

# Illicit financial flows in Africa

## Drivers, destinations, and policy options

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### Abstract

Since 1980, an estimated \$1.3 trillion has left sub-Saharan Africa in the form of illicit financial flows (per Global Financial Integrity methodology), posing a central challenge to development financing. In this paper, we provide an up-to-date examination of illicit financial flows from Africa from 1980 to 2018, assess the drivers and destinations of illicit outflows, and examine policy options to reduce them. Using trade misinvoicing and balance-of-payments discrepancies to estimate illicit financial flows, we find higher real GDP is associated with higher illicit financial flows due to the increased opportunities to channel illicit resources abroad generated by higher economic activity, suggesting a need for increased diligence as countries grow. We also find that higher taxes and higher inflation lead to higher illicit financial outflows, suggesting that firms seek out relatively more stable or favorable fiscal environments for their funds. We further find that, over the past decade, there has been an increase in illicit outflows of capital toward emerging and developing economies (e.g., China) as trade between Africa and these countries has increased. We conclude with policy recommendations to address illicit financial flows in order to shift the discussion toward effective policies applicable to all countries.

## 1. INTRODUCTION

While the international development community often focuses on the amount of aid and investment that enters the African continent, the other part of the balance sheet—the funds *exiting* the continent—has often been overlooked. Between 1980 and 2018, sub-Saharan Africa received nearly \$2 trillion in foreign direct investment (FDI) and official development assistance (ODA), but emitted over \$1 trillion in illicit financial flows. These flows, illicitly acquired and channeled out of the continent, continue to pose a development challenge to the region, as they remove domestic resources which could have been crucial for the continent’s economic development.

There is no widely agreed-upon definition of which specific forms of capital movement constitute illicit financial flows. Global Financial Integrity, a non-profit, Washington, D.C.-based research and advisory organization, defines illicit financial flows as “the illegal movement of money or capital from one country to another.” This narrow definition of illicit financial flows covers activities including hiding the proceeds of crime, channeling funds towards criminal destinations, and evading tariffs and taxes through misreporting of transactions. Wider definitions generally focus on actions that are not strictly illegal, but which are undesirable because they result in reduced tax revenues, including tax avoidance actions such as strategic transfer pricing (Forstater, 2018a).

Trade misinvoicing is one method of laundering money for illegal transfer to another country (World Customs Organization, 2018). It occurs when exporters or importers deliberately misreport the value, quantity, or nature of goods and services in order to evade taxes, take advantage of tax incentives, avoid capital controls, or launder money (Forstater 2018b). This paper analyzes the extent and destination of illicit financial flows from Africa through calculations of trade misinvoicing in order to track their change over time. We then recommend steps to reduce their extent.

Trade misinvoicing is one of the primary methods of laundering money for illegal transfer to another country (World Customs Organization, 2018). It occurs when exporters understate the value of exports and importers overstate the value of import, and is attributed to the desire of firms to evade trade restrictions and custom duties by illicitly shifting profits between countries (Cobham and Jansky, 2017). Multinational companies regularly evade taxes in countries where they operate, especially in developing countries, through trade misinvoicing, among other schemes.

Using calculations for trade misinvoicing and balance of payments discrepancies to generate estimates for illicit financial flows, we find that, as expected, larger economies have higher levels of illicit financial flows. We also find that higher taxes and higher inflation lead to higher illicit financial outflows, suggesting that firms seek out relatively more stable or favorable fiscal environments for their funds. Furthermore, we find that emerging and developing economies in Asia and the Middle East have become major destinations for illicit financial flows from Africa. While part of this shift can be explained by the reduction in trade levels with developed economies, the large upsurge of illicit flows to these economies cannot solely be explained by increased trade values.

The paper also studies the efforts put in place to curtail illicit financial outflows and elaborates on the extent to which repatriation efforts have been successful. Halting illicit flows requires international cooperation, and the global community must come together to create initiatives that effectively prevent money from illegally leaving and entering countries. Existing initiatives range from promoting information sharing across countries to more stringent monitoring of trade reporting. We conclude with policy recommendations to address and reduce illicit financial flows, in order to shift the discussion toward effective macroeconomic policies applicable to all countries.

This brief is structured as follows. Section II discusses the state of illicit financial flows in Africa and their impact on economic development. Section III describes the methodology used to estimate illicit financial flows in this paper. Section IV analyzes the change in illicit flows from Africa between 1980 and 2018 and the largest African emitters of illicit flows, and undertakes a correlation analysis to determine the relationship between illicit flows and various macroeconomic and governance indicators. Section V then analyzes the destinations of illicit financial flows, focusing on the two largest destinations, China and the U.S. Section VI discusses initiatives in place to combat illicit flows, while Section VII discusses repatriation efforts. Section VIII concludes.

## 2. ILLICIT FINANCIAL FLOWS IN AFRICA

Illicit financial outflows from Africa are concentrated in a few countries and a few sectors—in particular, the extractive and mining industries (Mevel, Ofa and Karingji, 2013). In fact, according to Phillippe Le Billion (2011), fuel exporters were responsible for nearly half of the illicit financial flows from Africa between 1970 and 2008. Notably, Kar and Cartwright-Smith (2010) find that oil price increases are associated with increases in illicit flows. Moreover, Boyce and Ndikumana (2011) find a statistically significant relationship between oil exports and illicit financial flows: Specifically, they estimate that, for every extra dollar in oil exports, an additional 11 to 26 cents leaves the country in the form of illicit financial flows. In addition, oil is not the sole resource conducive to illicit outflows of capital. In South Africa, the vast majority of illicit capital flows arise out of transfer pricing from the mining sector (Ashman, Fine, and Newman, 2011).

Resource-exporting countries are more prone to exporting large amounts of illicit financial flows due to several factors. First, large exports of oil provide more opportunities for trade misinvoicing (Almounsor, 2005; Mpenya, Metseyem, and Epo, 2016). Second, in oil industries, the line between private and public interests is often blurred, as government officials often own stakes in state-owned companies. Moreover, the funds created from extractive industries provide political leaders with a certain level of independence, then removing the need for accountability from politicians involved in those industries (Le Billion, 2011). Third, extractive industries require a high level of expertise, which leads to relatively low levels of competition, creating oligopolies who may collaborate with governments and competitors for contract negotiations, joint ventures, and other arrangements (Martin and Park, 2010). The low levels of competition can also lead to companies working together to export illicit capital outflows (Le Billion, 2011). Finally, resource-rich countries tend to have higher rates of corruption, further compounding challenges associated with illicit financial flows (Le Billion, 2011).

### Impact of illicit financial flows

Illicit financial flows drain resources that could be used for the continent's development (Geda and Yimer, 2016; Ndikumana, Boyce, and Ndiaye, 2015; Boyce and Ndikumana, 2000), meaning that a reduction in illicit financial flows could potentially lead to a corresponding reduction in aid dependence by increasing the availability of domestic resources. While illicit financial flows are a constraint to development financing in Africa, it remains difficult to assess the link between illicit financial flows and poverty reduction, as the channel through which this link materializes is through reduced government funding for poverty reduction programs such as in health and education, or through indirect channels such the negative effect of low investment on incomes (Nkurunziza, 2012).

Illicit financial outflows have been found to have a strong and negative effect on investment rates, notably private investment (Nkurunziza, 2012). In addition to foregone investment, illicit financial flows are presently curtailing Africa's savings rate. In fact, Janvier Nkurunziza refers to illicit financial

outflows as a “dissaving”:<sup>1</sup> In African countries where savings and investments are strongly correlated and traditional sources of investment provide limited funding, this “dissaving” effect is even stronger (Nkurunziza, 2012).

While increased savings can open the door for increased investments in human development, the relationship may be circuitous. A 2015 paper on financing investment in sub-Saharan Africa, for example, finds that human development—coupled with good governance—has a positive impact on savings rates. The paper claims that investments in education and health can lead to a more prosperous economy, which generates larger tax revenues and can increase domestic savings. It is possible that if decreasing illicit financial flows leads to increased savings, then these funds can be reinvested in activities that improve human development, which will in turn improve the savings rate (Caceres and Caceres, 2015).

### 3. MEASURING ILLICIT FINANCIAL FLOWS

In our estimates of illicit financial flows, we use the methodology of Global Financial Integrity (GFI). The estimation method combines a trade approach with a capital account residual method to generate illicit financial flows estimates. We rely on the GFI methodology as it is one of the few methodologies that compensates for the necessary data required to truly capture illicit financial flows in sub-Saharan Africa.

Experts such as Maya Forstater have criticized this methodology as well as issues related to using trade misinvoicing and net errors and omissions to calculate aspects of illicit financial flows.<sup>1</sup> In particular, the methodology may conflate trade discrepancies resulting from legitimate trade with those resulting from misinvoicing, and may, in fact, not capture all misinvoicing (Forstater, 2018b). Indeed, it is important to note that every trade misinvoicing entry cannot be counted as an illicit financial flow. First, the discrepancy can be attributed to a difference in valuation. While export values are reported at the point of departure (known as “free on board” or FOB), import values include freight and insurance (CIF). The CIF/FOB ratio has long been debated: Because a country’s composition of imports has a significant impact on its ratio, researchers argue that the ratio is not a reliable measure of direct shipping costs, which will result in some estimation error (Chasomeris, 2009). Second, the final destination country is not always known at time of shipping. For instance, if a company ships cargo from Baltimore, Maryland to Dakar, Senegal, which is later sent to Banjul, Gambia, the cargo is reported as a U.S. export to Senegal and a Gambian import from the U.S. Senegal does not record either flow (Nitsch, 2011). A third issue can be timing, as trade flows can be recorded in different years (Nitsch, 2011).

Nevertheless, trade misinvoicing can serve as a channel for tax evasion and capital flight. In particular, import over-invoicing, in which the reported value of imports exceeds the reported value of exports, is a common method of illegally moving money out of developing countries, often to shift wealth to countries with stronger currencies or to evade taxes. Similarly, export under-invoicing, in which the reported value of exports is less than that of imports, is often used to lower reported corporate profits within a country and thus pay lower taxes. Furthermore, even if the GFI aggregates are subject to issues, this paper largely investigates correlations with those aggregates, which sidesteps these issues somewhat. For example, if there is a policy change in a country that should

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<sup>1</sup> For their criticism and more information on the limitations to not only the GFI methodology, but all calculations of illicit financial flows, please see “Global Governance to Combat Illicit Financial Flows: Measurement, Evaluation, Innovation” (2018), by Miles Kahler, Maya Forstater, Michael G. Findley, Jodi Vittori, Erica Westenberg, and Yaya J. Fanusie and “Illicit Financial Flows, Trade Misinvoicing, and Multinational Tax Avoidance: The Same or Different?” (2018), by Maya Forstater.

only affect IFFs and the trade misinvoicing estimate goes up, then we can be confident that the difference is a change in IFFs, even if we may not be confident that the total estimate is an accurate measure of all IFFs.

As previously stated, trade misinvoicing occurs when a country's export data toward a partner country does not match said country's import data, and vice versa. Trade misinvoicing estimates, therefore, calculate the difference between reported exports and reported imports. In order to make the two measures comparable, GFI converts import CIF data to an FOB basis using a freight and insurance factor ( $r$ ) of 6 percent. Import and export data are extracted from the IMF Direction of Trade Statistics, which provides data on bilateral trade flows. Import and export discrepancies are calculated as follows:

$$ID_{jw,t} = \frac{I_{jt}}{r} - X_{wt} \quad (1)$$

$$ED_{jw,t} = \frac{I_{wt}}{r} - X_{jt} \quad (2)$$

where:

$I_{jt}$ : Imports by the developing country  $j$  from the world  $w$  at time  $t$

$I_{wt}$ : The world  $w$ 's imports from the developing country  $j$  at time  $t$

$X_{jt}$ : The developing country  $j$ 's exports to the world  $w$  at time  $t$

$X_{wt}$ : The world  $w$ 's exports to the developing country  $j$  at time  $t$

Here, when negative,  $ID_{jw,t}$  represents import under-invoicing. When positive, it represents import over-invoicing. Conversely, a negative  $ED_{jw,t}$  value represents export over-invoicing, while a positive value represents export under-invoicing. Illicit outflows are computed by summing export under-invoicing and import over-invoicing. Illicit inflows are computed by adding up import under-invoicing and export over-invoicing.

The second part of GFI's illicit financial flows estimates comes from balance of payments (BOP) discrepancies. The net errors and omissions (NEO) terms in the IMF Balance of Payments Statistics database capture the residual sums that emerge when the components of the BOP do not add up to zero. While NEO can reflect genuine mistakes in accounting, traditionally, NEO have been associated with capital flight. GFI states that BOP discrepancies only make up a small share of illicit financial flows, and that the disagreement on whether NEO represent an accounting error or capital flight is negligible.

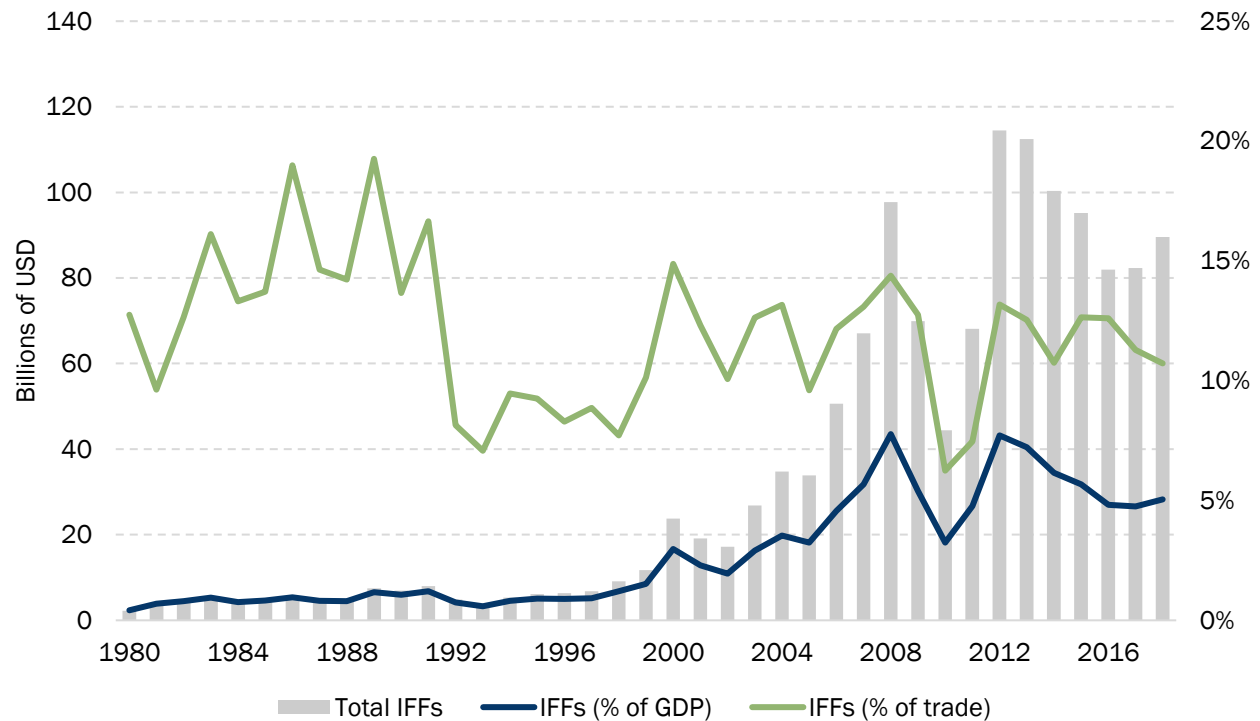
## 4. ANALYSIS OF ILLICIT FINANCIAL OUTFLOWS FROM AFRICA

Our analysis uses data that ranges from 1980 to 2018. Using the methodology described above, we find that, over the 38-year time span, Africa exported an aggregate \$1.3 trillion of illicit financial flows. Illicit financial flows saw a notable increase in the 2000s in correspondence to increases in trade from Africa. Despite one noticeable dip in the 2000s—which occurred during the 2008 financial crisis—aggregate illicit financial flows have remained relatively high, reaching a peak of \$114.5 billion in 2012.<sup>2</sup>

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<sup>2</sup> Value of IFFs is calculated in constant 2010 U.S. dollars for purposes of comparability.

**Figure 1: Evolution of aggregate illicit financial flows out of Africa**



Source: IMF Balance of Payments, IMF Direction of Trade Statistics

While the high aggregate amount of illicit financial flows may appear alarming, it is important to note that the relative share of illicit financial flows seems to be steady or declining. In 2018, illicit financial flows only made up 5 percent of GDP, down from 8 percent in 2012 and 2008 (Figure 1). Illicit financial flows as a share of trade also fell from 14 percent in 2008 to 11 percent in 2018.

The top four emitters of illicit flows—South Africa, the Democratic Republic of the Congo, Ethiopia, and Nigeria—emit over 50 percent of total illicit financial flows from Africa (Table 1). Among the top 10 emitters of illicit flows, nine countries attribute a significant portion of total exports to natural resources: mining products in South Africa, the Democratic Republic of the Congo, Botswana, and Zambia, and oil and gas in Nigeria, the Republic of the Congo, Angola, Sudan, and Cameroon.<sup>3</sup> Natural resources provide countries with opportunities to expand the volume of total trade, which is correlated with the volume of illicit financial flows; studies also suggest that extractive industries are particularly prone to illicit financial flows (UNCTAD, 2016).

As a percent of trade, illicit financial flows are highest—in excess of 50 percent—in São Tomé and Príncipe and Sierra Leone (Table 2). Small countries tend to have higher illicit flows as a percent of trade, suggesting that these countries lack the capacity to sufficiently regulate their domestic resources. Notably, however, and in contrast to this trend, Ethiopia and the Republic of the Congo are found in both the top 10 emitters of total illicit flows and the top 10 emitters of illicit flows as a percent of trade.

<sup>3</sup> While issues in the destination reporting of Zambia’s copper exports and South Africa’s gold exports distort bilateral estimates of misinvoicing (Forstater 2018a), the world aggregate method used in this section is not affected by these issues (GFI, 2017).

**Table 1: Top African emitters of illicit flows, 1980-2018 (by highest total IFFs)**

Country	IFFs (millions of USD)	IFFs (% of total trade)
South Africa	441,481	15.5
Democratic Republic of the Congo	165,649	20.4
Ethiopia	84,316	33.5
Nigeria	67,058	3.4
Republic of the Congo	55,083	23.8
Angola	45,133	4.4
Sudan	38,666	15.1
Botswana	31,486	16.1
Zambia	27,500	11.8
Cameroon	26,599	14.9

**Table 2: Top African emitters of illicit flows, 1980-2018 (by highest IFFs as a percent of trade)**

Country	IFFs (millions of USD)	IFFs (% of total trade)
São Tomé and Príncipe	1,538	57.3
Sierra Leone	15,221	53.9
Ethiopia	84,316	33.5
Togo	19,286	32.2
Lesotho	9,537	29.5
Benin	14,432	27.6
Burundi	3,796	26.7
Republic of the Congo	55,083	23.8
Comoros	843	23.2
Rwanda	7,546	21.5

Illicit flows have a non-exhaustive list of drivers. In their study of trade misinvoicing, Patnaik, Gupta, and Shah (2012) find that many factors affect misinvoicing, including capital account openness, political instability, corruption, differentials in interest rates, indebtedness, and exchange rate regimes. Analysis of African countries shows that the extent of illicit flows can be affected both by structural factors and by domestic policies targeting illicit flows with strong compliance mechanisms. In our analysis, we sort drivers into two groups: macroeconomic drivers and governance drivers. We provide a detailed data analysis of each of the two groups of drivers below.

### Macroeconomic indicators

We run a series of correlation estimates to assess the relationship between macroeconomic indicators and illicit financial flows. Table 3 presents results for variables for which the relationship with illicit financial flows is statistically significant. We find a positive and significant relationship between real GDP and illicit financial flows (aggregate). Inflation is also positively correlated with aggregate illicit financial flows. These findings could indicate that macroeconomic fluctuations, such as inflation, weaken confidence in a country's macroeconomic environment and encourage people to send their capital abroad. We further find a positive and significant correlation between illicit flows as a share of trade and tax revenue as a share of GDP. Likewise, we find a positive and significant correlation between illicit flows as a share of GDP and tax revenue as a share of GDP. When governments collect a large share of taxes, individuals and corporations have incentives to store capital abroad, away from government appropriation.

**Table 3: Correlation analysis: Illicit financial flows and macroeconomic indicators**

	<b>Total IFFs</b>	<b>IFFs (% of Trade)</b>	<b>IFFs (% of GDP)</b>
<b>Real GDP</b>	0.80***	-0.16	-0.14
<b>Inflation</b>	0.30**	0.16	0.22
<b>Tax revenue (% of GDP)</b>	0.12	0.27*	0.34**

\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

### Governance indicators

Some authors have found a significant relationship between poor governance and illicit financial outflows (Asongwu and Nwachukwu, 2017; Osei-Assibey, Domfeh, and Danquah, 2018; Everest-Phillips, 2012). Exportation of illicit funds often, though not always, requires using illegal means that involve corruption (Goredema, 2011). We use the World Governance Indicators to assess the link between illicit financial flows and governance. Developed by the World Bank, the six indicators measure control of corruption, government effectiveness, political stability, rule of law, regulatory quality, and voice and accountability. The indicators are scored between 0 and 100, where higher scores correspond to better governance. In the correlation analysis, we find that, throughout sub-Saharan Africa, there seems to be no statistically significant correlation between illicit financial flows and good governance (Table 4).

**Table 4: Correlation analysis: Illicit financial flows and governance indicators**

	<b>Including South Africa</b>		<b>Excluding South Africa</b>	
	<b>Total IFFs</b>	<b>IFFs (% of GDP)</b>	<b>Total IFFs</b>	<b>IFFs (% of GDP)</b>
<b>Control of corruption</b>	0.13	0.12	-0.21	0.13
<b>Government effectiveness</b>	0.24	0.01	-0.14	0.02
<b>Political stability</b>	-0.06	0.15	-0.24*	0.15
<b>Rule of law</b>	0.12	0.05	-0.18	0.06
<b>Regulatory quality</b>	0.21	-0.04	-0.17	-0.03
<b>Voice and accountability</b>	0.16	0.01	-0.22	0.02

\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

While there is a negative correlation between political stability and illicit financial flows, the relationship is not statistically significant when all sub-Saharan African countries are included in the analysis. Some of the difficulty in drawing a clear relationship between illicit flows and governance stems from the extent of illicit financial flows out of South Africa, a country that performs relatively well on most governance indicators. When we exclude South Africa from the analysis (Table 4, rightmost two columns), we find a negative, though statistically insignificant, relationship between illicit financial flows and most governance indicators as well as a negative and statistically significant relationship between aggregate illicit financial flows and political stability, implying that improvements in political stability are correlated with decreases in illicit flows.



## 5. DESTINATIONS OF ILLICIT FINANCIAL FLOWS FROM AFRICA

We now analyze the destinations of illicit financial flows out of Africa. While good domestic policies are necessary for reducing illicit flows, destination countries also carry part of the responsibility to fight illicit financial flows: Tax evasion, for example, though not by definition illegal, can be a key component of illicit financial flows, and is often done by multinationals from advanced economies. Identifying major destination countries can encourage them to take the precautions necessary to reduce the share of illicit financial flows they host.

To study the destination of illicit financial flows, we examine the countries with which sub-Saharan Africa has recorded the largest levels of trade misinvoicing. We note that our approach is limited because it excludes the net errors and omissions measures included in the aggregate estimates of illicit financial flows, as they are measured at the country level and not as a flow between countries. Furthermore, due to limited data in earlier years, some of the estimates in this paper may be lower than reported. For example, data for South Africa is very limited prior to 1998, yet South Africa in our analysis is one of the largest emitters and receivers of illicit flows in sub-Saharan Africa. In reality, these figures could be larger.

Table 5 shows that the majority of illicit financial flows from Africa between 1980 and 2018 have been hosted in the Europe and Central Asia or East Asia and Pacific regions; the volume of intra-African illicit flows is also large. As a percent of trade, however, illicit flows from Africa are highest with the Middle East and North Africa region.

**Table 5: Illicit financial flows out of Africa, by destination region (1980-2018)**

<b>Destination region</b>	<b>IFFs (millions of USD)</b>	<b>IFFs (% of bilateral trade)</b>
East Asia & Pacific	387,256	16.5
Europe & Central Asia	360,517	11.1
Sub-Saharan Africa	181,869	10.3
North America	136,304	11.2
Middle East & North Africa	123,680	20.7
Latin America & Caribbean	31,761	10.8
South Asia	8,599	1.2

Table 6 lists the destination of illicit financial flows from Africa by country; China hosts the greatest extent of illicit flows, almost twice as much as the second-position United States.<sup>4</sup> Between 1980 and 2018, China hosted 16.6 percent of all estimated illicit flows from sub-Saharan African countries, while the United States hosted 9.1 percent, the United Kingdom 5.4 percent, and India 5.0 percent. Reflecting the drastic increase in China-Africa trade in the past two decades, the majority of China's illicit financial flows from Africa have occurred in recent years: Our analysis finds that 85 percent of total illicit flows to China have taken place between 2010 and 2018.

**Table 6: Top destinations of illicit financial flows out of Africa, by volume (1980-2018)**

<b>Destination country</b>	<b>IFFs (millions of USD)</b>	<b>IFFs (% of bilateral trade)</b>
China	226,425	9.9
United States	129,460	12.6
Japan	81,579	20.5
United Kingdom	65,642	8.2

<sup>4</sup> Illicit financial flows are calculated for mainland China, excluding Hong Kong, Macao, and Taiwan.

United Arab Emirates	62,652	3.8
Germany	49,986	12.1
Spain	47,219	15.2
Belgium	38,594	18.8
South Korea	34,737	19.6
Democratic Republic of the Congo	34,623	10.7

Table 7 lists destination countries by illicit financial flows as a percent of total trade.<sup>5</sup> Mexico has the highest extent of illicit flows as a percent of trade, at over 50 percent of all trade, followed by Bahrain. Two sub-Saharan African countries—Benin and Niger—are among the top 10 hosts of illicit flows as a percent of trade.

**Table 7: Top destinations of illicit financial flows out of Africa, by IFFs as a percent of trade (1980-2018)**

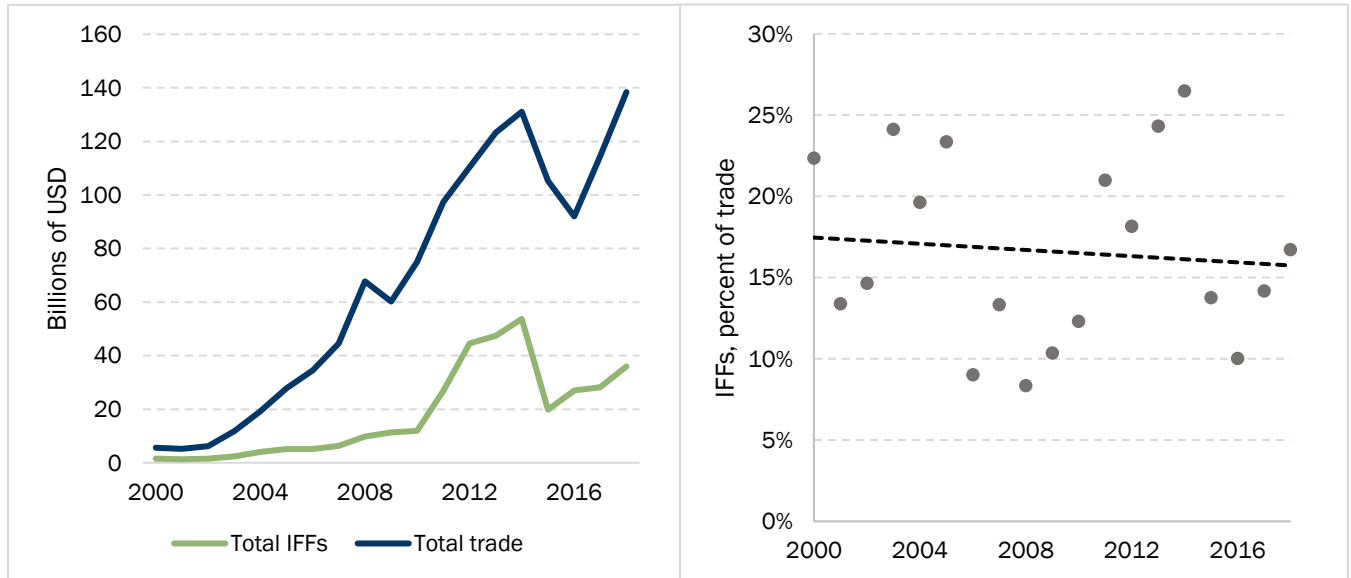
<b>Destination country</b>	<b>IFFs (millions of USD)</b>	<b>IFFs (% of bilateral trade)</b>
Mexico	8,962	58.2
Bahrain	9,662	57.7
Russia	16,633	42.9
Ukraine	8,578	41.2
Benin	5,931	35.2
Niger	1,149	34.4
Turkey	18,436	31.2
Hungary	1,517	26.9
Colombia	1,202	25.7
Austria	4,224	23.5

Analyzing the two largest hosts of total illicit flows, we see that total illicit financial flows to China have increased commensurately with trade since 2000 (Figure 2a), while total illicit flows to the U.S. remained fairly constant, increasing slightly in correspondence with an increase in total trade from 2008 to 2011 (Figure 3a). As a percent of trade, illicit flows to the United States followed a decreasing trend from 2000 to 2018 (Figure 3b). In contrast, in China, the evolution of illicit financial flows has followed a more complex pattern: As a percent of trade, illicit flows remained below 15 percent from 2006 and 2010, increased dramatically between 2011 and 2014 to a peak of 26 percent in 2014, and then declined to an average of 14 percent from 2015 to 2018 (Figure 2b).

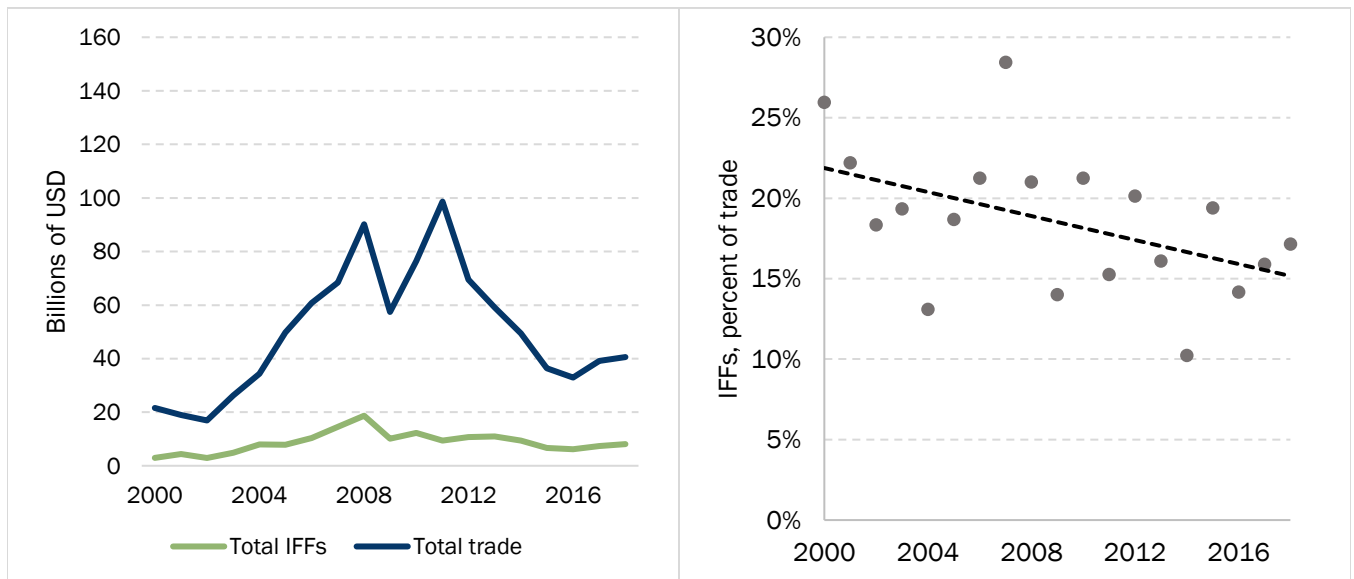
The change in illicit financial flows as a percent of trade to China during the 2008-2010 period provides insight into the pattern of illicit flows to China over the past two decades (Figure 2b). After dropping to their lowest levels in a decade in 2008, coinciding with the global financial crisis, illicit financial flows as a percent of trade toward China increased noticeably after 2010. In the post-crisis era, the Chinese government created a \$586 billion stimulus package to minimize the impact of the financial crisis and boost the country's economy. The package led to a 3.2 percentage point increase in China's GDP growth and to increased investment, consumption, and trade (Ouyang and Peng, 2015). Notably, studies have found that, in the period following the adoption of the stimulus package, both experiences and perceptions of corruption in China increased (Li and Mayraz, 2015).

<sup>5</sup> Destination countries are restricted to those with at least \$1 billion of total illicit financial flows from Africa between 1980 and 2018, as illicit financial flows as a percent of trade may be artificially high due to erroneous trade statistics in countries with little bilateral trade.

**Figure 2: Evolution of illicit financial flows from sub-Saharan Africa to China, 2000-2018**



**Figure 3: Evolution of illicit financial flows from sub-Saharan Africa to the United States, 2000-2018**



The stimulus package and the subsequent increase in both trade and corruption could be factors behind the surge in illicit financial flows witnessed in the post-crisis era. At the end of 2012, Chinese President Xi Jinping launched an anti-corruption campaign. To date, the campaign has resulted in the investigation and disciplining of thousands of government officials (Schmitz, 2017). Anti-corruption mechanisms in China could have contributed to the decline in illicit financial flows from Africa from their peak in 2014.

## 6. INITIATIVES IN PLACE TO COMBAT ILLICIT FINANCIAL FLOWS

As the case of China demonstrates, curbing illicit financial flows requires cooperation at the global level. Indeed, the past decade has seen increased effort from the global community toward reducing illicit financial flows. Such efforts range from creating initiatives to curb money laundering to improving the sharing of tax information across countries. One of the first legal instruments created to combat illicit outflows of capital was the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances of 1988, also known as the Vienna Convention. This instrument includes rules against money laundering and urges parties to work together to allow for the identification, tracing, and seizure of illicitly acquired financial proceeds (United Nations, 1988).

Other notable initiatives that aim to combat illicit outflows include the Financial Action Task Force (created 1998), the Global Forum on Transparency and Exchange of Information for Tax Purposes (created 2009), and the Inclusive Framework on Base Erosion and Profit Shifting (created 2016). We discuss each of these three initiatives in subsequent sections to determine their past effectiveness and long-term prospects.

### The Financial Action Task Force

In July 1989, during the G7/8 Summit in Paris, the group created the Financial Action Task Force (FATF). The original mission of the task force was to “prevent the utilization of the banking system and financial institutions for the purpose of money laundering, and to consider additional preventive efforts in this field, including the adaptation of the legal and regulatory systems so as to enhance multilateral judicial assistance.” Since its inception, the FATF’s mission has evolved to include fighting the financing of terrorism and the proliferation of arms to more comprehensively address the sources and intended uses of illicit financial flows.

A 2012 update to the FATF’s list of recommendations (first created in 1990) for curbing money laundering includes 40 suggestions. One of the measures includes the confiscation of goods: The task force suggests that authorities take measures to identify, trace, and evaluate property and prevent actions that hinder a country’s ability to seize goods that may be subject to confiscation. Similarly, the recommendations add that countries should be allowed to confiscate proceeds from money laundering without requiring a criminal conviction. The task force also recommends that financial institutions undertake customer due diligence when establishing business relations, such as establishing a declaration system for transactions that surpass \$15,000, refraining from opening anonymous or fictitious accounts, and keeping records on both national and international transactions for at least five years. The framework also recommends that countries take swift action to respond to requests from foreign countries in seizing, freezing, and confiscating proceeds from money laundering (FATF, 2012).

The FATF often evaluates the extent to which countries have implemented recommendations. The compliance of OECD countries varies across sub-categories and across countries. Notably, OECD countries generally comply with the recommendations on preventing financial authorities’ secrecy laws from interfering with the implementation of FATF recommendations, dual criminality (i.e., countries placing the same offence in the same criminal category), and extradition (OECD, 2014). However, OECD countries have been lagging in recommendations surrounding the actions that are to be taken by financial institutions, such as customer due diligence.

Some African countries have been evaluated as efficient, effective drivers of the FATF’s recommendations to combat illicit financial flows, even though they are not advanced economies. For example, in April 2018, the Inter-Governmental Action Group against Money Laundering (GIABA) released a report titled “Anti-money laundering and counter-terrorist financing measures – Ghana.”

The report found that, overall, Ghana has an adequate understanding of money laundering practices, and the country's large banks are strong at mitigating efforts. In addition, Ghana has a comprehensive framework that addresses asset freezing and confiscation. In short, the country has a fairly high level of technical compliance with FATF standards and is involved in concerns over international cooperation. International partners state that the assistance provided by Ghana is uniquely timely and of good quality. However, these efforts are not always reciprocated by international partners, and Ghanaian authorities state that foreign jurisdictions have not formally responded to requests, or have given delayed or erroneous responses. Botswana has reported similar issues; authorities claim that the average turnaround time for mutual legal assistance requests from Botswana to other jurisdictions is two years, and the response is usually inadequate, providing insufficient or low-quality assistance (ESAAMLG, 2017). OECD countries and other advanced economies should imitate Ghana and Botswana's adherence to the FATF's recommendations to further reduce the flows of illicit funds to their countries.

### **The Global Forum on Transparency and Exchange of Information for Tax Purposes**

Created in 2009, the forum is a major driver behind creating universal acceptance of international standards for tax transparency. The forum also encourages the cross-country exchange of tax information. Originally, the forum only consisted of OECD countries and jurisdictions; today the forum includes 150 countries, including South Africa and Nigeria. Noteworthy African countries missing from the forum include Angola, Equatorial Guinea, and Ethiopia.<sup>6</sup> The Global Forum promotes two tools to make the sharing of tax information more effective: the exchange of information on request (EOIR) and the automatic exchange of financial account information (AEOI).

Every country that joins the Global Forum is asked to commit to the exchange of information on request standard. The EOIR standard arises when a tax authority from one jurisdiction asks for specific tax information from authorities from another jurisdiction (United Nations, 2017). Under the AEOI standard, created in 2016, this exchange is automated so that every year, without prior request, jurisdictions request information on the financial accounts of non-residents from their financial institutions. This information is then shared with the jurisdictions of the nonresident's home country. South Africa and the Seychelles were among the first countries to undertake exchanges under AEOI in 2017. Ghana and Mauritius promised to undertake exchanges under AEOI in 2018, Nigeria committed to a 2019 date, and the remaining African countries in the Global Forum have yet to commit to a date by which they will start automatic exchanges (OECD, 2019a).

In 2014, the Global Forum launched the Africa Initiative with the aim of encouraging transparency and the effective exchange of information in order to combat tax evasion and illicit flows in Africa through enhanced transparency. Originally, the initiative had a three-year shelf life. In November 2017, it was extended for an additional three years. The initiative is led by a taskforce made up of African countries that are members of the Global Forum, international regional bodies such as the African Tax Administration Forum, the U.K. Department for International Development, and the World Bank Group. Since inception, the initiative has hosted training seminars attended by more than 700 officials from 20 African countries. One of its goals by 2020 is for all African members to have in place a strategy to ensure the effective use of exchange of information tools to improve tax audits (OECD, 2019a).

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<sup>6</sup> The 29 African countries in the forum are Benin, Botswana, Burkina Faso, Cameroon, Cabo Verde, Chad, Côte d'Ivoire, Djibouti, Eswatini, Egypt, Gabon, Ghana, Kenya, Lesotho, Liberia, Madagascar, Mauritania, Mauritius, Morocco, Niger, Nigeria, Rwanda, Senegal, Seychelles, South Africa, Tanzania, Togo, Tunisia, and Uganda.

Overall, African countries studied by the Global Forum, including Ghana, Senegal, and Botswana, have been helpful in providing assistance to foreign jurisdictions when requested. However, little to no requests for information have been made by these African countries. For example, between January 2012 and December 2014, Senegal did not send out any EOI requests though it received nine (OECD, 2016). Between October 2013 and September 2016, Ghana only made three EOI requests while eight were received (OECD, 2018). Jurisdictions who received the requests praised Ghana as a cooperative partner, though no details were provided on the response to said requests.

The overall low level of African requests indicates that African countries need better mechanisms to make requests to other jurisdictions. However, even given these low levels, the disparity between African countries' requests and those they receive is significant, and suggests that African countries are making efforts to curb illicit financial flows given their current capabilities to do so. This disparity also indicates that OECD countries should take a more active role in making requests and monitoring illicit financial flows.

### **The Inclusive Framework on Base Erosion and Profit Shifting**

Base erosion and profit shifting (BEPS) is a tax avoidance strategy taking advantage of differences and gaps in tax legislation to artificially shift profits and avoid paying taxes in certain jurisdictions. In October 2015, the OECD delivered a list of 15 measures to combat BEPS; the list is known as the BEPS package. The package has three pillars: (i) reinforcing the coherence of corporate income tax rules at the global level; (ii) realigning taxation with the substance of the economic activities; and (iii) improving transparency (OECD, 2017). The 15 actions are intended to equip governments with domestic and international instruments to combat tax avoidance and ensure that profits are taxed where they are generated. The “minimum standard” actions include countering harmful tax practices, such as preferential tax regimes that facilitate BEPS, through improved transparency; preventing tax treaty abuse by adopting minimum standards for treaty provisions; establishing country-by-country reporting to improve tax transparency; and improving the timeliness, efficacy, and efficiency of the dispute resolution process. Other actions include creating clear transfer pricing documentation through a country-by-country template, which allows multinationals to report annually on each tax jurisdiction where they do business, and following mandatory tax disclosure rules (OECD, 2017).<sup>7</sup>

To implement the BEPS package, the Inclusive Framework on Base Erosion and Profit Shifting was created. The framework brings together 129 countries and jurisdictions, 23 of which are African.<sup>8</sup> Overall, framework member countries represent over 95 percent of global GDP (OECD, 2019b).

To date, one of the most notable tools put in place to combat BEPS is the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the “Multilateral Instrument,” or MLI). The MLI ensures that countries implement the minimum standards that were agreed upon under the BEPS package: These include fighting harmful tax practices, preventing tax treaty abuses, improving transparency, and enhancing the effectiveness of dispute resolution. In short, the MLI allows for the modification of tax treaties between two or more countries.

The OECD estimates that the MLI will lead to the modification of 1,100 tax treaties. The convention has been signed by 88 countries or jurisdictions—the U.S. is not one of those countries (Deloitte, 2019). Moreover, countries have opted out of certain provisions of the MLI; notably, as of 2017, 39

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<sup>7</sup> A full list of BEPS actions is available at <http://www.oecd.org/tax/beeps/beeps-actions.htm>.

<sup>8</sup> The African member countries are Angola, Benin, Botswana, Burkina Faso, Cabo Verde, Cameroon, Republic of the Congo, Côte d'Ivoire, Democratic Republic of the Congo, Djibouti, Egypt, Gabon, Kenya, Liberia, Mauritius, Morocco, Nigeria, Senegal, Seychelles, Sierra Leone, South Africa, Tunisia, and Zambia.

countries had opted out of article 12, which deals with the avoidance of permanent establishment (i.e., taxable presence) status (PwC, 2017). The reluctance of the U.S. and other advanced economies to fully adhere to the MLI prevents full transparency and contributes to the continuation of harmful tax practices that inevitably lead to higher levels of illicit financial flows.

## 7. REPATRIATION EFFORTS

While stopping illicit outflows of capital before they happen is important, repatriating funds that have been smuggled out can also be an important tool to solidify the domestic resource base of African countries. Challenges to repatriation efforts are numerous. For instance, many developing countries lack the judicial capacity necessary to produce legitimate requests for asset recovery. Moreover, differences in legislation between the place where money is laundered and the place where the theft occurs is a hindrance to asset recovery. In addition, there can be a lack of cooperation from developed economies when asked for funds recovery (United Nations and the World Bank, 2007).

One example of successful repatriation of illicit financial outflows comes from Nigeria. In 1998, the country launched the Special Police Investigation to investigate former Nigerian leader General Abacha's alleged theft of more than \$3 billion. Recovering the funds, which were mainly housed in Switzerland, was a tedious five-year process. In 1999, the Nigerian government, then led by President Olusegun Obasanjo, hired the Swiss legal firm Monfrini and Partners to assist in tracing the looted funds (Jimu, 2009; Kingah, 2011). That same year, Swiss authorities issued an asset freezing order, upon receiving a request for mutual legal assistance. Still, repatriating the funds did not happen until 2004 as Swiss authorities were requesting a final forfeiture judgement from the Nigerian courts. Monfrini and Partners argued that Abacha's funds were obtained illegally, and the final forfeiture requirement was waived. While this example shows the difficulties that arise in trying to repatriate looted funds, it also shows that African countries can successfully relocate and repatriate illicit outflows from their countries. Then again, this initiative required significant resources from the Nigerian government which smaller African economies may not be able to afford.

In September 1999, Obasanjo gave an address to the United Nations General Assembly where he called for the creation of an international convention that will facilitate the repatriation of wealth that was illicitly acquired and kept abroad. In 2007, the U.N. Office on Drugs and Crime (UNODC) and the World Bank launched the Stolen Asset Recovery (StAR) Initiative. The initiative's action plans include the creation of a pilot program to help countries recover stolen assets through the provision of legal and technical assistance. This assistance could include helping countries draft requests for mutual assistance, such as the document that led to the freezing of Abacha's asset in the Nigerian example cited above (United Nations and the World Bank, 2007). Nevertheless, the funds that have been repatriated using some assistance from the initiative stand well below total looted funds. This outcome shows that countries still have difficulty acquiring the funds and support necessary to attempt repatriation requests and other efforts. Furthermore, between 2006 and mid-2012, OECD members returned only \$423.5 million of stolen funds to developing countries, barely affecting the gap of \$20 billion - 40 billion smuggled out of said countries annually (Gray et. al., 2014). In the Nigerian case cited above, only \$504 million of the stolen \$3 billion was repatriated to Nigeria. In another example, in 2012, Switzerland repatriated \$64 million in looted funds to Angola that were allegedly stolen between 2004 and 2012, but, over that period, our estimates show that illicit outflows from Angola to the world amounted to \$23 billion. Thus, while repatriation efforts are important, present actions must be scaled up and improved within and across countries to repatriate a more substantial amount of illicit financial outflows.

## 8. CONCLUSION AND POLICY RECOMMENDATIONS

Over the years, illicit financial flows from Africa have moved away from advanced economies toward emerging economies. Part of this shift can be explained by the reduction in trade levels with developed economies. However, the large upsurge of illicit flows to certain emerging and developing economies in Asia and the Middle East cannot solely be explained by increased trade levels. Instead, a deep analysis of host countries' macroeconomic and governance conditions is needed, as was conducted in the case of the Chinese government's anti-corruption efforts.

While there are initiatives in place to curtail illicit financial flows, many of them stem from advanced economies, including G-20 and OECD countries, and may fail to address the upsurge in illicit flows toward emerging and developing economies. Where emerging economy countries have difficulty launching efforts against illicit financial outflows from their countries, so too will these emerging host countries face enormous challenges in stopping illicit flows or repatriating funds. African policymakers should make more efforts to work with their counterparts in the Middle East and Asia to create policies that address the drain on Africa's development resources.

Additionally, repatriation efforts have been rather meager, failing to make a significant dent in the \$1.3 trillion that Africa has lost abroad from illicit flows over the past few decades. While African countries work to halt financial flows before they exit the continent, the global community must also increase and improve repatriation efforts. As discussed above, well-executed repatriation efforts do bring back stolen financial funds to African countries, such efforts should also be accompanied by additional initiatives or mechanisms designed to deter illicit financial outflows in the first place.



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## APPENDIX 1

**Table A.1: Total illicit financial flows from sub-Saharan African countries, by volume (1980-2018)**

<b>Country</b>	<b>IFFs (millions of USD)</b>	<b>IFFs (% of total trade)</b>
South Africa	441,481	15.5
Democratic Republic of the Congo	165,649	20.4
Ethiopia	84,316	33.5
Nigeria	67,057	3.4
Republic of the Congo	55,083	23.8
Angola	45,132	4.4
Sudan	38,666	15.1
Botswana	31,485	16.1
Zambia	27,499	11.8
Cameroon	26,598	14.9
Gabon	26,221	13.6
Uganda	25,201	21.3
Namibia	24,048	13.4
Zimbabwe	22,652	13.9
Togo	19,285	32.2
Tanzania	16,132	7.2
Sierra Leone	15,220	53.9
Guinea	14,797	18.1
Côte d'Ivoire	14,708	3.8
Benin	14,431	27.6
Mauritania	14,174	19.0
Mali	14,152	14.8
Mauritius	13,920	9.5
Mozambique	13,339	8.7
Malawi	13,169	21.1
Kenya	12,485	3.7
Madagascar	11,003	12.8
Eswatini	10,590	20.5
Lesotho	9,536	29.5
Niger	9,435	20.1
Rwanda	7,546	21.5
Liberia	6,775	3.7
Ghana	6,263	1.7
Burkina Faso	6,044	7.9
Senegal	3,901	2.7
Burundi	3,795	26.7
Seychelles	3,767	12.0
Central African Republic	1,968	19.3
Eritrea	1,790	15.7

The Gambia	1,787	16.8
São Tomé and Príncipe	1,538	57.3
Comoros	843	23.2
Cabo Verde	537	3.3
Somalia	413	1.1
Guinea-Bissau	339	3.7
Chad	158	0.3
Equatorial Guinea	147	0.1
South Sudan	122	0.7

**Table A.2: Destination of illicit financial flows from sub-Saharan African countries, by volume (1980-2018)<sup>9</sup>**

<b>Country</b>	<b>IFFs (millions of USD)</b>	<b>IFFs (% of bilateral trade)</b>
China	226,425	9.9
United States	129,460	12.6
Japan	81,579	20.5
United Kingdom	65,642	8.2
United Arab Emirates	62,652	3.8
Germany	49,986	12.1
Spain	47,219	15.2
Belgium	38,594	18.8
South Korea	34,737	19.6
Democratic Republic of the Congo	34,623	10.7
Zambia	29,457	15.9
Italy	27,521	10.2
Saudi Arabia	20,384	8.9
South Africa	20,082	2.8
Turkey	18,436	31.2
Republic of the Congo	17,361	3.9
Thailand	17,036	16.2
Russia	16,633	42.9
Switzerland	15,661	6.5
Sweden	11,873	10.4
Algeria	11,287	13.5
Bahrain	9,662	57.7
Zimbabwe	9,527	10.8
Mexico	8,962	58.2
Portugal	8,923	8.4
Ukraine	8,578	41.2

<sup>9</sup> List is restricted to countries hosting over \$1 billion in illicit financial flows from 1980-2018.

Netherlands	8,039	0.0
Hong Kong SAR, China	7,173	2.7
Canada	6,775	6.8
Angola	6,249	3.8
Mali	6,097	3.7
Norway	6,049	11.2
Togo	6,049	13.5
France	6,013	0.6
Benin	5,931	35.2
Egypt	5,633	21.9
Australia	5,472	5.4
Brazil	5,418	2.9
Denmark	5,311	17.9
Indonesia	5,002	6.9
India	4,873	0.0
Mauritania	4,801	8.5
Mozambique	4,581	3.7
Gabon	4,287	4.1
Peru	4,266	6.4
Austria	4,224	23.5
Poland	3,968	19.4
Mauritius	3,945	17.1
Côte d'Ivoire	3,848	1.4
Malawi	3,804	13.6
Ireland	3,317	11.3
Argentina	3,310	6.7
Oman	3,282	3.5
Malaysia	3,184	7.3
Vietnam	3,184	10.7
Namibia	2,872	7.5
Senegal	2,709	2.9
Lebanon	2,704	18.3
Nigeria	2,535	3.0
Ecuador	2,529	18.7
Finland	2,207	9.0
Greece	2,150	14.8
Pakistan	2,141	5.0
Yemen	2,080	6.3
Morocco	1,955	12.2
Chile	1,906	8.4
Hungary	1,517	26.9
Kenya	1,496	0.9

Romania	1,475	19.0
Cameroon	1,267	2.4
Colombia	1,202	25.7
Kuwait	1,180	10.3
Niger	1,149	34.4
Uruguay	1,126	8.3
Bulgaria	1,064	8.3
Philippines	1,034	17.0

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