Inter Press Service News Agency

'Record' Illicit Money Lost by Developing Countries Triples in a Decade

By Carey L. Biron **December 16, 2014**

Developing countries are losing money through illicit channels at twice the rate at which their economies are growing, according to new estimates released Tuesday. Further, the total volume of these lost funds appears to be rapidly expanding.

Findings from Global Financial Integrity (GFI), a watchdog group based here, re-confirm previous estimates that developing countries are losing almost a trillion dollars a year through tax evasion, corruption and other financial crimes. Yet in a new report covering the decade through 2012, GFI's researchers show that the rate at which these illicit outflows are taking place has risen significantly.

In 2003, for instance, cumulative illicit capital leaving developing countries was pegged at around 297 billion dollars. That's significant, of course, but relatively little compared to the more than 991 billion now estimated for 2012 – a record figure, thus far.

In less than a decade, then, these illicit outflows more than tripled in size, totalling at least 6.6 billion dollars. GFI reports that this works out to an adjusted average growth of some 9.4 percent per year, or twice the average global growth in gross domestic product (GDP).

One of the most common mechanisms for moving this money has been the falsification of trade invoices.

"After turning down following the financial crisis, global trade is going up again and so it's increasingly easy to engage in misinvoicing – a lot more people are coming to understand how to do this and are willing to indulge," Raymond Baker, GFI's president, told IPS.

"These rates are not only growing faster than global GDP but also faster than the rate of growth of global trade."

Further, these estimates are likely conservative, and don't cover a broad spectrum of data that is not officially reported – cash-based criminal activities, for instance, or unofficial "hawala" transactions.

Baker emphasises that these capital losses are a problem affecting the entire developing world. Yet given that illicit outflows run in tandem with a country's broader interaction with global trade, these rates are particularly strong in the world's emerging economies, led by China, Russia, Mexico and India.

There are also significant differentials between regions, both is size and the rate at which they're increasing. In the Middle East and North Africa, for instance, illicit financial flows are growing far higher than the global average, at more than 24 percent per year.

Even in sub-Saharan Africa, home to some of the world's poorest communities, these rates are growing at more than 13 percent per year. Such figures eclipse both foreign assistance and foreign investment – indeed, the 2012 figure was more than 11 times the total development assistance offered on a global basis.

"If we take [these] findings seriously, we can address extreme poverty in our lifetimes," Eric LeCompte, an expert to U.N. groups that focus on these issues, said Monday. "Countries need resources and if we curb these illicit practices, we can get the money where it's needed most."

Lucrative misinvoicing

There is a broad spectrum of potential avenues for the illegal skimming from or shifting of profits in developing countries, carried out by criminal entities, corrupt officials and dishonest corporations. And for the first time, certain of these key issues are receiving new and concerted international attention.

Multiple nascent multinational actions are now unfolding aimed at cracking down particularly on tax evasion by transnational companies. New transparency mechanisms are in the process of being rolled by several multilateral groups, including the Group of 20 (G20) industrialized nations and the Organisation for Economic Cooperation and Development (OECD), a Paris-based grouping of rich countries.

Such initiatives are receiving keen attention from civil society groups, and would likely constrict these illicit flows. Yet in fact, GFI's research suggests that the overwhelming method by which capital is illegally leaving developing countries is far more mundane and, potentially, complex to tackle.

This has to do with simple trade misinvoicing, in which companies purposefully use incorrect pricing of imports or exports to justify the transfer of funds out of or into a country, thus laundering ill-gotten finances or helping companies to hide profits. Over the past decade, the new GFI report estimates, more than three-quarters of illicit financial flows were facilitated by trade misinvoicing.

And this includes only misinvoicing for goods, not services. Likely the real figure is far higher.

Experts say that stopping misinvoicing completely will be impossible, but note that there are multiple ways to curtail the problem. First would be to ensure greater transparency in the global financial system, to eliminate tax havens and "shell corporations" and to require the automatic exchange of tax information across borders.

Efforts are currently underway to accomplish each of these, to varying degrees. Last month, leaders of the G20 countries agreed to begin automatically sharing tax information by the end of next year, and also committed to assist developing countries to engage in such sharing in the future.

GFI's Baker says that developing countries need to bolster their customs systems, but notes that other tools are already readily available to push back against trade misinvoicing.

"There is a growing volume of online pricing data available that can be accessed in real time," he says. "This gives developing countries the ability to look at transactions coming in and going out and to get an immediate idea as to whether the pricing accords with international norms. And if not, they can quickly question the transaction."

Development goal

There is today broad recognition of the monumental impact that illicit financial flows have on poor countries' ability to fund their own development. Given the centrality of trade misinvoicing in this problem, there are also increasing calls for multilateral action to take direct aim at the issue.

In particular, some development scholars and anti-poverty campaigners are urging that a related goal be included in the new Sustainable Development Goals (SDGs), currently under negotiation at the United Nations and planned to be unveiled in mid-2015.

Under this framework, GFI is calling for the international community to agree to halve trade-related illicit flows within a decade and a half. The OECD is hosting a two-day conference this week to discuss the issue.

"We're not talking about an aspirational goal but rather a very measurable goal. That's doable, but it will take political will," Baker says.

"We think the SDGs should incorporate very specific, targetable goals that can have huge impact on development and helping developing countries keep their own money. In our view, that's the most important objective."