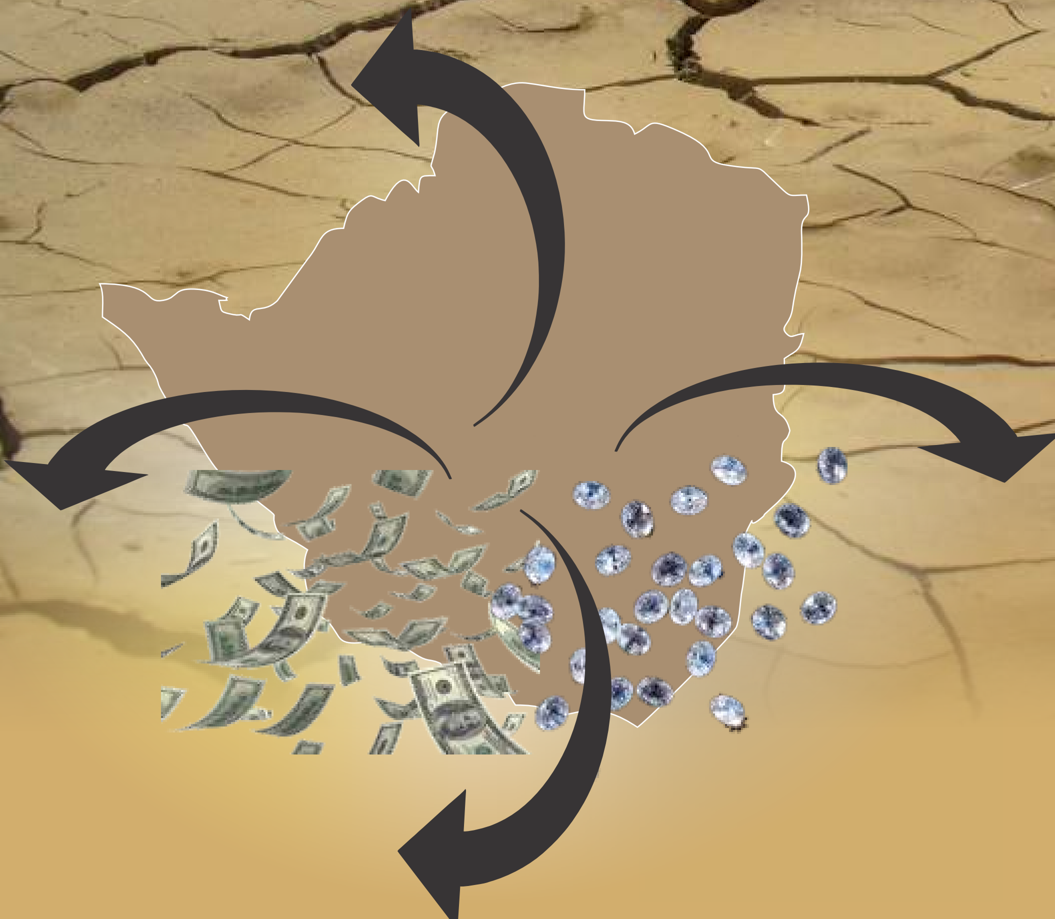
# Community voices on illicit financial outflows



Commisioned
by
**ZIMCODD**

# About ZIMCODD

The Zimbabwe Coalition on Debt and Development (ZIMCODD), is a socio-economic justice coalition established in February 2000 to facilitate citizens' involvement in making public policy and practice pro-people and sustainable. ZIMCODD views Zimbabwe's indebtedness, the unfair global trade regime and lack of democratic people-centred economic governance as root causes of the socio-economic crises in Zimbabwe and the world at large. Drawing from community-based livelihood experiences of its membership, ZIMCODD implements programmes targeted at;

Educating the citizen
Facilitating policy dialogue among stakeholders
Engaging and acting on socio-economic governance at local, regional and global levels

ZIMCODD's headquarters are in Harare with regional offices in Bulawayo.

**Vision**
Sustainable socio-economic justice in Zimbabwe through a vibrant people based movement.

**Mission**
To take action in redressing the Debt burden and Social & Economic Injustices through formulation and promotion of alternative policies to the neo-liberal agenda.

**Objectives**
To raise the level of economic literacy among ZIMCODD members to include views and participation of grassroots and marginalised communities;

- To facilitate research, lobbying and advocacy in order to raise the level of economic literacy on issues of debt, trade and sustainable development;
- To formulate credible sustainable economic and social policy alternatives;
- To develop a national

ZIMCODD is a member of the Southern Africa Peoples' Network and currently hosts the SAPSN Secretariat since 2003.

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# List of Abbreviations

| | |
|---|---|
| **BEPS** | Basic Erosion and Profit Shifting |
| **EITI** | Extractive Industry Transparency Initiative |
| **G20** | Group of Twenty |
| **G8** | Group of Eight |
| **IFF** | Illicit Financial Flows |
| **MDG** | Millennium Development Goals |
| **MNC** | Multinational cooperation |
| **OECD** | Organisation of Economic Cooperation and Development |
| **UNCAC** | United Nations Convention against Corruption |
| **UNODC** | United Nations Office on Drugs and Corruption |
| **ZIMCODD** | Zimbabwe Coalition on Debt and Development |

# Introduction

Illicit Financial Flows (IFFs) are at the forefront of the international agenda and have been considered as an issue of central importance by the Organisation of Economic Cooperation and Development (OECD). OECD countries are at risk of becoming safe havens for illicit assets by neglecting transparency of ownership. IFFs are an international problem as they originate in developing countries and then often reach OECD countries. In addition to this, the Group of 20 (G20) has placed tax avoidance and profit shifting at the top of its agenda further buttressing the fact that the issue of IFF is an international problem. The movement of financial resources across boundaries especially from the developing countries has raised so many questions than answers. According to Global Financial Integrity, IFFs are illegal movements of money or capital from one country to another. The movements are classified as illicit flows when the funds are illegally earned, transferred, and/or utilized. Africa has lost potential revenue for development through IFFs perpetuated mainly by multinational companies. When funds from legitimate activities are circulated through illicit methods, these funds become illicit. The flow of financial resources illicitly from Africa, partly explains the African development paradox. Africa is endowed with vast deposits of natural resources but the extraction of these resources has not translated into the much desired development that the continent desperately requires. It is estimated that Africa has lost over US$854 billion in IFF between 1970 and 2008.[1]

Zimbabwe is not immune to the flow of financial resources illicitly as it is endowed with vast natural resources such as gold, platinum and diamond. In 2000, Zimbabwe was ranked the fifth world largest producer of platinum in the World Platinum Production by Country (Kilograms) after 5 680 kilograms were produced and in terms of gold production, Zimbabwe was number 40 in the World Gold Production by Country (Kilograms). In 2004, 21 330 kilograms of gold were produced.[2] According to a report released by the Companies Diamond Industry Series in August 2013, the country will satisfy up to 30% of world diamond demand by 2015 as leading diamond groups such as Alrosa (Russia) and De Beers are likely to reduce production by venturing into underground mining.[3] Despite being endowed with vast natural resources, the majority of the Zimbabweans have continued to rot in the dungeons of poverty, living under $1.25 per day threshold.[4] The extractives industry has only managed to absorb less than 5% of the population into formal employment.[5] Civil servants who constitute the greater chuck of the formal sector are earning salaries below the poverty datum line which stood at $502.90.[6] Issues of concern are a negation on development as potential resources for development are shifted away. People's livelihoods are deteriorating and the state of social service delivery is appalling as the Government of Zimbabwe is gradually withdrawing its support from critical services such as education and health.

This paper documents with community voices regarding the issue of IFF in light of their causes, characteristics, forms, mechanisms, effects and the possible solutions. Community voices are expressions and projections of the general citizenry in platforms, of the day to day experiences and challenges of people in a particular community. This document uses voices as a form of popular research combining technical research and people voices about issues that affect their livelihoods.

[1]Global Financial Integrity, 2009
[2]www.ndexmundi.com
[3]zimsituation, September 2013
[4]*mdgs.un.org/unsd/mdg/Metadata.aspx?IndicatorId=0&SeriesId=580*
[5]OSISA, Open policy, 2013
[6]http://www.zimstat.co.zw/index.php?option=com_content&view=article&id=63

# Illicit Financial Flows

As noted in the preamble, IFF entails the illegal movement of financial resources from one country to another and from one continent to another. It is important to highlight that the illicit flow of financial resources includes and is not limited cross boarder transfers of the proceeds of tax evasion, corruption, trade in contraband  goods and criminal activities such as drug trafficking. The conditions that need to be fulfilled for funds to be considered illicit include the transfer itself, the extent to which funds are proceeds of illegal activities and legal obligations relating to the funds such a payment of tax have not been observed.

The major characteristics of IFF are listed below;

- The flows are largely unrecorded and not captured by the Balance of Payment and other official statistics.
- They are often associated with active attempts to hide origin, destination and true ownership etc. They seek secrecy.
- The flows are usually associated with public loss and private gain because no (or little) tax is paid on them or because they may be comprised of bribes paid.
- The flows constitute domestic wealth permanently put beyond the reach of domestic authorities in the source country.
- The flows are not part of a 'fair value' transaction and would not stand up to public scrutiny if any.
- Refer to all unrecorded private financial out-flows that increase foreign assets of residents through contravention of National Laws and Regulations.

# Facilitators

IFFs are facilitated by a number of factors. These are intertwined in smoothing the progress of the flows. The presence of tax havens facilitates IFF. A tax haven is a country that exempts foreign investors who hold bank accounts or set up companies in its territory from taxes.[7] According to the OECD, a jurisdiction is a tax haven when it imposes nil or nominal taxes and offer itself as a place to be used by nonresidents to escape high taxes in their country of residents, having laws that protect personal financial information and lacking transparency.[8] The monies that are shifted from countries through illicit means are then deposited in these tax havens. Depending on the situation, the term tax haven can be used interchangeably with the term secrecy jurisdiction. A secrecy jurisdiction provides facilities that enable people or entities escape and frequently undermine the laws, rules and regulations of other jurisdictions elsewhere, using secrecy as a prime tool.[9]

The presence of shelf companies can also facilitate IFF. Shell companies can be defined as companies which only exist on paper with no employees or offices. These companies are untraceable making them a vehicle of choice for money launderers, bribes and tax evaders. Closely related to this is also the presence of anonymous trust accounts and bogus charitable foundations. Tax evaders and money launderers will create these bogus institution and accounts so that their monies will not be traced.

[7] http://www.taxhavensguide.com/tax-haven.php
[8] http://en.wikipedia.org/wiki/Tax_haven
[9] http://www.financialsecrecyindex.com/faq/whatisasj

# Mechanisms

There are various ways that are used in the transfer of financial resources from one country to another. The most commonly used methods are transfer mispricing and transfer misinvoicing. These mechanisms account for 60% of all IFFs in developing countries. [10]

## Transfer mispricing

Transfer mispricing happens whenever two companies that are part of the same multinational group trade with each other. When the parties establish a price for the transaction, this is transfer pricing. It is the abusive manipulation of this process (establishing a price for the transaction) for the purpose of avoiding or reducing taxes, by deliberately hiding, disguising or accumulating money in one jurisdiction.[11] Transfer mispricing occur when a subsidiary of a company avoids paying taxes in a high taxation country by selling its products at a loss to a subsidiary in a low tax country, which then sells the product to final customers at market price and yields the profit.

## Trade Misinvoicing

Trade misinvoicing is a method for moving money illicitly across borders which involves deliberately misreporting the value of a commercial transaction on an invoice submitted to customs. A form of trade-based money laundering, trade misinvoicing is the largest component of illicit financial outflows.[12] Misinvoicing occurs when a buyer and a seller collude in a scheme in which the buyer only pays the standard market price for imported goods, but is billed for the goods at a higher price. The seller then deposits the difference in a bank account in a secrecy jurisdiction on behalf of the buyer, thus siphoning funds abroad and preventing national authorities from collecting much needed taxes. By fraudulently manipulating the price, quantity, or quality of a good or service on an invoice, criminals can easily and quickly shift substantial sums of money across international borders.Broadly, there are three primary reasons that criminals use in trade misinvoicing:

- Money laundering – Criminals or public officials may seek to launder the proceeds from crime or corruption. Directly evading taxes and customs duties, by under-reporting the value of goods, importers are able to immediately evade substantial customs duties or other taxes.
- Claiming Tax Incentives – Many countries offer generous tax incentives to domestic exporters selling their goods and services abroad. Criminals may seek to abuse these tax incentives by over-reporting their exports.
- Dodging Capital Controls – Many developing countries have restrictions on the amount of capital that a person or business can bring in or out of their economies. Investors attempting to break these capital controls often misinvoice trade transactions as an illegal alternative to getting money in or out of the country.

[10] Barker (2005) Kar and Cartwright- smith (2010)
[11] http://www.transparency.org/glossary#/transfer-mis-pricing
[12] http://www.gfintegrity.org/issue/trade-misinvoicing/

## Tax avoidance

Tax avoidance is a process whereby an individual plans his or her finances so as to apply all exemptions and deductions provided by tax laws to reduce taxable income. Through tax avoidance, an individual takes advantage of all legal opportunities to minimize his or her income. This act of dodging without directly breaking the law is achieved through several schemes including shifting profits from high tax rate jurisdictions to low tax rate jurisdiction. MNCs are the major players in tax avoidance. In a survey conducted to assess the economic practices of European MNCs domiciled in the African continent, Action Aid International noted that out of 476 MNCs from Europe operating in Africa, 80% acknowledge that transfer pricing remains central to their tax strategy.

## Tax evasion

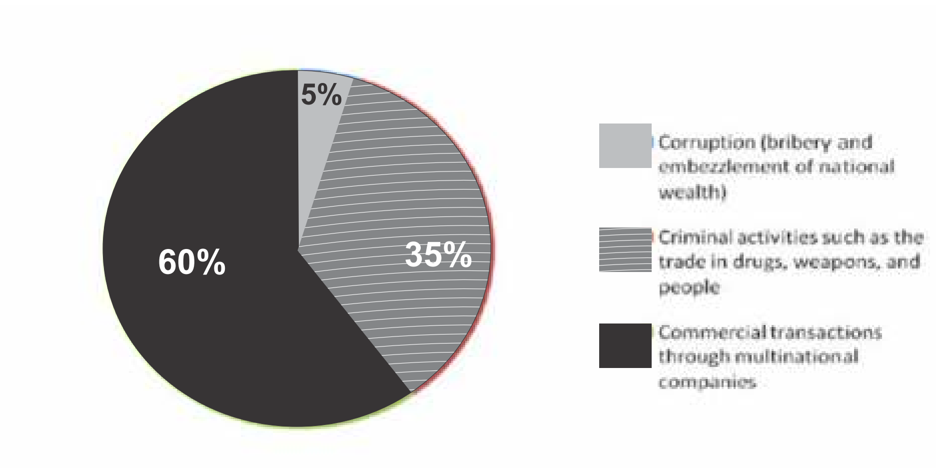
**This** is the illegal non-payment or under-payment of taxes, usually by deliberately making a false declaration or no declaration to tax authorities - such as by declaring less income, profits or gains than the amounts actually earned, or by overstating deductions. It entails criminal or civil legal penalties. **Tax evasion** is facilitated by complex corporate structures and hidden company ownership. Governments should establish mandatory, public registers that disclose the beneficial ownership of trust funds and companies to allow ill-gotten gains to be more easily traced. Enhanced corporate transparency provides information that can monitor behaviour.

*The rising of the African continent is exciting as it has a potential for transformation. Africa is experiencing economic growth in terms of the value of minerals being exported. However there are contradictions to this. Revenues from the exploitation of resources are not kept in Africa as the net outflows are more than net inflows. When exporting, they (MNCs) understate the value of minerals because they do not export to real third parties; they export to their companies cheaply. The money acquired never really come to Africa. In the tourism sector, Zimbabwe has not benefited much from natural wonders such as Victoria Falls. Foreign tourists make their bookings using agencies outside the country so the money never really comes here. MNCs also overstate the value of their imports so that they can shift the monies they have. Our governments are getting insufficient taxes so that financial resources can be deployed into the social services delivery, -* ***Tendai Murisa.***

*It doesn't make any sense to talk about countries and states on issues of illicit financial flows when the culprits are transnational in nature. MNCs are the major culprits and they are an integrated industrial complex. They have an integrated market system selling to each other's subsidiary at prices below market levels-* ***Adijah***

# Forms of IFF

Illicit money can be classified into three main forms: (i) the proceeds of theft, bribery and other forms of corruption by government officials; (ii) the proceeds of criminal activities including drug trading, racketeering, counterfeiting, contraband, and terrorist financing; and (iii) the proceeds of tax evasion and laundered commercial transactions. Baker (2005) estimates that laundered commercial money through multinational companies constitute the largest component of IFF, followed by proceeds from criminal activities, and lastly corruption. The chart below shows the forms of IFF.




Baker (2005) quoted by Kar and Cartwright-smith, (2010).

# Curbing IFF

There are a number of measures that have been and still being adopted to address the problem of IFFs at international and national level. At the international level, the United Nations Convention against Corruption (UNCAC) which came into force in 2002 has been adopted by 150 governments. The convention obliges member states to implement wide ranging anti corruption measures including measures aimed at preventing and criminalizing corruption related activities. It is managed by the United Nations Office on Drugs and Corruption (UNODC). It is the first truly global legal instrument aimed at fighting corruption. By providing broad and universal standards, it represents a major landmark in global anti-corruption efforts, with detailed provisions related to prevention, criminalisation and enforcement of a wide range of corruption-related offences, international cooperation, mutual legal assistance, technical assistance and asset recovery.

UNCAC addresses both the national and international dimensions of corruption and provides a consensus-based comprehensive framework. The Convention also acknowledges that all States, whatever their level of development have a shared responsibility in corruption-related matters by calling on States Parties to work together to address corruption. With regard to illicit flows, the value of an international framework is critical. If a country, a region or a group of countries is not successful in curbing illicit flows, an international framework can prevent them to flow into other countries. The major highlights of the convention include; prevention, criminalisation, international cooperation and asset recovery.

# G20, G8 and illicit financial flows

The year 2013 has actually seen notable moves by the international community to close down certain avenues used to hide or shield unreported wealth from prying states. Major multilateral groupings including the Group of Eight (G8) rich countries and the Group of 20 (G20) industrialised countries, for instance, have put tax abuse at the top of their list of priorities. A high-level United Nations panel negotiating the next phase of the Millennium Development Goals (MDGs) stated that one of its highest priorities would be tackling the abuse of offshore tax havens and illicit financial flows. A new global reporting standard that will make it easier for national tax collectors to automatically share information on where multinationals are reporting their profits was endorsed by finance ministers in Cairns.

Though IFFs are an international problem and the issue being discussed in international forums, it is surprising that African countries are not part of the discussions. Discussions on other issues that relate to IFFs are only done by Western countries yet Africa is also an equal stakeholder.

*There are a number of measures that are being initiated in a bid to curb illicit financial flows; amongst them is the Extractive Industry Transparency Initiative (EITI). EITI is silent on tax avoidance and tax evasion there by rendering it inadequate in addressing the problem of illicit financial flows. The adoption of the EITI has been on the government agenda, but up to now nothing on the ground. There is need for the reconciliation of information between companies and governments-* ***Gilbert Makore, Co-ordinator Publish What You Pay Campaign.***

*There are a number of frameworks to curb illicit financial flows. The Anti-Corruption Commission aims to combat corruption, theft, misappropriation, abuse of power and other improprieties in the conduct of affairs in both public and private sector. Other frameworks focus on the suppression of money laundering, receive and analyse suspicions transaction reports from financial institutions. Other legal instruments that curb illicit financial flows include the Forest Act, Criminal Code, Criminal Matters (Mutual Assistance) Act, Trafficking of Persons Bill, Money Laundering and Proceeds of Criminal Act. However, the shortfall of the legal frameworks is that they are responsive rather than preventive-* ***Tafadzwa Chikumbu, Policy Research Officer, AFRODAD***

*Rules on financial reporting are made by accounting firms and detected by western companies. These rules are made by OECD countries are made without Africa being involved and yet African countries are affected the most by the impact of these rules. The solutions being discussed at the OECD are nowhere near the resolutions of the problem-* **Saviour Mwamba, Africa Tax Justice Network**

*IFFs became of interest to the West after they realised that they were also affected. In response they set the Basic Erosion and Profit Shifting (BEPS) project which is limited to OECD countries. Developing countries are excluded because the issue is too technical. Conclusions and recommendations by countries drawn from the BEPS project should not become international policies and the project must be open to developing countries. It not an argument that any matter in international trade can be so technical that only one party can deal with it and other party has to wait for the recommendations of its counterpart-* ***Momodou Toure, Acting Executive Director, AFRODAD.***

# People's voices

After conducting various workshops and trainings on IFF, ZIMCODD managed to gather community voices that reflected their reactions and what they feel with regards to IFFs.

# Impacts of IFF

- **Stifle Zimbabwe's socio-economic development**

  IFFs have choked progress on social and economic development in Zimbabwe as the majority continue to languish in the dungeons of poverty. The majority of the citizens are living below the poverty datum line which stood at $502.90 as September 2014. The Government of Zimbabwe has failed to collect sufficient funds for social and economic development **.**

*"A lot of companies in the country are looting natural resources and failing to pay tax. Zimbabwe is one of the richest continents in Southern Africa with sought –after minerals such as lithium in Bikita, but illicit outflows and tax havens continue to cripple the economy there by affecting the education sector. Government must deal with IFFs and ring fence a percentage of funds from tax to finance universal education under the new constitution". -* ***Ruvarashe Marimo of Queen Elizabeth Girls High School.***

*"Tax evasion has led to poor performance of the government. Taxpayer funds have to be redirected from developmental projects towards employing expensive foreign tax experts to train tax officials to curb tax evasion. The government's capacity to provide social services has been crippled. Multinational companies and other tax evaders are undermining development and exacerbating inequality and poverty in Zimbabwe", -* ***Masimba Manyanya-Simukai Goromonzi Trust.***

- **Undermines political institutions including weakening public institutions and domestic private sector development.**
  Another impact that illicit financial flows have had is undermining political institutions there by weakening them. The net result of illicit financial flows is limited financial resources. If there are limited financial resources, institutions are underfunded. This will negatively impact on the achievement of their developmental programme.

- **Reduces government tax revenues, aggravates foreign debt and increases Africa's economic dependency.**
  As a result of illicit financial flows, governments have failed to collect sufficient revenues for social and economic development. This has resulted on heavy reliance on aid and external borrowing there by increasing the debt stock.

*Though we have an institutional framework on issues that relate to illicit financial flows, they are not effective in dealing with the issue. They are ineffective because they lack the capacity, and sufficient funds to effectively conduct their duties. In our case the Anti-Corruption Commission is independent and on the driving seat – not in terms of finances and control. It is influenced and affected by the operation of the invisible hand and those who are well resourced. The institutional framework is remote controlled and those who speak out are the ones who will suffer at the expense of the perpetrators-* ***Mr Magiga,*** **Prevention and Advocacy Manager at ZACC**

*Addressing illicit financial flows will automatically increase the level of development while simultaneously increasing government revenues and reducing poverty. The money we receive in aid is less than the money we lose through illicit financial flows, meaning that if there were no leakages Zimbabwe could be in a better position to finance its development and address the debt problem-*
***Farai Mutondoro, Transparency International Zimbabwe.***

*Our governments are not collecting enough taxes for development. Insufficient taxes have led to the privatisation of social services and are being reduced to corporate social sector. We see Foreign Direct Investment actors as heroes because of the little investments that they are making in education, water delivery and health sector but compared to what they are extracting and then what they invest as corporate social responsibility, it is a mere pittance. Foreign direct investment is not a panacea to development. There is need to put in place tax regimes that measures the financial performance of MNCs and curtail IFF-*
***Arthor Taderera CHIRRA***

- Illicit financial flows had their greatest impact on those at the bottom of income scales in their countries, removing resources that could otherwise be used for poverty alleviation and economic growth. As a result of limited revenues collected, social services are being privatised on a market that is not even. The poor who earn paltry salaries are heavily affected as they cannot afford to access the social services.

> *Most diamond companies are hiding under the name of exploration stealing Zimbabwe's minerals. These revenues they are stealing are supposed to provide for social service delivery and subsidise other services in the country – Lorrain Marima,* ***Chiadzwa Community Development.***

- IFF undermines the quality and accountability of democratic institutions, helping to keep corrupt elites in power. Exacerbates inequality by increasing private gains for a few at the expense of public gains.
- Promote corruption and bribery in financial institutions and other sectors of the economy.
- Drains scarce foreign exchange resources
- Distort of consumption and investment

# This is what politicians had to say with regards to illicit financial flows

Information gathered revealed that politicians are involved in illicit financial flows. It is alleged that they receive kick backs to cover up the activities of the MNCs. Some of them have acquired assets that do not tally with their incomes. The Chairperson of African Parliamentarians Network Against Corruption (APNAC) said that asset declaration for legislators and other people in high positions of power had been proposed long back but up to now there is nothing on the ground.

> *It is high time that Zimbabweans should react whenever any individual is fingered for corruption. We need to speak out and demand to know how that person acquired his or her wealth because we have seen a lot of people getting rich overnight while the country suffered-* ***James Maridadi Mabvuku–Tafara Member of Parliament***

> *There is need for urgent crafting of the Whistle Blowers Act to protect whilst blowers. There is also need to ensure that bodies like Zimbabwe anti-Corruption Commission are adequately resourced to deal with issues of corruption and illicit financial flows-* ***Fanny Chirisa, Proportional Representation MP for Manicaland Province (MDC-T).***

# Conclusion and Recommendations

Illicit financial flows have hindered the desired growth in Zimbabwe and Africa as a whole. They are facilitated by trade mispricing and lack of transparency and accountability. Multinational co-operations are the major culprits. Failure of the Zimbabwean government to combat illicit financial flows has resulted in revenue losses. The collection of limited revenues from the extractives sector has negated social and economic development. Social services expenditure has been cut and essential services have been privatised. The hardest hit are the poor who live under the $1.25 threshold. Illicit financial flows have also weakened and undermined the quality and accountability of democratic institutions.

In a bid to address the problem of illicit financial flows, the following recommendations have been suggested:

- Need for geological survey to determine the quality and quantity of the underground natural resources that Zimbabwe has.
- Strengthening of the legal and institutional frameworks to curb illicit financial flows. The frameworks must be preventive rather than responsive.
- Institutional building to combat corruption. There is need for institutional building in terms of knowledge, adequate resources (human and financial)
- Transparency and accountability in the awarding of companies that deal with natural resources.
- There is need to put in place tax regimes that measures the financial performance of MNCs,
- Cooperation and information sharing between authorities in different countries to investigate money laundering and recover assets.
- Improve fiscal transparency by disclosing financial information
- Strengthen Parliamentary oversight roles of institutions such as the Auditor General Office and the Zimbabwe Anti-Corruption Commission.
- There needs to be a multilateral effort to disclose the beneficial owners of shell companies operating in tax haven jurisdictions. Until then, companies will continue to hide behind them to misinvoicing trade offshore.

*"Disclosure of revenues by MNCs is due to civic pressure. We urge all MNCs to disclose their revenues to us Zimbabweans, the owners of these natural resources. The financial reports must be explicit in terms of the exact amounts they paid as taxes, dividends or government advances"* – ***Tatenda Simukai Mombeyarara (Human rights and governance).***

*''Nothing tangible is coming out from these MNCs especially mining companies. They use pledges as a scapegoat to siphon financial resources to offshore accounts. We urge the government to curb illicit financial flows so that we can have funds to start projects that will sustain our lives''.* – ***Grace Mariwo (Debt and Trade sector)***

*''Clear and people centred mechanisms are not yet in place so we advice government to stop all mining operations till we have people centred mechanisms guiding operations in the extractive sector. Also, the government must conduct a geological survey to know the amount and quality of the resources that we have so that it becomes easy to monitor the quantity of resources extracted and amounts''*
***Israel Mabhoo***

*“Here in Binga we have vast mineral and timber resources but we are not benefiting from them so we have resorted to fishing for survival. We the local people are supposed to benefit from the Zambezi River but we are cut off. Big companies that are given preference are doing nothing to develop our area. More so we have heard that they are stealing from the government when they export fish. In 2013 the government has lost about $11 million from the export of fish so we don't see the benefit of prioritising big companies while we the local people are living in abject poverty Laina -* ***Dube Binga Fisherwoman****.*

*“We were displaced by mining companies as our land is rich in diamonds. Our expectation as local people is development in the form of roads, hospitals, schools and broader national socio-economic development at large. Since the mining companies have started their operations, we have seen no meaningful development in our areas. They are making huge profits from diamonds and we wonder what that money is being used for. There is need to investigate on the finances of mining companies to find lasting solutions to the issue of illicit financial flows -* ***Cephas Gwayagwaya Displaced resident, ARDA Transal.***

*“There is need to enhance citizen participation in natural resources governance to promote transparency and accountability. The people must be involved the governance of natural resources through consultation -* ***Freeman Bhosso CNRGF***

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