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Illicit Financial Flows and Economic Development in Nigeria

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ABSTRACT

This paper analyzes the trend of illicit financial flows and its impact on economic development of Nigeria between 2005 and 2014. The study finds that IFF had drained Nigeria of billions of Naira of potential development funds. This is in no doubt a contributing factor to underdevelopment in Nigeria over time. Money meant for the provision of education, health facilities, transportation and other critical infrastructures needed to spur economic development had been diverted to other countries thereby leaving a huge gap in the provision of infrastructures in Nigeria. The author advocated for total change of legal system, creation of strong institutions, international collaboration, among others to fight Illicit Financial Flow.

INTRODUCTION

The general consensus is that globalization had done more good than bad. Some even argue that our generation is happier than our fore fathers. Technology had made the World a global village. We will continue to see more advantages of globalization but we must not lose sight of its attendant negative consequences. Africa is one continent that is suffering from the negative effect of globalization because some people had taken it as a means to do evil against the people and or society. Over the years, Africa remains in the headlines in unemployment, poverty, poor development and illicit financial flows out of the region. Despite the enormous resources available in the region, it has remained poor, underdeveloped and developing. Mobilization of domestic public resources is seen by many as crucial component of Sustainable Development Goals (SDGs) and targets. In fact, it occupied a chapter of the Addis Ababa Action Agenda 2 (the Addis Agenda). These are critical in the provision of public goods and services and the management of macroeconomic stability. The 2030 agenda call, in addition to resources mobilization, for increase investment and increased capacity for revenue generation. The member states showed commitment for resources mobilization and effective use of domestic resources to achieve SDGs goals. In addition, the Addis Agenda stressed the need to combat illicit financial flows and outlines different measures to significantly reduce IFFs by 2030 with the ultimate aim of eradicating them. It went further to commit member states to eliminate all channels known to be helping IFFs in the region and invite international organizations to publish estimates of the volume and composition of IFFs. The renewed attention from experts and organizations on the impacts illicit financial flows (IFFs) could have on macroeconomic variables form the motivation for this work. It had been identified by many experts that IFFs is one contributing factors to unemployment and poverty in Africa especially West Africa. Domestic tax evasion, criminal activity and corruption are rampant and it impact on the ability of countries to raise the finance needed to invest in sustainable development.

Despite the substantial work done by the region, the United Nations system, the World Bank, the IMF, the OECD and civil society organizations on IFFs, countries' inability to reach a political consensus has left the international community without a proper definition and solution to the problem it cause.

On the international stage, the challenges are high because it involves many countries' efforts to curb it. West Africa continued to depend, economically, on other countries for economic transformation even in this 21st century. For West Africa to gain economic independence there must be improve productive capacities. This in turn requires increasing investment in infrastructures, promotion of technology transfer and innovation for value addition, boosting Agricultural productivities, etc (UNCECA and AUC, 2012). However, efforts to achieve the above developmental goals had been constrained by the IFFs. The structure of IFFs undermines economic transformation via draining tax revenues, scarce foreign exchange, reduce investment and increase opportunity cost of saving. For instance, most foreign firms operating in the region depend heavily on imported input which its price is highly subject to exchange rate. IFFs reduce foreign exchange available for legal business such as the importation of inputs for local production, thereby rendering firm ineffective and could lead to the closure of such firms, increasing unemployment rate and poverty as a result. In Nigeria, the indirect devaluation due to scarcity of foreign exchange and recession led to the closure of about 226 manufacturing companies. Specifically, the Manufacturers Association of Nigeria (MAN) in its survey reports that about 226 companies have either closed shop or downsized between 2015 and 2016. Over 4 million jobs were lost as a result and Nigeria unemployment rate skyrocket from around 10% to over 18.8% (2015 to third quarter of 2018).Among many reasons given by MAN for this negative trend in the manufacturing sector in Nigeria were lack of funding and lack of foreign exchange for import of inputs. These two factors are not unconnected with the Illicit Financial Flows from Nigeria. The problem is compounded by the continued reduction official Development Assistance (ODA).to many West Africa states including Nigeria.

The estimated illicit Financial Flows from West Africa stood at a whopping USD528,898 million between 2003 and 2012. Nigeria top the list of countries from Africa with the highest IFFs between 2003 and 2014 according to the Global Financial Integrity report (2017) with about with about US$ 17880 million in 2005 and rising to about US$ 26735 million (about 2.3% of GDP)in 2013. Unfortunately during the same period, there are zero dollar HMN illicit financial inflows to Nigeria during the same period. The report further states that West Africa led other regions in IFFs outflows with IFFs accounting to between 7.5% and 11.6% of total trade on average in the region. On average, a total of about USD 22,751 Million illicit finance flows out of the 16 West Africa between 2003 and 2012. Europe led the others in the destination of these outflows from West Africa with an estimated 12.4% and 21.0% of the region's trade.

Nigeria with the highest IFFs from the sub region has an average unemployment rate at 13.3% between 2003 and 2014. As at 2017, Nigeria unemployment rate rise to 18.8% and fall to 16.7% in 2018. Nigeria was ranked first among countries with the highest number of poor people (about 80 millions) in the World in 2018. Cote d'Ivoire which ranked second in the region with an average IFFs of USD 2,406 Million (2003-2012), has an average of 4.2% unemployment rate during the period (WDI, 2017). As at 2011, 51% of Ivory Coast lived below poverty line according to the World Bank report. However, World Bank Survey carried out in 2015, shows that the economic upturn in the country had brought down the poverty rate to 46%. This report is not far from the reality given the effort by the government of the country in tackling poverty in the state. One of such effort is the establishment of the Poverty Rate Reduction Strategy programme (PRSP) in 2009.

In an attempt to proffer solutions to the myriad of economics problems facing Africa the executive secretary of Economic Commission for Africa, Mr. Carlos Lopez, points out that inequality in Africa could be greatly reduced if illicit financial outflows, which is costing the region an estimated USD 60 billion annually were nip in the bud. This finance could have been used to reduce inequality, poverty and unemployment through social transfers, investment in productive activities and create employment for the region.

In this study, I analyze the impact of illicit financial outflows on the economic development of Nigeria. Nigeria economy is more than twice the economies of the 15 countries in Sub Sahara combine. Thus, whatever happen to Nigeria economy will have huge impact on the overall economy of the sub region This study was motivated by the growing concerns about illicit financial flows and poor economic condition of Nigeria. With huge resources available in Nigeria, the rate of unemployment, poverty, high income inequality, stunted economic growth, etc should be confine to the history book but unfortunately, this is not the case. The economic and social implications of unemployment according to Kingdom and Knight (2007) include capital flight, social exclusion, unrest, and rise in crime rate, morbidity, income inequality and widespread poverty. The gap between the haves and have not keep widening in a country. Each of the country under study have various policies aim at reducing unemployment in their respective countries even though the efforts are not enough to drastically bring down unemployment rate.

With rising population growth rate (about 3% annually), the numbers of young people that join the labor force each year keep rising with no good plan of job creation for them. What should have been used to provide jobs for them is taken outside the shore to the detriment of Africa countries. Analyzing the impact of IFF outflows on the economy will help to come up solutions and draw the attention of policy makers to this economic crime against the economy with a view to providing solution to it.

This paper I divided into five sections. Sections one cover introduction and research questions. Section two contains the review of relevant literatures and empirical literatures and section three deals with the trend of IFF in Nigeria between 2005 and 2014. Section four relate with the impact of IFF on economic development in Nigeria and the last section is the conclusion of the paper.

Research Objectives

The main objective of the study is to do a descriptive analysis of the impact of illicit financial outflows on the economic development of Nigeria.. Other sub-objectives of the study include:

- Review the trend of illicit financial outflows between 2005 and 2014
- To make policy recommendations to reduce illicit financial outflows

Review of Related Literatures

Definition of IFFS

Countries are yet to reach a political consensus on the proper definition of illicit financial flows and this had made it difficult to come up with methodologies for monitoring and evaluation of progress. Due to lack of conceptual clarity, disagreement and dissatisfaction with method of estimate of the volume of IFFs are common in literature. However, for the purpose of this study we shall adopt a working definition. First let us look at IFFs from the point of view of illicit financing. Illicit finance is national and cross border financing of illicit activities.. UN and World Bank definition of IFFs will be the working definition in this paper. United Nations definition of IFFs as contained in its paper: "Coherent Policies for Combating Illicit Financial Flows" ("UN 2016 (1)"), 7 in the footnote. It defined IFFs broadly as,

"all cross-border financial transfers, which contravene national or international laws. This wide category encompasses several different types of financial transfers, made for different reasons, including: funds with criminal origin, such as the proceeds of crime (for example tax evasion, money laundering, fraud and corruption); funds with a criminal destination, such as bribery, terrorist financing or conflict financing; transfers to, by, or for, entities subject to financial sanctions under UN Security Council Resolutions such as 1267 (1999) and its successor resolutions (e.g. Al Qaida and other terrorist organizations); and transfers that seek to evade anti-money laundering/counter-terrorist financing measures8 or other legal requirements"

The World Bank has recently defined the concept of IFFs:

"Now generally refers to cross-border movement of capital associated with illegal activity or more explicitly, money that is illegally earned, transferred or used that crosses borders."

I therefore define the term IFFs as the proceeds from criminal activities, transferred and or used across borders. It includes "trade misinvoicing, Illicit Hot Money Outflows, money laundering, abusive transfer pricing, trade mispricing, misinvoicing of services and intangibles and using unequal contracts, for purposes of tax evasion, aggressive tax avoidance and illegal export of foreign exchange."

Empirical Literatures

Few literatures on illicit financial outflows are available, as little empirical works are carried out in this area. No well-known theory exists to explain illicit financial outflows in any typical economy. However, several theories of unemployment exist in literature over time. The two popular theories of unemployment are the classical and Keynesian theories. Classical theory states that unemployment is a short run phenomenon and that market forces (invisible hand) will adjust to restore full employment in the economy. Keynesian theory on the other hand postulated that unemployment is due to a fall in aggregate demand. Keynes therefore advocated policy such as expansionary monetary policy as solution to solve the unemployment problem in the economy.

Expansionary monetary policy is when the Central Bank uses its tools to stimulate economic activities. It involves increasing money supply, reducing interest rate and increase aggregate demand. The most common tool for many Central Banks is Open Market Operation. Central Bank will purchase Treasury notes from the commercial banks thereby giving them more money to lend to the public at lower interest rate. Lower lending rate will give companies opportunity to expand in order to meet up consumer demand. Due to this expansion, more workers are needed and hired, thus reducing unemployment in the economy. Other tools includes inter-bank funds rate, discount rate, and reserve requirement. The summary of it all is that there is scarcity of fund to stimulate demand leading to contraction which causes unemployment to rise. The huge amount of cash flow out of West Africa could be responsible for paucity of funds in the region and (indirectly) for high unemployment in the region.

Illicit financial outflows undermine government revenues that could have been used or invested in growth-driven reforms and social investment projects that could have reduce unemployment in the region.

Oligane (2018) advise that Africa countries should explore other options for resource mobilization to reduce the infrastructural deficit gap, promote productivity and mitigate increasing social demands. This should start by recovering of funds lost through illicit financial flows to invest real sectors in order to put the continent on the path of rapid and sustainable economic growth.

From the point of dis-saving, illicit financial flows have strong and negative impacts on the rate of investment and this effect is stronger in Africa where there is a strong correlation between savings and investment (Nkurunziza 2010). Whatever reduces investment, especially private investment, will affect job creation and level of poverty negatively as well.

Janvier (2012) performed two simulations to determine the effect of IFFs on poverty in Africa. One of the results shows that additional income per capita would have been generated if all capital flight are invested in the originating countries. The second simulation suggest that between 2000 and 2008 poverty would have been lower in Africa had all the IFFs from the region are invested in the originating countries. The average rate of poverty reduction will be, on average, 6 to 6 percent per year higher. Amah and Okezie (2015) evaluate the impact of illicit financial flows on economic growth and development. The result shows that there is a long run relationship between illicit financial flows and economic growth and development. It is recommended that Nigeria must develop customs capacity to effectively curtail massive capital outflows through illicit practices.

Handson et al (2016), evaluate the impact of economic growth on unemployment in South Africa between 1994 and 2012. The result of VECM indicates that GDP, budget deficit (BUG) and Real Effective Exchange Rate (REER) have positive long run impact on unemployment whilst the impact of Labor Productivity (LP) on unemployment is negative. This result shows that IFFs can indirectly affect unemployment through Real Effective Exchange Rate (REER) by increasing it (lower the value of domestic currency against foreign).

Trends of IFF in Nigeria and Other Sub Sahara Africa Countries

In 2005, the sum of Hot Money Narrow outflows and Trade Misinvoicing in Nigeria was US$17,880 million and 6.8% of GDP for that year. It rose by 7.2% to US$ 19,160 million accounting to 6.8% of GDP in 2006. This rise follows the overall rise in IFF outflows from sub Sahara Africa. Year 2007 witnessed slight increase in IFF outflows of 1.2% to US$ 19393 million from US$ 19160 million in 2006. This increase represents 6.4% of GDP in the year. IFF outflows from Nigeria increased again by 22.6% in 2008 to US$ 23,779 million accounting for about 7.4% of GDP. The rise in IFF outflows from Nigeria continued to year 2009 with 36% increase from US$ 23779 million in 2008 to US$ 26,378 million representing 7.7% of Nigeria GDP in 2009. 2010 witnessed an downturn in the amount of IFF outflows from Nigeria as it fell by 32% to US$ 17932 million representing 4.9% of GDP. This amount is still higher than the 2005 figures but lower in terms of its percentage of the GDP. The decrease continue in year 2011 with an estimated IFF outflow of US$ 14,621 million which is equivalent to 18.5% fall and 3.8% of GDP. The least total IFF outflows from Nigeria were US$ 4,998 million in 2012, a 65.8% decrease relative to 2011 and accounting for 1.2% GDP that year. This follow a sharp rise in 2013 from US$ 4,998 million in 2012 to a whooping US$ 26,735 million (its highest between 2005 – 2014). This represents 434.9% increase relative to the preceding year and 6.3% of GDP in 2013. It fell again to US$ 13,086 million from US$ 26,735 million in 2013. Out of the 15 West Africa countries under study, Nigeria occupied the first position of the country with the highest IFFs on average with USD 15,746 million between 2005 and 2014 followed by Cote d'Ivoire with USD 2,406 million. The figure below summarizes the shares of IFFs of each country under study.

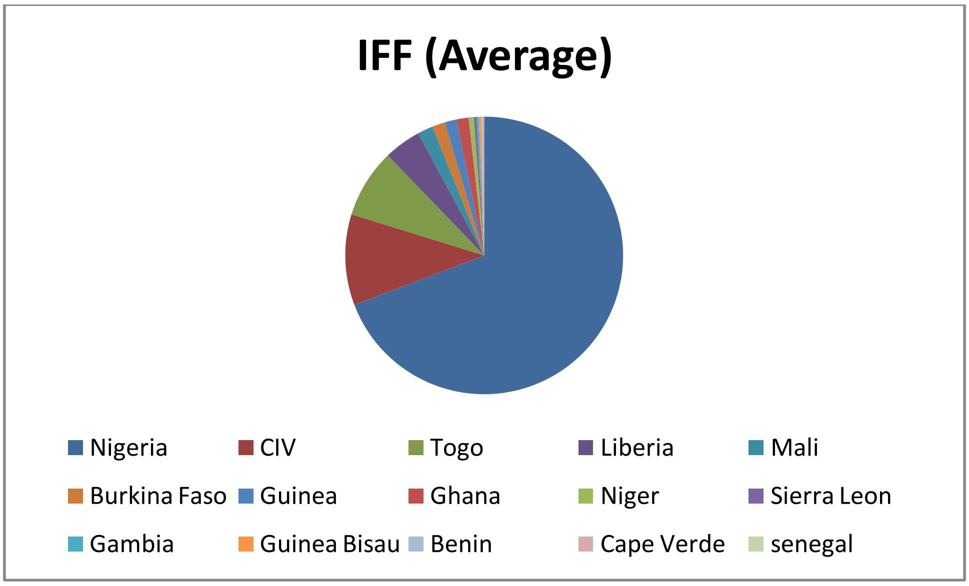

Figure1. *Average Illicit Financial Flows from 15 West Africa countries (2014)*

Source: *author's compilation using GFI data*

Impacts of IFFs on the Economic Development of Nigeria

Over the years, developing countries including Nigeria had lost billions of dollars in illicit financial flows from money laundering, tax evasion, trade misinvoicing, and corruption (Erik, 123:2015). According to Global Financial Integrity (GFI) an estimated US$ 1 trillion flows out of developing countries every year. This amount could be a little bit conservative given the fact that it is practically impossible to account for the true figure of IFF outflows. This is because so many elements of the flows cannot be accurately measure or determine. Large percentage of this sum is used to finance crime and terrorism in most developing countries.

Efforts to reduce or eradicate illicit financial outflow are very important for economic development of any country including Nigeria. It is important Nigeria use her on money to finance her development. To finance developmental projects such a schools, hospitals, and other public essential services and or infrastructures, majority of the fund must come from within the economy or from domestic resources.

Achieving these development agendas becomes difficult if not impossible if large amount of money needed for the project are drained out of the country using the network of banks, money exchangers, shell companies and other multinational firm operating in Nigeria. According to literature review by Unger (2006), the consequences of money laundering, include the following: distortions on consumption; distortions on investment and savings; artificial increases in prices; changes in imports and export; negative and positive effects on growth rates; effects on output, income and employment; among others. No country will develop with these consequences enumerate above. An estimated US$ 60 billion flows illegally out of Africa, higher than the amount they received as development assistant (UN, 2015)[1].[1]

Illegal money from Nigeria usually ends up in developed countries like UK, Switzerland, US, France and Canada among others. These monies are a source of funding for capital projects in those countries at the detriment of Nigeria. Sometimes in 2010, a two term governor of an oil rich state in Nigeria, Chief James Ibori was convicted of money laundering in UK and had already served his jail term and back in Nigeria. In addition, former military Head of states, Late General Sani Abacha took huge amount of Nigeria's money and deposit it in Switzerland bank during his tenure that lasted up to 1998.

[1] "High Level Panel on Illicit Financial Flows from Africa to Launch its Final Report", United Nations Economic Commision for Africa. January 26, 2015, http://www.uneca.org/stories/high-level-panel-illicit-financial-flows-africa-final-report.

Part of the last tranche of the money was repatriated to Nigeria in 2018. Unfortunately, some of these developed countries conspired with criminal element to perpetrate this crime by refusing to disclose the illegal transaction in time and prosecute the offenders as quick as possible.

Causes of IFF outflows includes corruption, lack of political leadership, poor institutions, lack of development cooperation to stop this crime, lack of global partnership to stop it, among others. The best reason behind Nigeria's high level of IFFs (in my opinion) is not unconnected with weak institutions and governance which made it easy for public officials to divert funds from Nigeria to other economy. In addition, fear of being caught (and subsequent prosecution that may result) with huge amount of money in their bank account. For example, in Nigeria, there is Economic and Financial Crime Commission (EFCC) and Independent Corrupt Practices and other Related Offences Commission (ICPC) charged with the responsibilities of tracking, prosecuting all persons engaged in corrupt related economic activities in the country. The fear of these agencies is the reason why some launder these monies outside the country.

Conclusion

Illicit financial out flows has drained Nigeria of billions of Naira of potential development funds. This is in no doubt a contributing factor to underdevelopment in Nigeria over time. Money meant for the provision of education, health facilities, transportation and other critical infrastructures needed to spur economic development are being diverted to other countries thereby leaving a huge gap in development of Nigeria. The scourge of illicit financial outflows must be fought both on global and national levels.

In the case of Nigeria, there is need for a change in the constitutions, which will usher in a new way or method of leadership and help in creating strong institutions to fight IFF. For example, Chief James Ibori was freed by Nigeria court of the same allegation in Nigeria before he was arrested, prosecuted and jailed by UK authority over the same offence in UK. This shows the difference in legal systems and constitution operating in both countries. The new constitution that reflects the new reality will promote leadership with political will to tackle corruption. With strong institutions, problems of corruption, illicit financial flows, tax evasion, trade misinvoicing, money laundering, and asset recovery will be address.

On the global level, there is urgent need for national leadership and global partnership to work together to tackle the problems of IFF globally. This has to do with exposing, prosecuting and recovering stolen or illegally transfer funds across the border by the perpetrators of this crime. There is no better way to clamp down on IFF than to decisively deal with the offenders in the developed countries where these monies are saved.

Finally, both Nigeria and her partner countries must devise and enforce adequate laws to punish people engage in IFF and make effort to streamline regulations, and improve their capacity to investigate as well as prosecute financial criminals in both the developed and developing countries.

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