital flight. However, a drawback is that some illicit flows captured in the WBR model may also be excluded from this analysis.

**Statistical errors not equaling illicit flows.** These methodologies also suffer from the problem that discrepancies may be as a result of statistical reporting errors rather than actual IFFs. As such, similar to trade-based methods, BOPS methods are affected by the degree to which statistics are reported accurately.

**Using the data as an indication of risk.** Due to the concerns raised above, we argue that the current methodologies for quantifying IFFs are not necessarily appropriate to be used as precise measures of the quantum of IFFs, because they are prone to under and over-estimation errors. However, we note that large, consistent discrepancies in trade and BOPS cannot reasonably be explained by reporting errors and other misnomers. Moreover, these methodologies are conservative because they only attempt to quantify small portions of illicit flows. They exclude things such as trade of services, bulk cash trades and same-invoice faking, which are likely to be more significant channels of IFFs (Nicolaou-Manias & Wu, 2016). Much like GDP, this data has limitations but is robust as indicators of macro-economic trends. As such, although the current methodologies are not appropriate for measuring the precise quantity of IFFs, they are appropriate and robust as indicators of magnitude. They can therefore be used to understand the risk of IFFs in countries and regions. Ideally, they could be used as a sub-indicator alongside other qualitative factors to form a comprehensive risk indicator for IFFs.

**Developing a comprehensive risk indicator.** In a forthcoming note, we are developing a comprehensive risk indicator and applying it in specific case study countries. This indicator would include quantitative and qualitative factors. Some of the qualitative factors that would be included are presented below:

- Validity and accessibility of local data
- Extent to which government departments understand and view IFFs as part of their mandate
- Extent to which government departments can work together, share resource and share information
- Record-keeping ability
- Capacity to detect IFFs
- Capacity of legal system to prosecute IFF offences
4.1.2. Overview of methodology employed for this study

Having weighed the factors discussed above, on balance we have opted to utilise GFI’s analysis of IFFs in its latest report “Illicit Financial Flows from the Developing World: 2005–2014”. GFI employs a mixed-method approach whereby an analysis of trade-based IFFs using the IMF DOTS data is added to an analysis of finance-based IFFs from BOPS data. An overview of this method is provided below, but a more detailed description of GFI’s method can be found in their latest report indicated above.

GFI includes a low and high estimate of illicit flows, with the low estimate being more conservative than the high estimate. The difference between the low and high estimate is that, for its trade mispricing estimate, the low estimate only quantifies IFFs between developing countries and developed countries, whereas the high estimate quantifies IFFs between developing countries and the rest of the world (including other developing countries). The differentiation is included for two reasons. Firstly, when adding each country’s IFFs to get a regional value (for example SSA), IFFs between developing countries will be counted twice. Secondly, the nature of developing-country data is assumed to be less reliable than developed-country data; thus, on balance, it would be more conservative and accurately indicative to limit analysis between developed and developing country.

For the purpose of this report, we use the low estimates so that the illustration of risk is as conservative as possible, and because we intend to analyse IFFs at the regional level. This has the obvious drawback of being even more conservative than the original methodology by excluding potential IFFs between developing countries. The analysis presented below is therefore not a measurement of the full extent of the narrow definition of IFFs, but only those portions that the data can accurately reveal, such as the trade mispricing between developed and developing countries revealed by the DOTS data and the financial flows revealed in the BOPS data.

4.2. The risk of IFFs in sub-Saharan Africa

As noted earlier, we focus on sub-Saharan Africa (SSA) due to the large opportunity cost associated with IFFs in this region. For example, in SSA, all countries but the Seychelles reported a fiscal budget deficit in 2016, and the average size of the fiscal deficits across SSA increased from 3.5% in 2014 to 5.1% in 2016 (African Development Bank, 2017). It is therefore important to explore what the available data reveals in terms of the risk of IFFs in SSA.

The risk of illicit flows is expressed by calculating IFFs as a percentage of GDP for each country and for the SSA region. This is used to show proportional risk (low to very high).

- **Very high risk (>10% GDP)**
- **High risk (6-10% GDP)**
- **Medium/high risk (3-6% GDP)**
- **Medium risk (1-3% GDP)**
- **Low risk (0-1% GDP)**

While this serves as an indication of risk for the purpose of this note, it is not a comprehensive risk indicator but rather a sub-indicator. As discussed above, it only measures detectable illicit flows within the formal financial system. As such, a country that is reported as low risk or medium risk in this sub-indicator may in fact be very high risk according to the more comprehensive risk indicator we are developing. This is especially true for countries that are trafficking resources and drugs across borders without those showing up formally in their trade records or their trading partners’ records. This needs to be kept in mind when assessing the risk map below, whereby some countries that are notorious for IFFs and transnational crime do not show as high risk. However, if a country is classified as high risk in terms of this sub-indicator, it is very unlikely to be low risk in the comprehensive risk indicator. This is because the sub-indicator is robust at detecting specific types of illicit flows but does not capture all illicit flows.
Table 1: Categories of risk

<table>
<thead>
<tr>
<th>Level of risk</th>
<th>Percentage GDP</th>
<th>Rationale to achieve the state required to support a given level of illicit flows</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>0–1%</td>
<td>Will not materially disrupt normal processes and markets</td>
</tr>
<tr>
<td>Medium</td>
<td>1–3%</td>
<td>Small to moderate disruption of processes and markets</td>
</tr>
<tr>
<td>Medium/high</td>
<td>3–6%</td>
<td>Significant disruption of processes and markets with some undermining of governance structures</td>
</tr>
<tr>
<td>High</td>
<td>6–10%</td>
<td>Very significant disruption of processes and markets with significant undermining of governance structures</td>
</tr>
<tr>
<td>Very high</td>
<td>&gt;10% (or no data)</td>
<td>Severe disruption of processes and markets with subversion or displacement of governance structures</td>
</tr>
</tbody>
</table>

Source: Author’s own

Risk of illicit flows in SSA very high in many SSA countries. Based on categories of risk distinguished in Table 1, Figure 1 indicates the risk of IFFs for each country in SSA in 2014. The figure shows that the most common category in which countries fall is the Very high risk category (33%). This is either due to values exceeding 10% of their GDP or due to there being no available data to calculate IFFs. As previously mentioned, lack of trade or BOPS data from which IFFs can be derived indicates weak governance and controls, which presents a very high risk of IFFs. Roughly 30% of countries in the Very high risk category are there due to a lack of data. The second most common category is Medium/high risk (27%), followed by High risk (20%), Low risk (11%) and Medium risk (9%). This indicates that most countries in SSA are exposed to levels of risk that pose serious developmental concerns, while few are exposed to low levels of risk, which could be deemed acceptable in the absence of other non-financial risk factors such as commodity smuggling or transporting outside of the local economy. What is also clear is that both least developed countries and middle-income countries in SSA are at similar risk of IFFs, while West Africa tends to be at particularly high risk of IFFs, with many countries exhibiting High risk or Very high risk.

Figure 1: Risk of IFFs across countries in SSA

Risk of IFFs not evenly distributed across countries in SSA. According to the data, IFFs are as large as 22% of GDP for the average country in SSA in the year 2014, which equates to a Very high level of risk. However, the median level of risk is Medium/high (5.8% of GDP). This shows that the average level of risk is skewed by outlying countries that are particularly exposed to IFFs. This could indicate that certain countries are targeted for IFFs due to the governmental structures, location, or economy, and that the extent of IFFs is not evenly distributed across regions. From 2005-2014, when summing IFFs across all countries in SSA and comparing to GDP, IFFs were 6.8% of GDP (High risk). This is likely a more accurate representation of the risk of IFFs across sub-Saharan Africa than the 22% average per country, which is affected by outliers.

Positive effects of ODA and FDI potentially outweighed by IFFs. When assessing the aggregated risk of IFFs for the entire region between 2005 and 2014 (depicted in Figure 3 on the next page), risk has decreased over time, from High risk to Medium/high risk. However, this is due to a higher growth rate of GDP compared with IFFs, and not a decrease in IFFs. Moreover, when benign inflows such as Official Development Aid (ODA) and Foreign Direct Investment are expressed as a percentage of GDP and compared with IFFs, it is clear that IFFs are significant enough that they could completely nullify the positive implications of ODA. These are also decreasing in a relative sense over time due to the rate of growth of GDP being high.

![Figure 2: Risk of IFFs for the SSA region compared with ODA and FDI](source)
Risk of inflows higher than risk of outflows.
The risk of IFFs can be split according to inflows and outflows. Prior to 2010, outflows were more significant than inflows in terms of total risk. However, since 2010, outflows decreased significantly in relation to inflows as a proportion of total risk, with inflows accounting for the larger portion. Figure 4 on the next page shows the change in the distribution between inflows and outflows over time.

Higher risk of inflows than outflows indicates that the intention to move money into countries in SSA is as large as, or larger than, the drive to move money out of them. However, as GFI (2017) suggests, the data on outflows is more likely to be underestimated than the data on inflows, because mis-invoicing of services and intangibles, same-invoice faking and cash movements related to many criminal activities tend to affect outflows from developing countries more than inflows to those countries. Moreover, the intention to move money into a country generally leads to a subsequent movement of money out of a country (Baker, 2005).

Erratic swings in IFFs indicating sensitivity to reporting. The sudden change in distribution of outflows versus inflows between 2009 and 2010 (depicted in Figure 4, on the next page) can be explained by fluctuations in the level of reported outflows by major countries such as South Africa and Nigeria in the affected years. South Africa’s outflows were 5.3% of GDP in 2008, 0.6% of GDP in 2009 and then 1.7% of GDP in 2010. It is unlikely that these fluctuations represent changes in

Figure 3: Distribution of illicit financial outflows and inflows in SSA (2005–2014)

criminal behaviour. Rather, they likely represent changes in the extent to which criminal behaviour was intermittently revealed by the data. Erratic changes in data reporting are indicative of flawed reporting processes, elusive governance standards, and issues with data validity and record completeness, which all point to opaqueness, lack of trust and higher risk.

Large economies in SSA associated with higher risk of outflows, and smaller economies associated with higher risk of inflows. The distribution of outflows and inflows between the countries reveals that risk of inflows and outflows are not similar, and the risk drivers are varied.

Figure 4 shows that in 2014, Nigeria and South Africa together accounted for 61% of the outflows proportion of total risk, but only accounted for 22% of inflows. Given that Nigeria and South Africa together accounted for 55% of SSA’s GDP in 2014, it makes sense that the majority of IFFs risk would stem from these countries.

4.3. Conclusion

Methods for calculating IFFs still developing. A review of the methodologies for calculating IFFs reveals that there are shortcomings with these methods, which lead to potential over-estimations and under-estimations. However, when applying necessary methods and assumptions to reduce potential errors as much as possible, these methods are robust as indicators of risk. Work in the field of quantifying IFFs should continue to bring greater clarity to this area.

Very high risk of IFFs in SSA. The analysis reveals that SSA is at very high risk of IFFs. This is due to the fact that, of the five risk categories, more countries fall into the very-high-risk category than any other. Additionally, when expressed as a percentage of GDP, IFFs outweigh benign development flows such as ODA and FDI, which could be limiting the extent to which these flows are able to bring about positive outcomes in SSA.

Risk of IFFs unevenly spread across SSA. The risk of IFFs does not always correlate directly with the size of the economy and is unevenly spread across SSA. For example, some countries have very-high-risk levels (above 100% GDP), while others have low risk (less than 1%). Moreover, inflows are not correlated with the size of the economy, with smaller countries accounting for the majority of inflows despite having minor GDPs.

The fact that inflows are much more spread across SSA and not necessarily correlated with GDP reveals that risk of inflows is more likely correlated strongly with other factors such as location, legal environment and relative attractiveness as a location for illegal activity.
Financial integrity refers to the soundness of a financial system and its ability to deal with risks and malpractices, such as money laundering and terrorist financing. While some illicit financial flows (IFFs) happen outside the financial system, most (such as transfer mispricing, trade mispricing, tax evasion and corruption) make use of the financial system, thereby compromising financial integrity. This section explores the link between IFFs and financial integrity and assesses the extent to which current efforts to curb IFFs are succeeding.

IFF and ML/FT sharing similar risk drivers. Just as in typical AML/CFT risk assessment frameworks, IFF risks broadly arise from the following sources:

• **Product**
  Apart from physical products such as commodities, different financial products and transactions have different IFF risk profiles as perpetrators arbitrage across them to minimise detection.

• **Jurisdiction**
  Some jurisdictions are prone to IFFs more than others. For example, areas with weak regulation or regulation that protects ownership or transactional secrecy internationally are at higher risk of IFFs.

• **Delivery channel**
  Certain delivery channels may pose a higher risk than others due to the type of interaction points and the security of the channels. Newer channels with underdeveloped regulation may pose greater risks than established channels.

• **Sector**
  Certain sectors pose much higher risks than others. For example, extractive sectors in Africa tend to pose much higher risks due to the difficulty associated with valuing minerals (Oxfam, 2017).

Table 2, on the next page, provides a list of product risks relevant to IFFs. The similarities between ML and IFF risks suggest that IFFs could be integrated into current risk assessment frameworks relatively easily.
<table>
<thead>
<tr>
<th>Factors</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transaction size</td>
<td>Size of a transaction through an account or in a single transaction. The lower the transaction size, the lower the value that may be related to illicit flows and ML/TF.</td>
</tr>
<tr>
<td>Transaction frequency</td>
<td>Frequency of transactions through an account or single transactions. A single transaction is likely to represent a different risk profile to an unlimited number of transactions, in any business period.</td>
</tr>
<tr>
<td>Transaction flows</td>
<td>Transaction flows through accounts, and the stakeholders involved. Where transaction flows can be tracked and are transparent, the illicit flows and ML/TF risk can be reduced. For example, where all transaction flows are accounted for through an account and can be tracked - either traditional branch account delivery or virtual account delivery.</td>
</tr>
<tr>
<td>Methods of funding</td>
<td>Methods that an account or single transaction can be funded, e.g. cash, money orders or anonymous funding. Cash, anonymous funding and funding via multiple third parties are considered to pose higher illicit flows and ML/TF risk.</td>
</tr>
<tr>
<td>Cross-border functionality</td>
<td>Ability to transact across borders. The transfer of funds across national borders, as well as access to funds and funding from other jurisdictions, is considered higher risk.</td>
</tr>
<tr>
<td>Non-face-to-face business</td>
<td>Non-face-to-face establishment of business relationships and transactions. Where customers are required to visit a branch or agent to undertake transactions (for example), the risk is reduced.</td>
</tr>
<tr>
<td>Anonymity</td>
<td>Anonymity increases illicit flows and ML/TF risk, especially tax havens and secrecy jurisdictions. Anonymity is not permitted in terms of FATF Recommendations, and this can be leveraged to fight IFFs.</td>
</tr>
<tr>
<td>Elusiveness</td>
<td>Difficulty in understanding business/transactions. Higher risk is posed where multiple transactions (e.g. smurfing) through multiple accounts are conducted. Elusiveness is more often prevalent with IFFs.</td>
</tr>
<tr>
<td>Rapidity</td>
<td>Speed at which transactions can move through the financial system. Where funds cannot be moved through the system rapidly, this will reduce risk. It is noted that one of the main risks associated with mobile money is rapidity.</td>
</tr>
<tr>
<td>Oversight</td>
<td>Level of oversight of all steps in a transaction. Where there is effective oversight and coordination of individual services providers, illicit flow and ML/TF risk will be reduced, particularly oversight between exports/imports and associated financial transactions.</td>
</tr>
</tbody>
</table>

Source: Cenfri (Authors’ own)
**IFFs not sufficiently emphasised by FATF.**

Despite posing a risk to financial integrity, the current FATF recommendations do not explicitly capture IFFs as a key risk, except through money laundering and terrorist financing, which are merely sub-components of IFFs. The original 40 guidelines and subsequent additions primarily target the prevention and prosecution of money laundering and the combatting of the financing of terrorism. Typology studies focus on finding new methods of ML, but they do not investigate new methods of IFFs. Although these are important issues and although the issue of IFFs is intrinsic to financial integrity, FATF does not emphasise it adequately.

A number of additional issues exist within current efforts to combat ML and IFFs. These are highlighted below.

**Limited capacity in the private sector and the public sector to implement proportional AML.**

The change from a rules-based approach to a risk-based approach (RBA) has been difficult for African stakeholders in both the public sector and the private sector. Due to a lack of capacity and key skills, regulators are struggling to assess risk at the national and industry level and are therefore unable to provide sufficient guidance to the financial service providers and designated non-financial businesses and professions (DNFBPs) (Centfri Engagements, 2017/2018). This affects the ability to identify suspicious transactions and flag these to the FICs. FATF has released guidance over the years to assist countries to implement the RBA and to understand different levels of risk. However, as noted by AFI (2011), many developing countries are not always involved in important FATF discussions where these issues are discussed in more detail and clarity is provided. This has resulted in poor assessment ratings from both a technical and effectiveness perspective for most African countries. A detailed assessment of some of these scores can be found in the annexure.

**Insufficient mandate of FICs hindering the ability to receive important information and data from other governmental departments.**

Contributing to the above is the fact that FICs are unable to get key data and insights from other governmental departments involved in IFFs and ML. This is because FICs are often not at the necessary political level to request data from other departments, or their mandate does not empower them to do so. For example, some financial intelligence authorities noted that a “Director” in the Financial Intelligence Centre or Unit may not have the same authority and legal status as a “Director” in a Ministry or other government department (Centfri Engagements, 2017/2018). This compromises the ability to engage with peers across departments and to obtain and share requisite information. It results in FICs not being able to quantify or understand risks. An evaluation of several MERs reveals that only Côte d’Ivoire and Zimbabwe have quantified the proceeds of ML.

**Uncoordinated approach to combating crime concealing the bigger picture of IFFs.**

This uncoordinated approach not only hinders FIC’s efforts to combat ML; it also hampers the broader effort to control IFFs. Centfri engagements with ESAAMLG and GIABA (2017/2018) reveal that the different parties involved in tackling IFF-related issues do not cooperate. This is either due to a lack of political will, or the fact that departmental mandates do not allow for coordination between departments. This results in a “silo” approach to combating crime, whereby each department deals with its specific crime area without sharing across departments. This is ineffective because IFFs capitalise on siloed approaches by arbitraging weaknesses across industries. In other words, as it becomes more difficult to launder money within traditional channels, perpetrators use a new mix of channels across incongruent regulatory regimes. Without a holistic approach to IFFs, departments are only able to view pieces of the picture and cannot see what might be happening in other

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5 The rules-based approach refers to a set of requirements and guidelines required by the public sector and the private sector to mitigate ML within the financial services sector. This was replaced by the risk-based approach, which required that proportional measures were implemented to mitigate ML, based on the relative level of risk associated. The application of a risk-based approach requires a robust understanding of risk and risk management (Rusare, et al., 2018)

6 DNFBPs refer to any business or profession that poses a money laundering risk but cannot be classified as a financial institution, such as a casino
sectors. For example, a revenue authority in an African country might have important information on tax avoidance activities that could be useful to FICs in identifying possible ML leads. However, they may be unable or unwilling to share this information with FICs.

**Trade-based money laundering not adequately addressed under current financial integrity initiatives.** Without an understanding of where key risks emanate from, FICs are ignoring major elements of ML. The most notable is the case of trade-based money laundering (TBML). TBML refers to a process whereby perpetrators use invoice faking and similar methods, often facilitated by the freight forwarding industry, to launder money through the trade system. This may seem different to money laundering, because the money could stem from an originating activity that was legal. However, whether the predicate offence for money laundering happened during the originating activity or during the trading process does not change the fact that the money is “illegal”; therefore, the transaction is money-laundering. For example, a legal mining operation may use criminal techniques to transfer funds out of (or into) the country, such as forgery of official documents or bribery of officials. This means that the resulting financial flows in the trade and financial systems are essentially the proceeds of crimes that are predicate offences for money laundering. Cenfri engagements in ESAAMLG and CIABA reveal that FICs view elements of TBML (such as trade and transfer mispricing) as something that falls outside of their ambit. However, it doesn’t fall out of their ambit and should be treated no different to typical money laundering offences. Figure 5 below illustrates the scope of IFFs and where trade-based money laundering fits within this.

**Inconsistent and harsh mutual assessments incentivising risk-averse behaviour.** Even within this limited scope of ML (portrayed by the middle circle in Figure 5), implementation of the risk-based approach has been disproportionately focused on removing risk rather than managing it.

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**Figure 5: The scope and components of IFFs**

- **Illicit Financial Flows**: The entire scope of IFFs
- **AML/CFT-targeted ML**: The current scope and focus of AML initiatives aimed at strengthening financial integrity
- **TBML**: Trade-based money laundering, which is generally considered to be IFFs and therefore seen as a trade/tax issue and neglected as ML/TF

Source: Authors’ own
This is due to the limited capacity and understanding of risks identified above, as well as the fact that country evaluations of FATF compliance have been harsh and inconsistent. For example, in South Africa’s Exemption 17 that allowed for simplified CDD on low-transaction products was highlighted as an example of good practice in proportional risk assessment in FATFs guidance paper on financial inclusion. However, it was also listed as eroding South Africa’s ability for effective record keeping with regard to client information in its MER (AFI, 2011). This inconsistency in evaluation means that good practice financial inclusion processes that are proportional can actually lead to worse ratings. Countries are therefore understandably risk-averse and tend to de-risk rather than implement low-risk measures for low-risk customers and correspondents. This leads to financial exclusion.

Financial exclusion stimulating illicit financial flows. The driving of financial exclusion is leading to the development of informal channels. This is aptly showcased in the DRC, where USD9 billion was reportedly remitted informally to the DRC, compared to only 17 million remitted formally in 2017 (World Bank, 2017). These informal channels are channels not only for remittances but also for IFFs. Indeed, IFFs have become the rails on which the informalisation of retail and trade transactions takes place (AFI, 2010). The informal sector is able to grow and scale because IFF proliferators use informal and unregulated markets through which to transfer money illicitly. As such, the infrastructure of informal markets (such as liquidity, payments and settlements in country) is built and maintained through IFFs. Ultimately, current AML initiatives are not only missing the main channels through which IFFs emanate; they are actually driving further IFFs through exclusion.

7 De-risking refers to a process whereby institutions terminate accounts of clients and correspondent institutions that are high risk or where the risk is not well understood.
Based on the above insights, we propose a number of recommendations, which fall under key themes.

**Illicit financial flows should be recognised as a key risk to financial integrity.**
- FATF should start the process of recognising IFFs as a key risk to financial integrity. Research into this area should be deepened to support changes in policy and guidance.
- IFFs should be incorporated in risk assessments, including national risk assessments, and industry-level risk assessments.
- Typology studies on AML/CFT should now include IFFs to uncover the new types of illicit flows that are emerging.
- Trade-Based Money Laundering should be included as a key component of standard ML/TF risk assessments.
- Non-state authorities, such as NGOs and CSOs, should develop and provide guidance on proportionate implementation of IFF-combatting strategies to ensure that financial exclusion is not facilitated.
- The definition of the Designated Non-Financial Business or Professions (DNFBPs) category should be broadened. The freight forwarding industry should be included in the DNFBPs category, as prescribed by FATF. This would require them to collaborate in the AML sphere and provide important information to relevant authorities.

**Empower Financial Intelligence Centres**
- Capacity to collect and analyse illicit financial flows data and use it to inform proportional AML/CFT measures should be improved.
- The mandate and power of FICs should be enhanced to allow them to request ML and IFF-related information from other departments.

**Improve coordination between agencies**
- Departmental mandates should be restructured to be aligned so that departments that deal with different crimes can work together to inform a holistic picture of IFFs.
- Joint infrastructure (such as shared databases that different parties involved in different crimes can use to gain insights) should be established.
- Common platforms, where relevant authorities in IFF matters can share insights and learnings, should be established.

**Enhance capacity and involvement of the private sector**
- A regional and/or country-level compliance institute should be created to upskill compliance officers and to provide a common platform for engaging with FICs and other compliance officers. This will enhance private sector ability to identify ML and IFF risks, as well as monitor criminal activity.
- The FATCA obligations that compel all financial institutions that deal with American citizens across the world to identify and document them for tax purposes could be leveraged to reduce illicit financial flows. African countries could also request that America does the same for its multinationals that operate in Africa. This will provide FSPs with important client information.

**Further develop research methodologies for understanding the risk of illicit flows, particularly in SSA and LDCs**
- A comprehensive risk indicator for IFFs, which includes qualitative and quantitative factors, should be established.
- The risk indicator in select countries in SSA should be tested.
Impossible to combat ML and TF without considering TBML. The current approach to addressing money laundering (ML) is not focusing on trade-based money laundering (TBML) due to it not being understood by FICs as a key component of ML. This is particularly problematic given the extent to which the trade system is being abused for laundering purposes. The fight against ML cannot be successful without considering TBML and incorporating it into risk assessment frameworks.

Disproportional approach to AML worsening IFFs. The current implementation of the RBA approach is causing financial exclusion. This is due to a multitude of reasons, including capacity issues as well as inconsistent mutual evaluations that incentivise risk-averse behaviour. Much work needs to be done in shifting AML approaches towards proportionality. Cenfri is currently providing technical assistance in countries in SSA to upskill the public and private sector on this issue.

Need for a holistic approach, which involves all stakeholders, to combat IFFs. The scope of IFFs is broad and cuts across multiple regulatory areas and industries. It is therefore important to have a holistic approach to combatting IFFs, where different private-sector and public-sector entities are able to share insights and data. This will create a much clearer picture of the scope and nature of IFFs.
Table 3 provides an overview of some of the global initiatives aimed at curbing IFFs or an element of IFFs.

**Table 3: Global initiatives to combat illicit flows**

<table>
<thead>
<tr>
<th>Initiative</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base Erosion and Profit Shifting (BEPS)</td>
<td>The BEPS process is spearheaded by the OECD. The inclusive framework on BEPS provides a set of actions that equip governments with the necessary tools to combat corporate tax evasion and avoidance.</td>
</tr>
<tr>
<td>More than 100 countries and jurisdictions are collaborating to implement the BEPS measures in order to tackle BEPS.</td>
<td>Frequency of transactions through an account or single transactions. A single transaction is likely to represent a different risk profile to an unlimited number of transactions, in any business period.</td>
</tr>
<tr>
<td>Tax inspectors without borders</td>
<td>This initiative is spearheaded by OECD and UNDP, and it is aimed at helping developing countries improve their tax and audit capacities. The intention is for tax audit experts from all over the world to work in close collaboration with local authorities to assist governments in mobilising domestic revenues to achieve the SDGs.</td>
</tr>
<tr>
<td>Automatic Exchange of Information (AEOI)</td>
<td>The AEOI portal is spearheaded by the OECD and provides for the exchange of non-resident financial account information with the relevant tax authorities in the account holders’ country of residence. Therefore, through global participation, it has the potential to greatly reduce tax evasion.</td>
</tr>
<tr>
<td>African Tax Authorities Forum (ATAF)</td>
<td>The ATAF is a network of tax authorities. It aims to improve the tax systems in Africa through various initiatives. Its main focus is on the strengthening of African tax authorities through knowledge dissemination and capacity-building.</td>
</tr>
<tr>
<td>United Nations Sustainable Development Goals (SDGs)</td>
<td>Inclusion of IFFs (as target 16.4) within the United Nations SDGs emphasises the global nature of the phenomenon. Under the SDGs, all UN members will report on progress they are making to “significantly reduce illicit financial flows”.</td>
</tr>
<tr>
<td>The Stolen Assets Recovery Initiative</td>
<td>This initiative is spearheaded by the World Bank and aims to recover assets that have been stolen due to IFFs.</td>
</tr>
</tbody>
</table>

Source: Authors’ own compilation

Table 4 provides an example of typical bodies responsible for various components of IFFs.

**Table 4: The typical authority responsible for tracking the relevant monetised illicit flow**

<table>
<thead>
<tr>
<th>IFF type</th>
<th>Lead agency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Money laundering and financing of terrorism</td>
<td>Financial intelligence authority</td>
</tr>
<tr>
<td>Tax evasion</td>
<td>Tax and revenue authority</td>
</tr>
<tr>
<td>Transfer pricing</td>
<td>Tax and revenue authority</td>
</tr>
<tr>
<td>Trade mispricing</td>
<td>Tax and revenue authority</td>
</tr>
<tr>
<td>Corruption</td>
<td>Anti-Corruption Commission, Office of the Public Protector</td>
</tr>
<tr>
<td>Prosecuting money laundering, IFFs and predicate crimes</td>
<td>Ministry of Police/Home Affairs, National Prosecution Authority, Ministry of Justice</td>
</tr>
</tbody>
</table>

Source: Authors’ own
Table 5 provides an overview of the outcomes for the MERs of some African countries. Countries were chosen based on availability of recent MERs.

**Table 5: Summary of key Mutual Evaluation Report findings for select African countries**

<table>
<thead>
<tr>
<th>Country</th>
<th>Key identified predicate crimes for money laundering</th>
<th>Perceived threat of money laundering (ML) and terrorist financing (TF)</th>
<th>Compliance with ML and TF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sudan</td>
<td>Drug trafficking • Smuggling • Financial fraud • Corruption</td>
<td>ML: High threat TF: High threat</td>
<td>ML: Partially compliant (PC) Predicate offences do not include all 20 offences. TF: Non-compliant (NC)</td>
</tr>
<tr>
<td>Uganda</td>
<td>Tax evasion • Corruption • Smuggling of wildlife • Smuggling of gold</td>
<td>ML: Moderate threat TF: High threat</td>
<td>ML: Partially compliant (PC) Illicit trafficking in narcotic and psychotropic substances not criminalised TF: Non-compliant (NC) Scope of TF offence not comprehensive enough</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>• Smuggling • Illicit gold and precious stones dealings • Corruption • Fraud • Tax evasion including externalisation of currency</td>
<td>ML: High threat TF: Low threat ML quantified at USD1.8 billion in 2013</td>
<td>ML: Compliant (C) TF: Compliant (C)</td>
</tr>
<tr>
<td>Côte d’Ivoire</td>
<td>Theft Financial crimes • Information and communication technologies crimes</td>
<td>ML: High threat TF: Low threat ML quantified at USD730 million annually</td>
<td>ML: Partially compliant (PC) TF: Partially compliant (PC) No criminalisation of the financing of a “terrorist organisation” and the financing of a “terrorist individual”</td>
</tr>
<tr>
<td>Guinea</td>
<td>• Drug trafficking • Migrant trafficking • Corruption</td>
<td>ML: High threat TF: High threat</td>
<td>ML: Partially compliant (PC) Predicate offences not criminalised: Insider trading and market manipulation Piracy TF: Non-compliant (NC) TF not criminalised</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>• Corruption • Tax evasion • Smuggling of migrants and drugs • Providing illicit financial services</td>
<td>ML: High threat TF: High threat</td>
<td>ML: Largely compliant (LC) TF: Largely compliant (LC)</td>
</tr>
</tbody>
</table>

Source: Mutual Evaluation Reports, various
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About Cenfri

The Centre for Financial Regulation & Inclusion (Cenfri) is a global think tank and non-profit enterprise that bridges the gap between insights and impact in the financial sector. Cenfri’s people are driven by a vision of a world where all people live their financial lives optimally to enhance welfare and grow the economy. Its core focus is on generating insights that can inform policymakers, market players and donors seeking to unlock development outcomes through inclusive financial services and the financial sector more broadly.

About FSD Africa

FSD Africa is a non-profit company which aims to increase prosperity, create jobs and reduce poverty by bringing about a transformation in financial markets in Sub-Saharan Africa (SSA) and in the economies they serve. It provides know-how and capital to champions of change whose ideas, influence and actions will make finance more useful to African businesses and households. It is funded by the UK aid from the UK Government. FSD Africa also provides technical and operational support to a family of 10 financial market development agencies or “FSDs” across SSA called the FSD Network.