

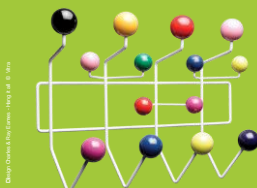
Illicit financial flows

Concepts and first macro estimates for Belgium and its 18 preferred partner countries

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Brussel, Directie-Generaal Ontwikkelingssamenwerking en Humanitaire Hulp DGD

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Content

- International literature survey
 - Measuring informal economy
 - Measuring tax evasion or fraud
 - Measuring tax avoidance
 - Measuring illegal financial flows
- And its relevance for Belgian policy making for 18 partner countries: formal and estimates of informal macro figures
 - National income
 - Underground economy
 - And its reasons
 - Government revenue
 - External sources
 - Illicit financial flows
 - And its potential consequences
- Provide similar information for Belgium (and Netherlands, Luxembourg)

Growing awareness

- Concern about illegal money flow, but more and more also tax evasion ...and avoidance (for instance BEPS discussion)
- Growing concern for money laundering, corruption, transparency
- Growing attention for international capital flows and role of tax havens
- In search for the global grand but dark figure
 - 1 trillion USD illicit financial flows in the world
 - More than 2 trillion euro undeclared economy in the EU
 - Or more than 1 trillion euro missed revenue for the government in EU
 - Global financial wealth of households is USD 95,5 trillion of which 7,6 trillion in tax havens of which 2,3 trillion in Switzerland (Zucman)
- Frequently quoted but go back to same sources
- Become 'facts by repetition' (P. Reuter)

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Belgium and its preferred partner countries: size op population, GDP and GDP per capita

Country	Population (2012, million persons)	GDP (2012, billion USD)	GDP/capita (2012, current prices USD in units)
Algeria	37,5	207,8	5.542
Benin	10,1	7,5	751
Bolivia	10,8	27,3	2.517
Burundi	8,8	2,5	286
Congo, Dem. Rep.	74,7	27,5	368
Ecuador	15,5	87,5	5.637
Mali	16,3	10,3	627
Morocco	32,5	95,9	2.949
Mozambique	25,2	14,3	567
Niger	16,1	6,7	416
Peru	30,5	192,7	6.323
Rwanda	10,5	7,3	694
Senegal	13,7	14,0	1.023
South Africa	52,3	382,3	7.314
Tanzania	44,9	28,5	633
Uganda	35,6	21,2	596
Vietnam	88,8	155,6	1.753
West Bank and Gaza	-	10,2	-
Belgian Partner countries	523,9	1.288,9	2.460
Belgium	11,1	483,2	43.551
Luxembourg	0,5	55,2	103.806
Netherlands	16,8	823,6	49.158
Benelux	28,4	1.362,0	47.988

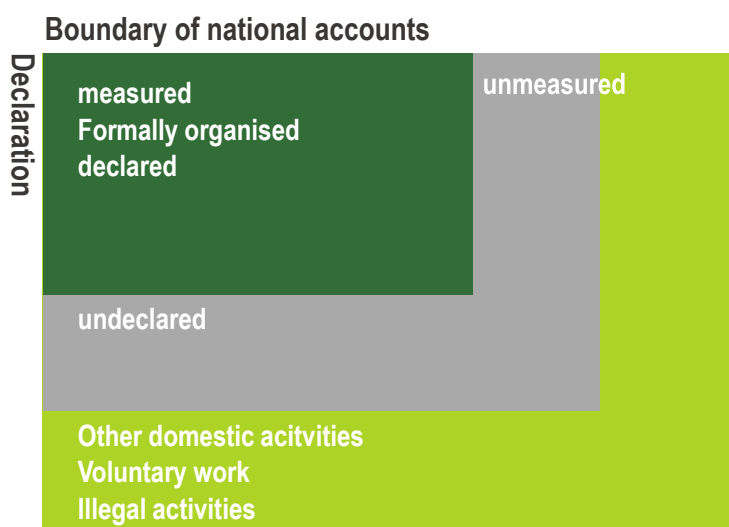
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Informal economy versus illegal economy versus illicit economy

- Definitions of UN national accounts and definitions of OECD
 - underground production,
 - illegal production,
 - informal production,
 - household production for own final use,
 - production missed due to deficiencies in data collection

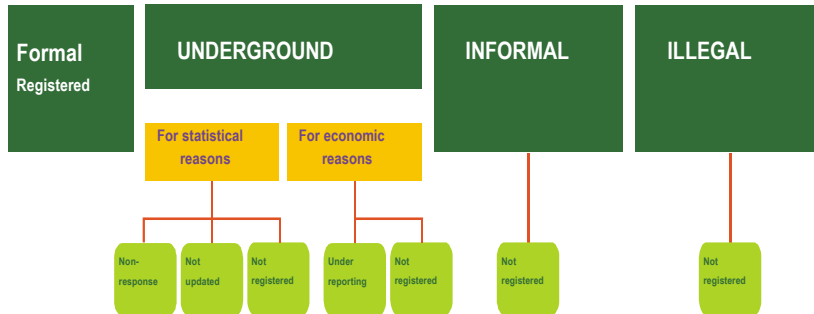
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Perimeter of formal and informal economy



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Perimeter of formal and informal economy



Istat (Italian Statistical office) analytical framework for non-observed economy

The unclear borderline between evasion, avoidance, non taxation, illegal and illicit

Fiscal contributions	Evasion	Grey zone	Avoidance	Charge not or less taxes because Cannot fully tax	Grey zone	Don't want fully tax	Fiscal underestimation	
	Undeclared income		<ul style="list-style-type: none"> To form Relocate fiscal basis Spread in time 	Moveable property		Cadastral income own house Savings account	A fixed deduction of certain occupations	
	Undeclared work		<ul style="list-style-type: none"> To form Relocate fiscal basis Spread in time 	Exemption and subsidy		Domestic help, fiscal amnesty	Domestic help, service vouchers	A fixed deduction of certain occupations
	Benefit fraud and misuse							
Criminal and illegal activities								

Measuring the informal economy

- National accounting :limited interest of national accountants
- Administrative data (Inspection services)
- Micro-economic methods: surveys, case studies, (households, firms, inspection services),
- Macro-economic methods as used by Prof. Schneider (i.e. DYMIMIC model)
- Need for reconciliation of methods

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Illicit financial flows: definitions

- Cannot be considered as synonym with illegal
- Illicit financial flows strictly defined as illegal in the way they are created, transferred and used. Source can be illegal, use can be legal or illegal (OECD)
- A larger definition of illicit refers to all flows that 'have 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'
- Is a flow illicit when it breaches the spirit, and not the letter of the law? Is it illicit when it aims at lobbying for tax concessions made within the legal powers to give those? And is it illicit or illegitimate when it tries to avoid a state itself that is considered as 'illicit' or 'illegitimate'
- Illicit (or illegal) financial flows aim to transfer financial capital out of a country; in contravention of (inter)national laws, through in general several illegal practices like money laundering, bribery by international companies and tax evasion, and mispricing (OECD, 2014a, p. 16). They partly can be called 'tax-motivated illicit financial flows' which certainly will undermine the development of the economy in developing countries (Hearson, 2014).
- The term flight capital or capital flight states that the underlying problem is totally caused by the developing countries where the money comes from. In contrast, illicit financial flows states that this phenomenon is caused by both the developed countries and the developing countries.
- It reminds us in any case of our sympathy of an exhaustive and large definition of tax evasion, tax avoidance and non taxation

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Illicit financial flows

- Limited number of estimates: Global Financial Integrity, Boyce & Ndikumana, High level panel for Africa
- Originally based on surveys, later on macro-economic parameters
- Based on balance of payment figures: trade misinvoicing and hot money outflows
- Capital flight for some countries by Boyce & Ndikumana
- Difference between gross outflows, net flows or should it not be gross outflows plus inflows
- Cumulated outflows is gross stock of illicit flow or capital flight

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Measurement

- Hot money narrow model HMN
Capital flight = all funds coming in (credit)–all funds going out (debt)
- World bank residual model WBR
Capital flight = (increase in foreign debt+increase in foreign direct investment)–
(the current account deficit+additions to country's foreign reserves).
Or:
Capital flight = (sources of funds)–(uses of funds).
- Trade misinvoicing
- Transfer mispricing
- Unrecorded remittances
- Walker Gravity model linking illegal activities with illicit flows
- Surveys
- Composite model

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Major sources

- Global Financial Integrity (Kar & Spanjers)
Gross outflows
- Boyce & Ndikumana
Net outflows of capital flight

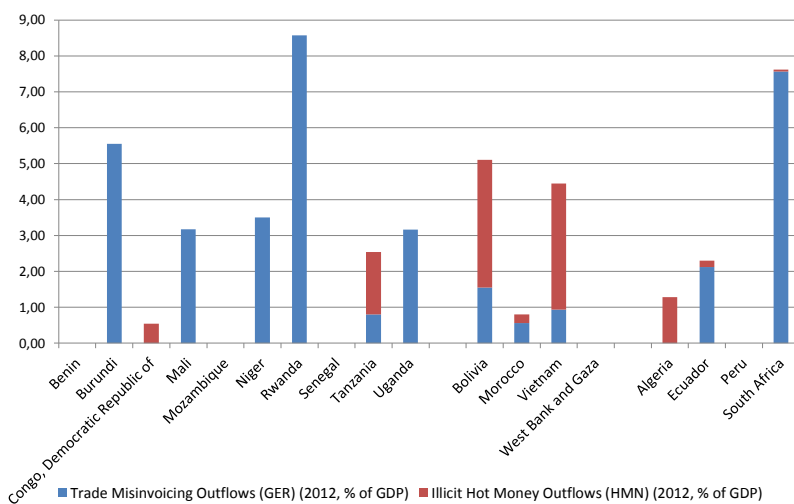
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Size of illicit financial flows, some alternatives as % GDP

Country	GFI (2012)*	GFI (2005-2012, average)*	Boyce and Ndikumana (2010)**	High Level Panel on Illicit Financial Flows from Africa (n.d.).
Algeria	1.28	1.20		N.A.
Benin	0.00	0.48		N.A.
Bolivia	5.10	2.19		N.A.
Burundi	5.55	5.46	-0.31	5
Congo, Democratic Republic of	0.54	1.58	8.85	3
Ecuador	2.29	3.30		N.A.
Mali	3.17	5.33		1
Morocco	0.80	1.47		N.A.
Mozambique	0.00	1.61	7.68	2
Niger	3.50	2.91		3
Peru	0.00	0.86		N.A.
Rwanda	8.57	5.47	-5.65	3
Senegal	0.00	0.02		3
South Africa	7.62	4.78		5
Tanzania	2.54	2.49	-0.66	3
Uganda	3.16	5.88	-0.95	5
Vietnam	4.44	2.83		N.A.
Partners of Belgium (excl. West Bank and Gazainian Territories)	3.53	2.80	0.43	N.A.

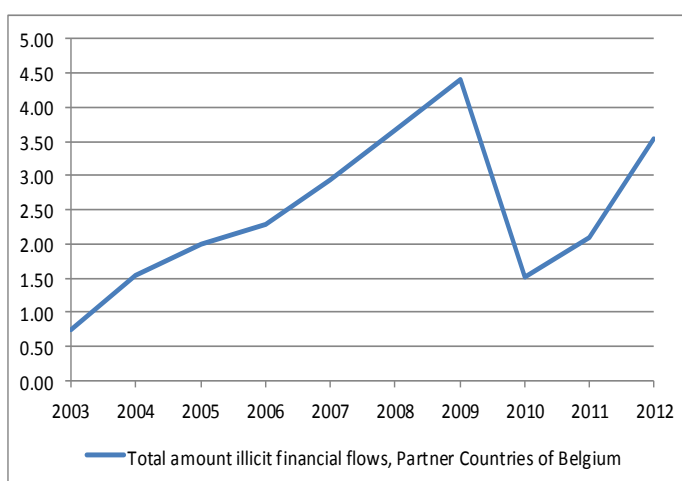
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Components of illicit financial outflows: misinvoicing and hot money movements



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Estimates of gross illicit financial outflows for Belgian partner countries, in % of GDP: 2003 - 2012



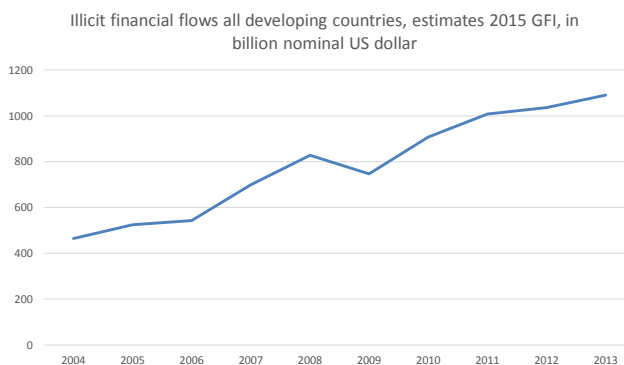
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[Global Illicit Financial Flows Report: 2015](#)

This December 2015 report from Global Financial Integrity, "Illicit Financial Flows from Developing Countries: 2004-2013," finds that developing and emerging economies lost US\$7.8 trillion in illicit financial flows from 2004 through 2013, with illicit outflows increasing at an average rate of 6.5 percent per year—nearly twice as fast as global GDP.

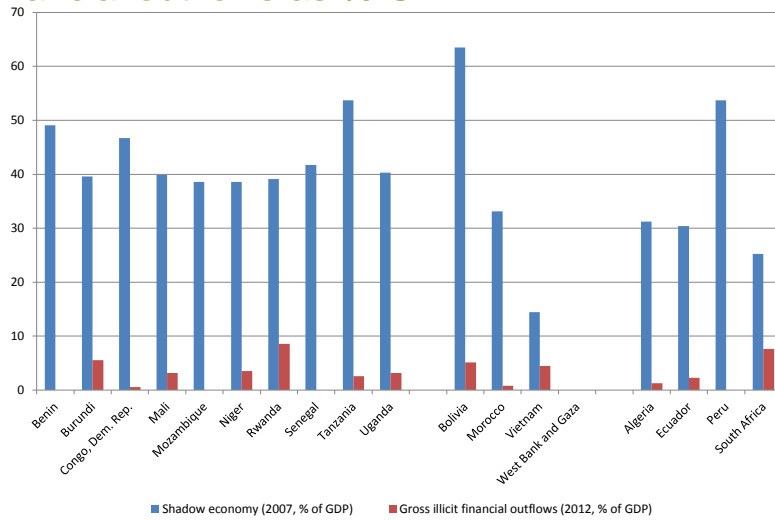
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Illicit financial flows all developing countries



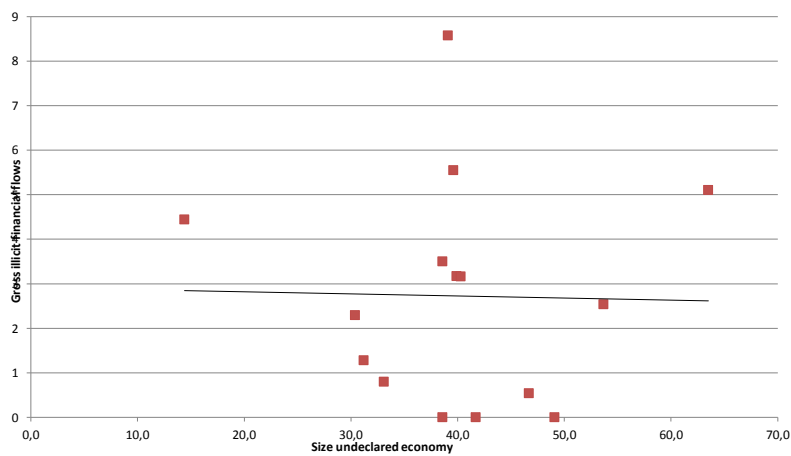
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Size of undeclared economy and gross illicit financial outflows as % GDP



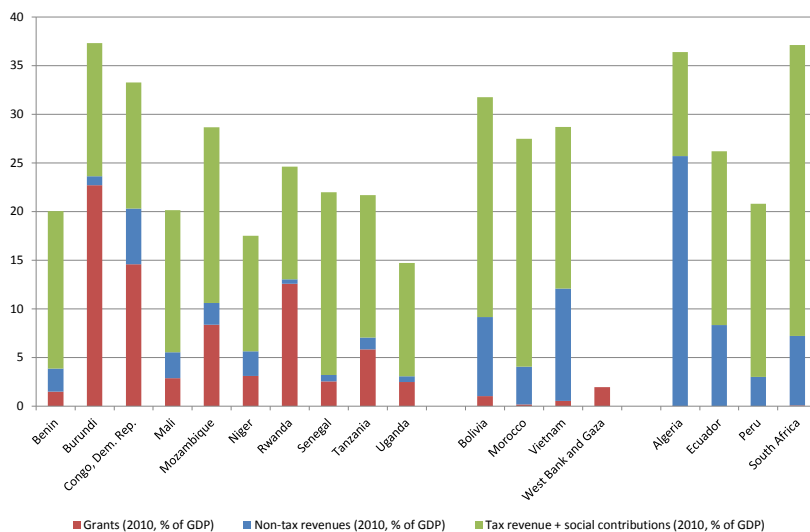
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Gross illicit financial outflows (2012, % of GDP) versus size undeclared economy (2007, as % of GDP)



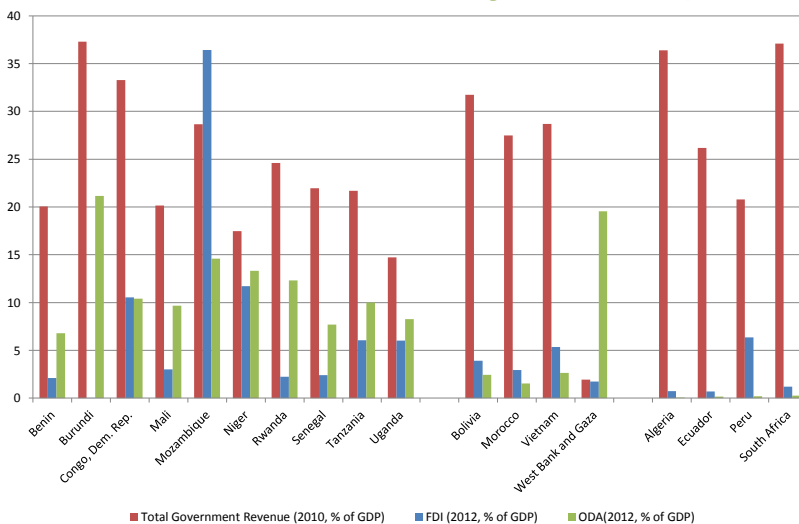
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Structure Government revenue



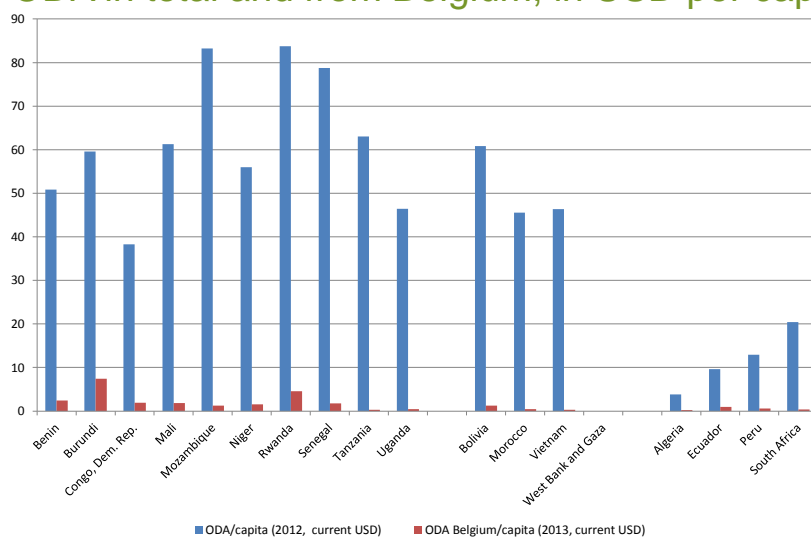
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Internal and external financing for development



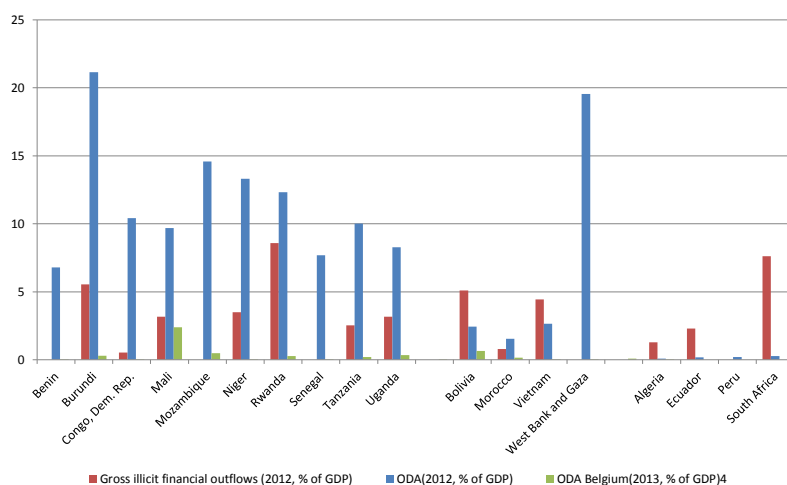
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ODA in total and from Belgium, in USD per capita



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Illicit financial outflows compared to ODA in total and from Belgium, as % of GDP



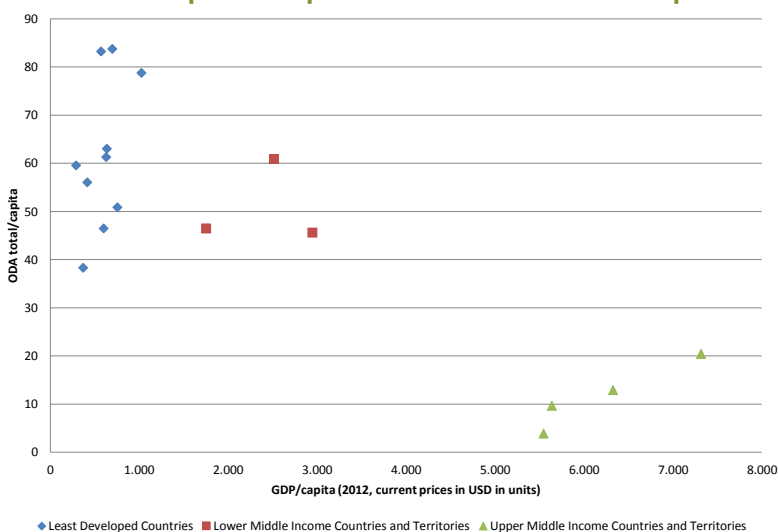
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Grand (but dark) figures for 18 partner countries and Belgium

- 45,6 billion USD gross illicit financial flows for 18 partner countries, some 3,5% of their GDP
- Estimated underground economy is 261,4 billion USD or 31,6% of GDP
- Estimates for Belgium on same methodology of underground economy is some 21% of GDP, now declining to 17% ...but according to national accounts rather 4%

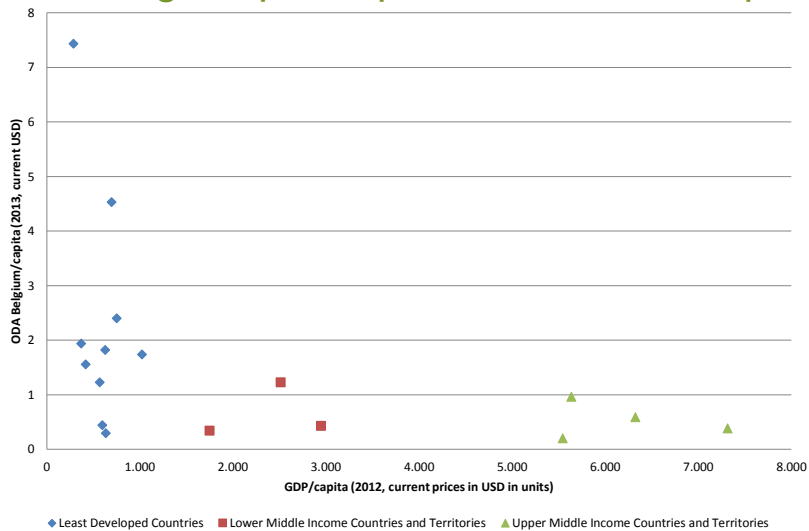
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Total ODA per capita versus GDP/capita



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ODA Belgium per capita versus GDP/capita



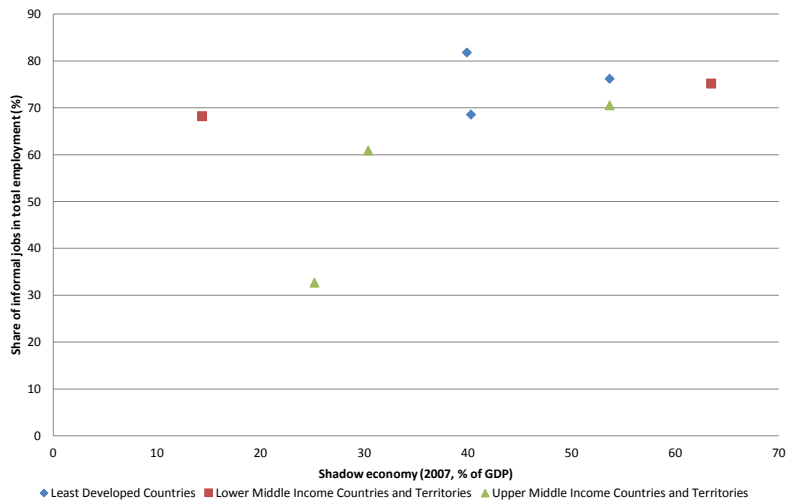
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Determinants of size undeclared economy and illicit financial flows

- Growth to formal economy
- Fragility of state
- Corruption
- Indexes
 - Corruption perception of Transparency International
 - Fragile State index
 - Basel Anti-Money laundering index

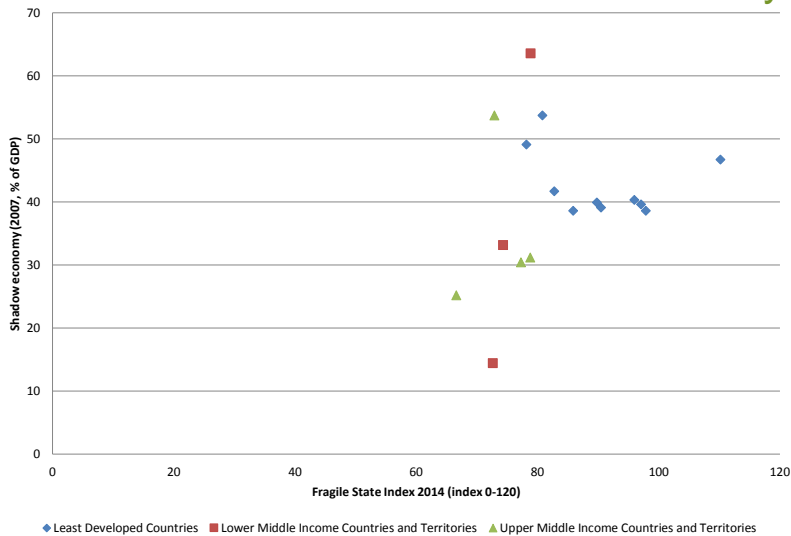
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Relation between estimate of underground economy and informal work



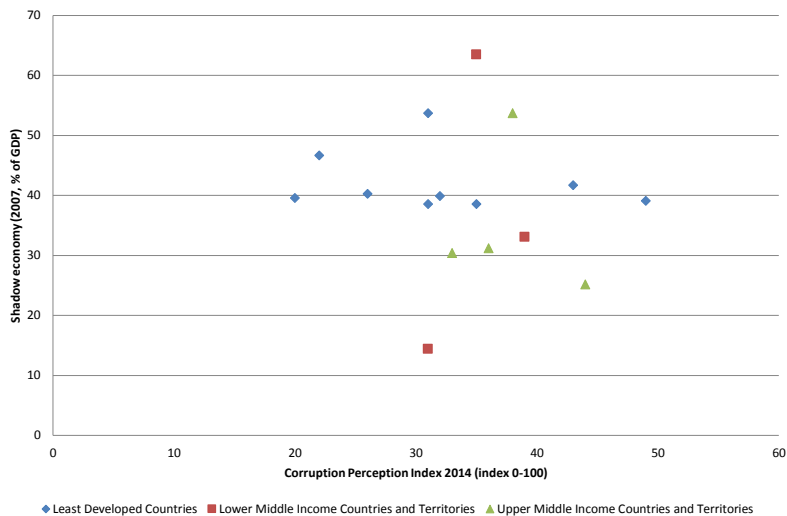
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Determinants of size undeclared economy



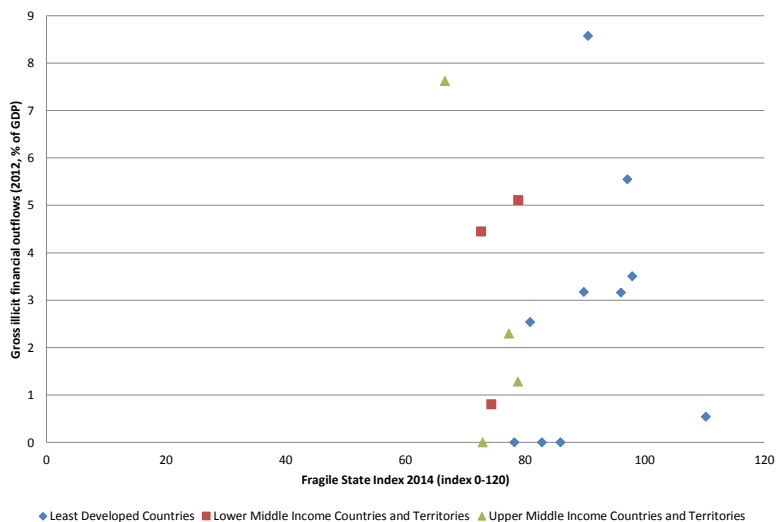
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Determinants of size undeclared economy



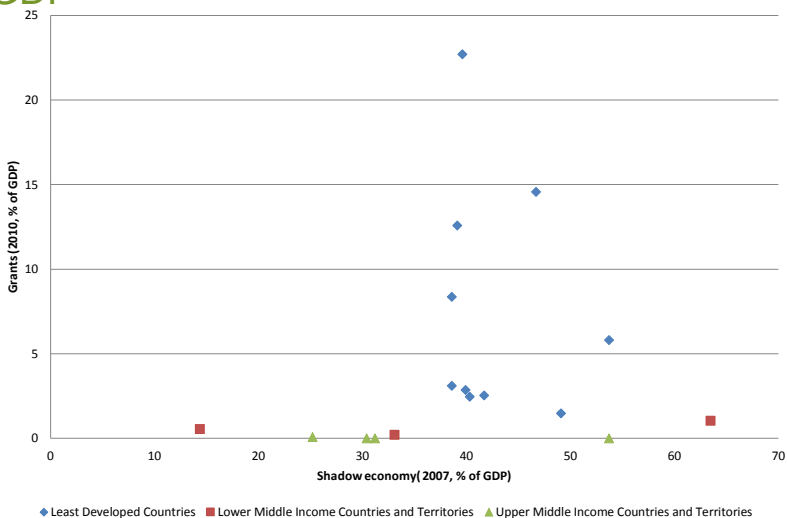
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Determinants of size illicit financial flows

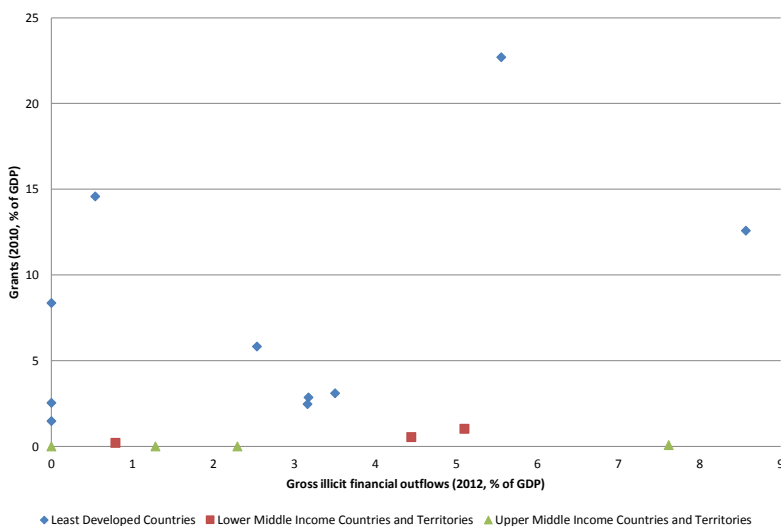


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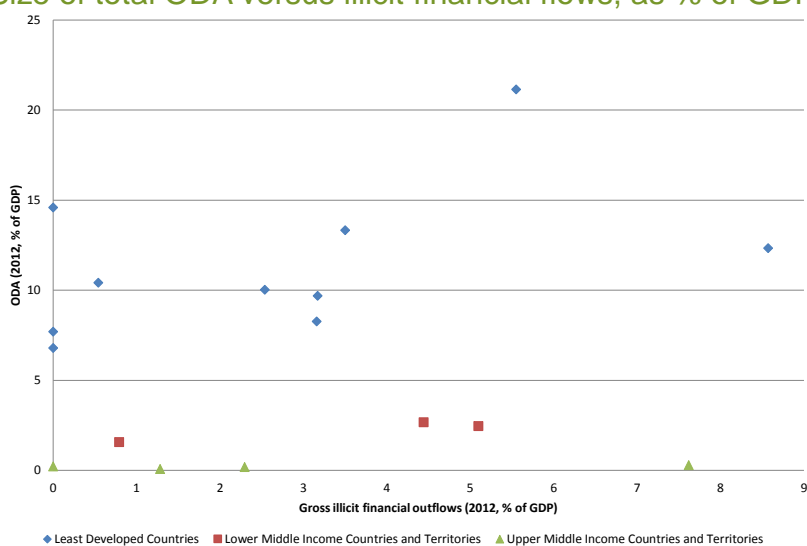
Size of grants versus shadow economy, as % of GDP



Size of grants versus illicit financial flows, as % of GDP

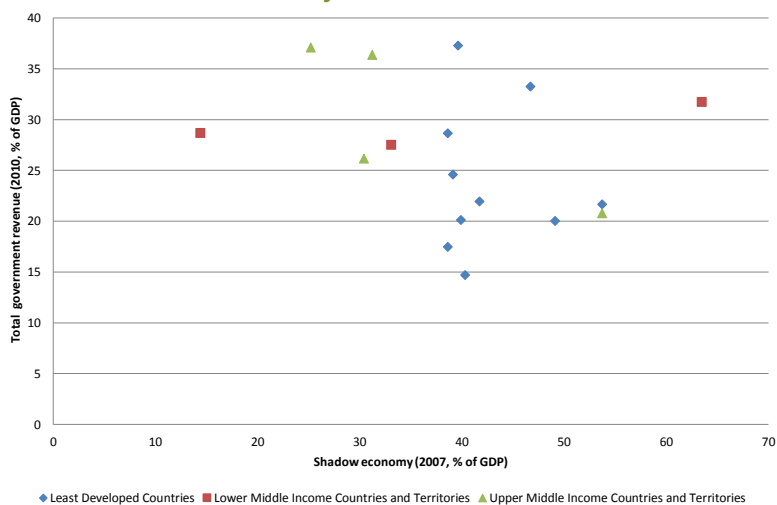


Size of total ODA versus illicit financial flows, as % of GDP



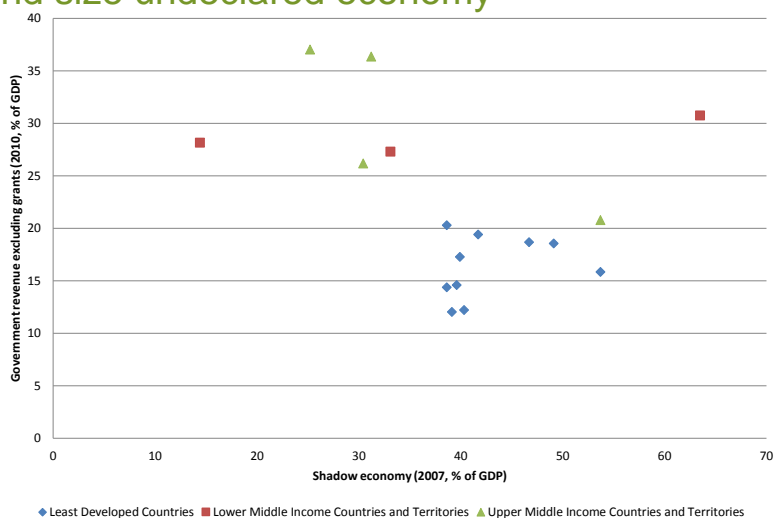
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Relation total government revenue and size undeclared economy



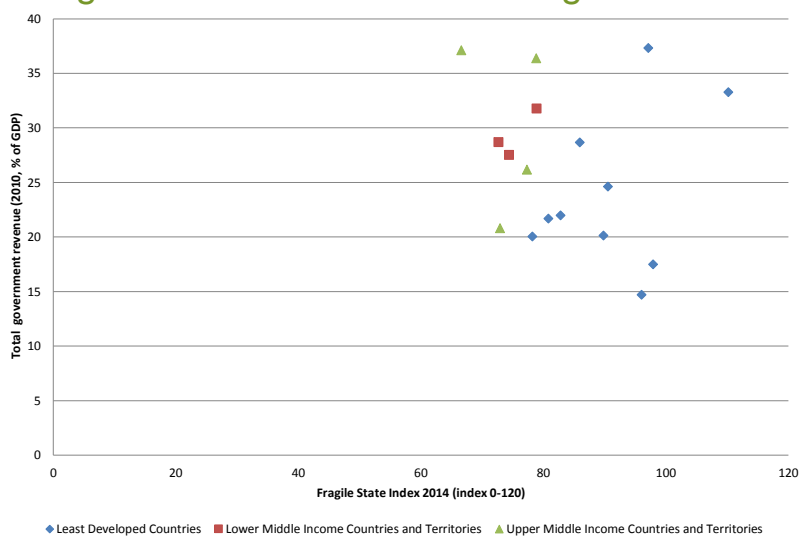
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Relation total government revenue less grants and size undeclared economy



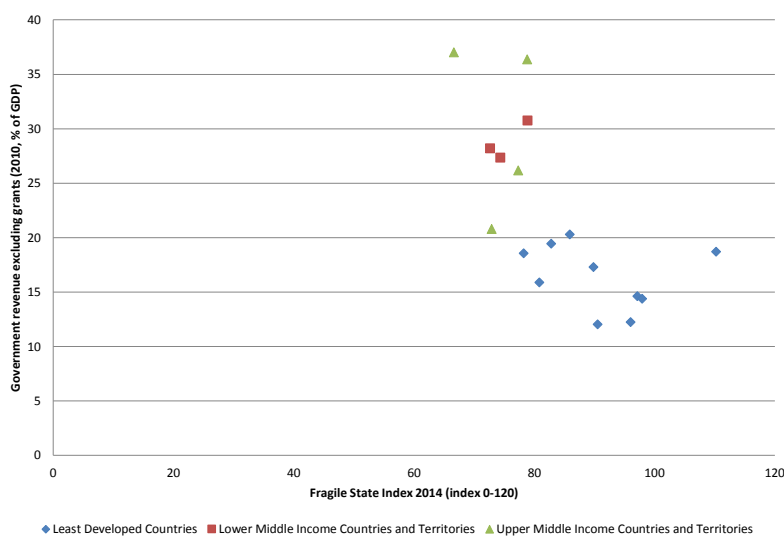
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Total government revenue and fragile state index



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Total government revenue excluding grants and fragile state index



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Consequences of illicit financial flows: estimates High level panel on illicit financial flows from Africa

Country	Under-5 mortality rates in 2000 (per 1000)	MDG 4 target (under-5 mortality rates, 2000-2011)	Actual annual Reduction in under-5 mortality rates (2000-2011)	Illicit financial flows (percent of GDP)	Potential annual reduction in under-5 mortality absent IFFs	Number of years from 2000 to reach MDG 4 at current rate of decline	Number years from 2000 to reach MDG 4 if IFFs curtailed
Burundi	164	63	1.5	6	3.8	63	25
Congo, Democratic Republic	181	66	0.7	3	1.8	144	54
Mali	213	83	1.8	3	2.9	52	32
Mozambique	177	83	4.7	5	6.6	16	11
Niger	218	102	5.0	3	6.1	15	12
Rwanda	177	58	11.1	5	13.0	9	8
Senegal	119	50	6.4	1	6.8	13	12
South Africa	78	19	4.2	4	5.7	33	24
Tanzania	130	52	5.7	2	6.5	16	14
Uganda	144	62	4.1	3	7.5	20	16
Total	143	56	3.3		3.8	29	16

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