Financing For Development – Focus Capital Flight

A Re-Define Seminar Briefing

Sony Kapoor

Sony.Kapoor@re-define.org

Financing for Development

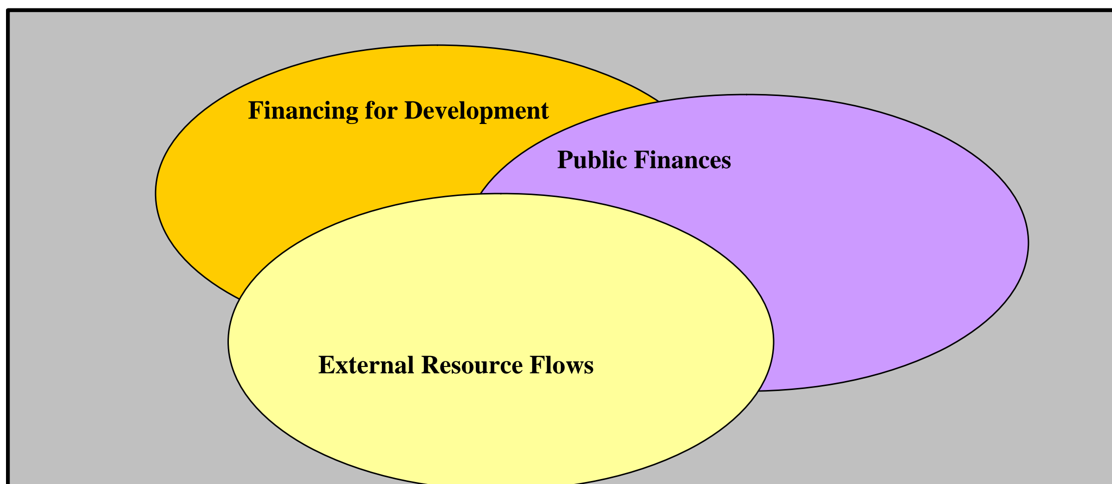
What does it really mean?

This is a non-trivial question as there are many interpretations of what development is and what financing can be said to have been made available. For example, at one end one can claim that any money being made available to a developing country constitutes FfD. At the other end of the spectrum this can be narrowed much more into referring just to MDG related financing or financing which leads directly to poverty reduction etc. Much of this, for example, comes from government expenditure and/or aid inflows.

To get an accurate picture of the landscape it is important to develop appropriate analytical tools. For this purpose, it is best to have three main levels of analysis. These are

- How much money and through what channel is flowing into and out of developing countries
- How much money and thorough what channel is making its way into the public finances of developing countries and how is this money being spent
- How much money is actually available for financing development related expenditure

The inter-relationships between these three different levels of analysis are equally important in helping define effective policies which can help maximise development outcomes.



For example, theoretically all financial resources (cash and cash equivalents) available to a developing country can help finance development. But in reality elite capture, massive inequality, poor governance and a skewed international system dilute the development impacts of much of the potential financing available.

On the other hand, multiplier effects, direct and indirect tax revenue and higher growth can help amplify the possibility of positive development outcomes in a developing country even when the money does not directly end up being channelled into pro-poor expenditure.

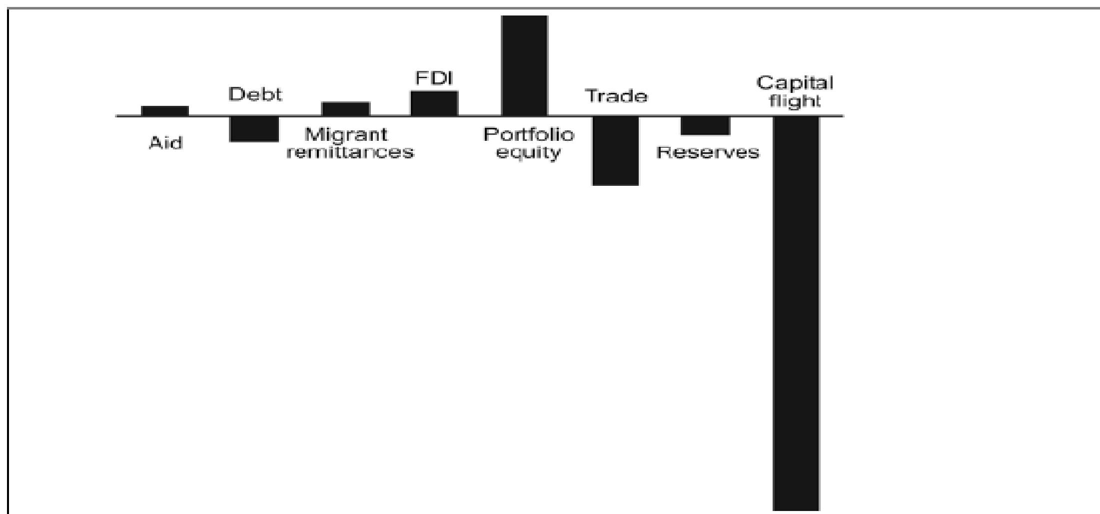
There is thus a complex relationship between overall financial resource flows development related financing and final development outcomes.

A comprehensive discussion of all of these analytical lenses is beyond the scope of this limited discussion but can be crystallized without too many complications in a subsequent seminar/paper.

For now, start by looking at the external inflows into and outflows from developing countries and try and interpret the development impact of these flows.

Exposing the Myth and Plugging the Leaks

Major inflows and outflows for South Africa between 1994 and 2003[xiii]



For this purpose it is useful to turn to an analytical framework I developed in 2006 called "*Exposing the myth & Plugging the Leaks*" which looks separately at all the channels of inflows and outflows and scratches the surface to try and paint a picture that exposes commonly held misconceptions to help develop a more accurate analysis.

One recurring conclusion of much of this analysis is the importance of "plugging the leaks" in helping developing countries maximise the availability of development financing.

The main channels of transfer are listed below. Each of them can be (and needs to be) analysed further

External (cross-border) inflows

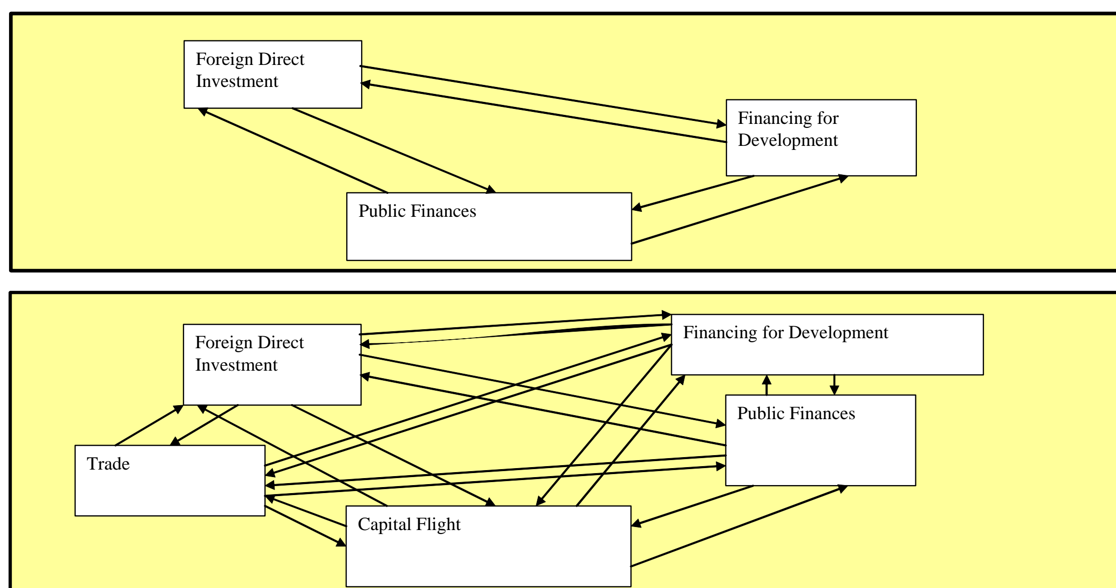
- Aid – there are serious issues in terms of what should and what should not be counted as aid all the way from debt that has been cancelled to tied aid etc
- Debt – many issues in interpreting new borrowings as development finance – should the debt being taken on by a emerging market MNC to buy a foreign company be counted for example
- Foreign Direct Investment – despite the rosy sounding headline figures on net FDI inflows the truth is that there are very serious difficulties in measuring FDI flows and stocks accurately. Also, the development impact of FDI is far from obvious and needs to be looked at in some detail
- Portfolio Flows – there are serious questions about whether portfolio flows have the potential to have a positive development impact and there are concerns about their negative impact on financial stability
- Migrant Remittances – are now fashionable and are being touted as the new panacea but their concentration and use cast serious doubts on how nig a role they can play
- Export Earnings – it is important to analyse where the export earnings end up and whether they are earned in exchange for non-replenishable resources
- There are other relatively minor items such as earnings and interest on investment abroad etc…which are not that significant for most developing countries yet.

External (cross-border) Outflows

- Debt Servicing (Principal, Interest, Arrears)
- Foreign Direct Investment Profit Repatriation
- Imports
- Unwinding of FDI and Portfolio Investments
- Minor (Outward FDI, Portfolio Investments, Aid)
- Foreign Exchange Reserve Build-up
- Balancing entry– Errors and Omissions
- **Capital Flight (What is this – cash or non-cash, licit or illicit, short term or permanent, reversible or not, how does it relate to other flows???)**

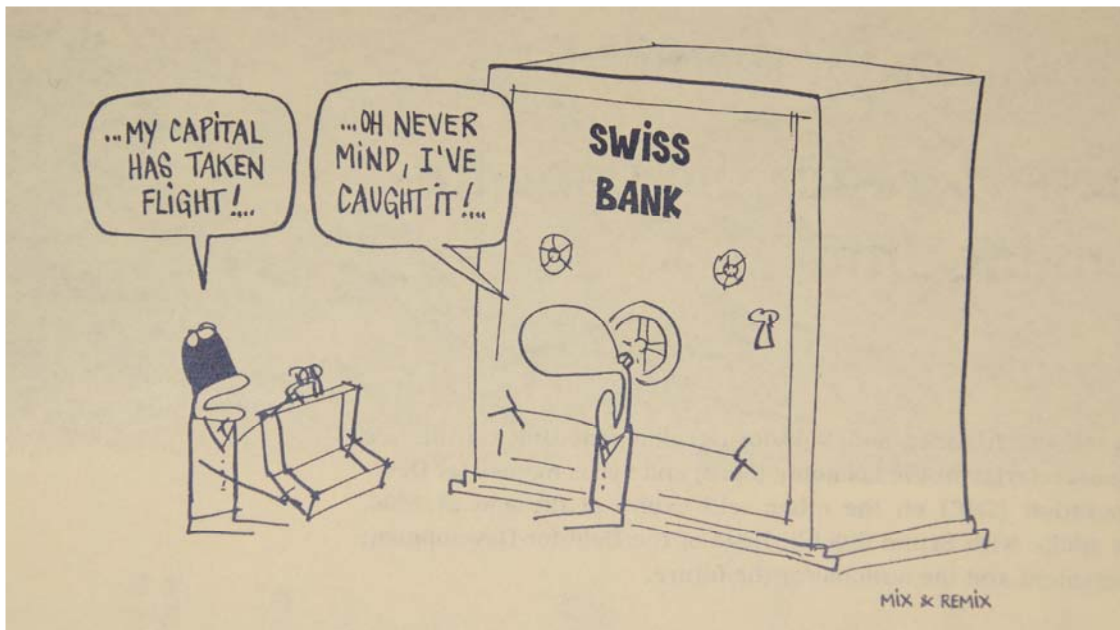
Complex Interactions – Our focus today is capital flight

It is important to remember that all these channels of inflows and outflows interact in a complex way and exhibit multi way causality etc. But of course the analysis is tractable and even simple frameworks can provide very useful policy conclusions and recommendations.



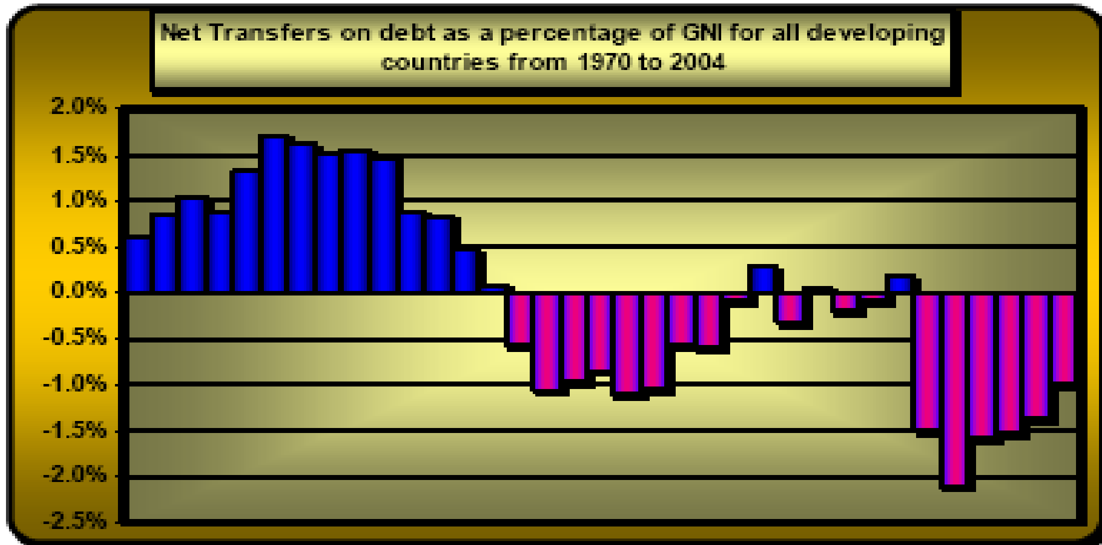
Using Capital Flight as an example

- Capital flight and Debt - new borrowing can be used to supply foreign exchange which can then get channelled as capital flight. Sometimes as in the case of Mobutu the new borrowing never makes it into the country and stays out as fled capital. Conversely, a country that experiences high capital flight faces serious resource and fiscal shortfall so is forced to over borrow



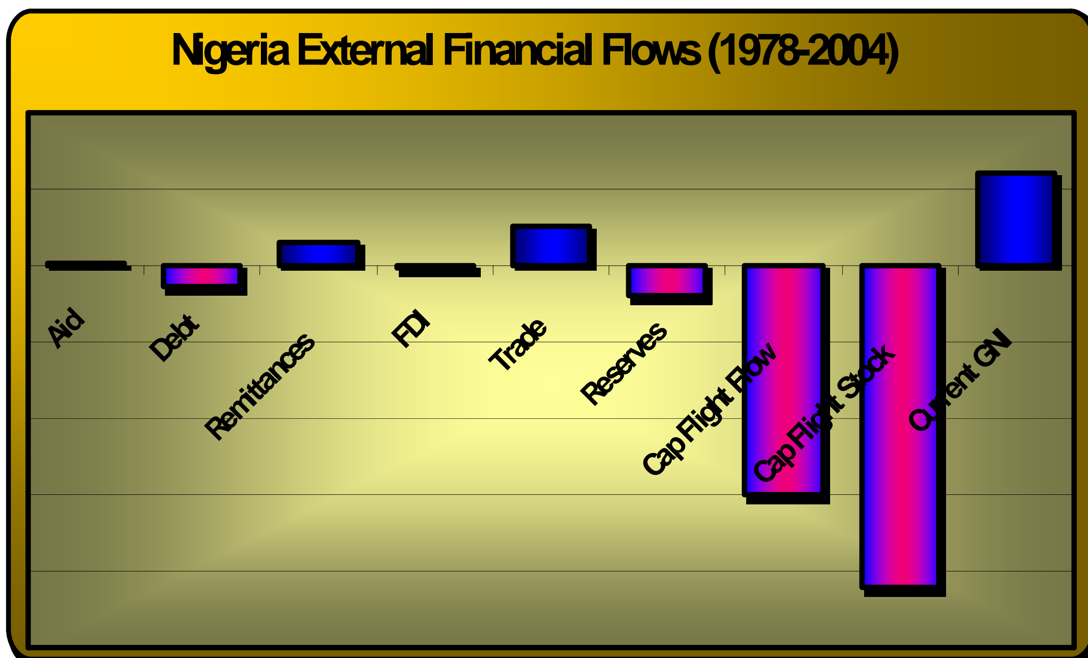
- Capital flight and Exports – Under-priced exports, especially of natural resources are a major channel for the flight of capital. At the same time countries which experience significant capital flight have depressed exchange rates which can make other exports more competitive but at the same time increase the incentives to accrue the earnings in foreign exchange in offshore havens
- Capital flight and Imports – Over priced imports are another major channel for the flight of capital. But depressed exchange rates make the import of essentials such as food, oil and capital goods more expensive for developing countries
- Capital flight and FDI – high capital flight depresses the incentives for FDI. At the same time some capital flight comes back disguised as FDI (round tripping) to take advantage of preferential tax and investment regimes that are increasingly offered to foreign investors. Moreover a lot of FDI is related to the extractive sector and thus has a direct bearing on exports (of raw materials) and imports (of capital goods) and capital flight through those channels

Dictator	Country	Period Active	Conservative Estimate
Mohamed Suharto	Indonesia	(1967-1998)	$15 - $35 billion
Ferdinand Marcos	Philippines	(1972-1986)	$5 - $10 billion
Mobutu Sese Seko	Zaire	(1965-1997)	$5 billion
Sani Abacha	Nigeria	(1993-1998)	$2 - $5 billion
Slobodan Milosevic	Yugoslavia	(1989-2000)	$1 billion
Jean Claude Duvalier	Haiti	(1971-1986)	$300-$800 million
Alberto Fujimori	Peru	(1990-2000)	$600 million
Pavlo Lazarenko	Ukraine	(1996-1997)	$114 - $200 million
Arnoldo Aleman	Nicaragua	(1997 – 2002)	$100 million
Joseph Estrada	Philippines	(1998 – 2001)	$78 - $80 million.



Questions to address on capital flight

- What is capital flight?
- What is the magnitude?
- How and why is it does capital flee?
- Who are the main players?
- How does it relate to other financial flows in and out of developing countries?
- What impact does it have on development?



What is capital flight?

While the terms capital flight and illicit financial flows etc may be used differently by different experts, for the purpose of our analysis it is important to realize that most references to them include a number of shared implicit characteristics which can be broadly listed as

- these flows are largely unrecorded (not captured by the BoP and other official statistics)
- these flows are often associated with active attempts to hide origin, destination & true ownership etc (they seek secrecy)
- these 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
- these flows constitute domestic wealth permanently put beyond the reach of domestic authorities in the source country
- these flows are not part of a 'fair value' transaction and would not stand up to public scrutiny if all information about them was disclosed
- In most cases, these flows violate some law or the other in their origin, movement or use.
- Sometimes, such as when exports are under-priced or when bribes are paid into offshore accounts, there is no actual cross-border flow of money. Capital has fled nonetheless.

How big is it?

- The global estimate of $539 billion - $829 billion of annual capital flight from developing countries dwarfs the annual aid flow of $104 billion.
- Country level estimates show that it is not unusual for a developing country to lose as much as 5% - 10% of GDP annually to capital flight.
- South Africa, for example, is estimated to have been losing an average of 9.2 per cent of GDP (losing US$13 billion in 2000),
- China 10.2 per cent of GDP (losing US$109 billion in 1999),
- Chile 6.1 per cent of GDP (losing US$4.7 billion in 1998) and
- Indonesia 6.7 per cent of GDP (losing US$14 billion in 1997)
- Russia is estimated to have lost as much as $400 billion between 1990 and 1995 alone
- Cumulatively, more than $230 billion is believed to have fled Nigeria and
- Some 17 sub Saharan African countries are estimated to have lost in excess of 100 per cent of GDP since 1970
- I have estimated that there is an annual tax loss of at least $600 billion associated with these figures

The main channels for flight

- The mis-invoicing of trade transactions
- Transfer mis-pricing
- Using mis-priced financial transfers
- Unscrupulous wire transfers
- Other mechanisms such as smuggling
- The payment of bribes and corrupt monies offshore

The mis-invoicing of trade transactions. This can be done by:

- Under-invoicing the value of exports from the country from which cash is to be expatriated. The goods are then sold on at full value once exported with the excess amount (constituting flight capital) being paid directly into an offshore account
- Over-invoicing the value of imports into the country from which cash is to be expatriated, the excess part of which constitutes capital flight and is deposited in the importer's offshore bank account.
- Misreporting the quality or grade of traded products and services to assist value over or under-statement for the reasons noted above;
- Misreporting quantities to assist value over or under-statement for the reasons noted above;
- Creating fictitious transactions for which payment is made. As has been noted: *One well-worn wheeze is to pay for imported goods or services that never materialize*[i]

For example, it has been reported that Gum Arabic was exported from Nigeria to the United States at a price of $0.69/ kg, a fifth of the prevailing world price. On the other side, cassette recorders were imported into Nigeria from the US at an inflated price of $1,410 per unit, 2500% of the prevailing world price[ii]. In both cases, capital fled Nigeria for the United States through the channel of trade.

Transfer mis-pricing This is the manipulation of prices of cross-border transactions between related affiliates of MNCs. The motives and mechanisms are similar to those above. However, the practice is made easier and is harder to detect as the transactions are now done between related parties – so no outside party is involved.

Around 60 per cent of trade takes place between subsidiaries of MNCs. As these transactions occur between different parts of the same company, there is ample scope for mis-pricing and, as a result, shifting of profits[iii].

Detecting transfer mis-pricing is complicated within the highly complex international production networks that exist today and where companies use trade marks, brands, logos and a variety of company specific intangible assets. Finding independent benchmark valuations for many of these is highly problematic.

For example, oil companies such as Chevron, Texaco and Caltex are estimated to have avoided US$8.6 billion in taxes by using a novel design of accounting and tax transactions with domestic and foreign governments between 1964 and 2002[iv].

Using mis-priced financial transfers, such as intra-corporate financial transactions – for example, loans from parent to subsidiary company at exaggerated interest rates – to shift profit out of a host country is another way illicitly transferring capital out. Real estate, securities and other forms of financial trades can also be mis-priced to facilitate capital flight and exaggerated payments for intangible such as goodwill, royalties, franchising rights and use of patents etc is yet another channel for the flight of capital.

For example, Microsoft has been accused of siphoning exaggerated payments of royalties to its low tax Irish subsidiary to which it had transferred many of its main patents and copyrights[v].

Unscrupulous wire transfers. These involve a bank or a non-banking financial institution transferring money out of a country illicitly. Wire transfers are of course a legitimate way of moving money between countries but it is when such transfers violate laws, or are used to avoid taxes or hide ill-gotten wealth that they constitute illicit capital flight. Banks can mis-report the source, destination or ownership of funds to help disguise illicit transactions.

For example, the US General Accounting Office (GAO) determined that private banking personnel at Citibank helped Mr Salinas (the brother of the then Mexican president) transfer US$90-100 million out of Mexico in a manner that 'effectively disguised the funds' source and destination, thus breaking the funds' paper trail'[vi].

Other mechanisms. These include the smuggling of cash and other high value mobile assets. Luxury yachts have been regularly sold and moved across oceans to shift capital from one country to another. Popular with journalists seeking good stories, such transfers are generally less important than the mis-pricing and wire transfer mechanisms discussed above. The illegal export of currencies (especially hard currencies) in the form of smuggling of bank notes is fairly common. Diamonds[vii], gold, illegal drugs and other high value commodities such as arts, antiques and rare coins also serve as means to take wealth out of poor countries.

The widow of Sani Abacha, for example, was stopped at Lagos airport, trying to leave with tens of suitcases stashed full of cash[viii].

The payment of bribes and corrupt monies offshore. In many instances involving bribes payable to public officials by commercial organisations there is an element of capital flight involved. The payment of a bribe always means that the recipient country will not get a fair value on the commercial activity undertaken by the firm paying it and that both tax evasion and capital flight will deprive the country of scarce resources.

For example, tens of millions of dollars of bribes, paid into the offshore accounts of public officials was uncovered when the Elf scandal broke out in the 1990s[ix].

Not all the capital that flees developing countries stays out. Some of it comes back guised in the form of foreign investors – a process called round tripping. The preferential treatment accorded to many foreign investors provides an incentive to engage in round tripping.

For example, in the case of China foreign investors typically enjoy lower tax rates, favourable land use rights, convenient administrative supports and even favourable financial services from domestic and foreign financial institutions. As a result of these incentives, it has been estimated that as much as a quarter of the more than $100 billion that China loses every year to capital flight comes back in the form of round-tripping FDI[x]. In the case of other slower growing economies however, the amount of round-tripping is likely to be much lower.

Who are the main actors?

Capital flight is driven by a complex web of perpetrators and facilitators who exploit an increasingly sophisticated but poorly regulated international financial and trading system to their unfair advantage.

- These perpetrators include multinational corporations and domestic businesses seeking to evade taxes and circumvent regulations in a bid to maximise income; wealthy domestic business and political elites trying to evade taxes or hide ill-gotten money abroad to escape detection; criminals and terrorists trying to escape the clutches of law.
- However, without facilitators in the western world, the means and incentives for capital to flee would not exist. These facilitators include:
- complicit business counterparts in western countries (for domestic exporters and importers);
- armies of well-paid lawyers, accountants and company formation agents who design aggressive tax-planning & transfer pricing strategies and incorporate dummy corporations and sham trusts;

- financial centres which legislate for low taxes and the existence of bank secrecy and provide services such as the incorporation of shell corporations, sham trusts and other impenetrable legal structures with nominee directors
- bankers and financiers who solicit and enable the flight of capital and manage the illicit wealth

Some Random clips (from a well publicized offshore finance website advertised in The Economist every week – please visit www.sovereigngroup.com to see for yourselves)

- "Some jurisdictions require a public record of the details of the shareholders to be maintained. In such cases, nominees or trustees will frequently hold the shares allowing the beneficial owner to retain anonymity."
- "Where we are not providing directors the client may choose to have mail directed to his own address but this is rarely advisable as the connection between the client and the company will be revealed and it is sometimes not convenient for a client to receive mail issuing out of a recognised offshore financial centre. For these reasons we offer to provide re- mailing and other office services out of the jurisdiction of incorporation or out of one of our other Group offices located in Hong Kong, London or elsewhere."
- "When we receive mail we will re-package it into a plain envelope and can arrange for it to be posted, according to your instructions, directly from the place of receipt or via one of our onshore offices to ensure that correspondence is not received at your home address bearing an offshore postmark and the name of your company. In this way confidentiality which would be lost if mail was received directly can be maintained. Faxes, e-mails and telephone calls can be dealt with according to agreement to further ensure confidentiality."
- "Sovereign frequently provides directors who reside and meet offshore. This prevents a company being considered as resident in the high tax country where the owners reside. These directors will, after carefully consideration, normally carry out the wishes of the ultimate owner but, if the tax status of the company is not to be prejudiced, those directors must be capable of demonstrating that they exercise independent mind and management."

A brief discussion of Public Finances

Sources of Money

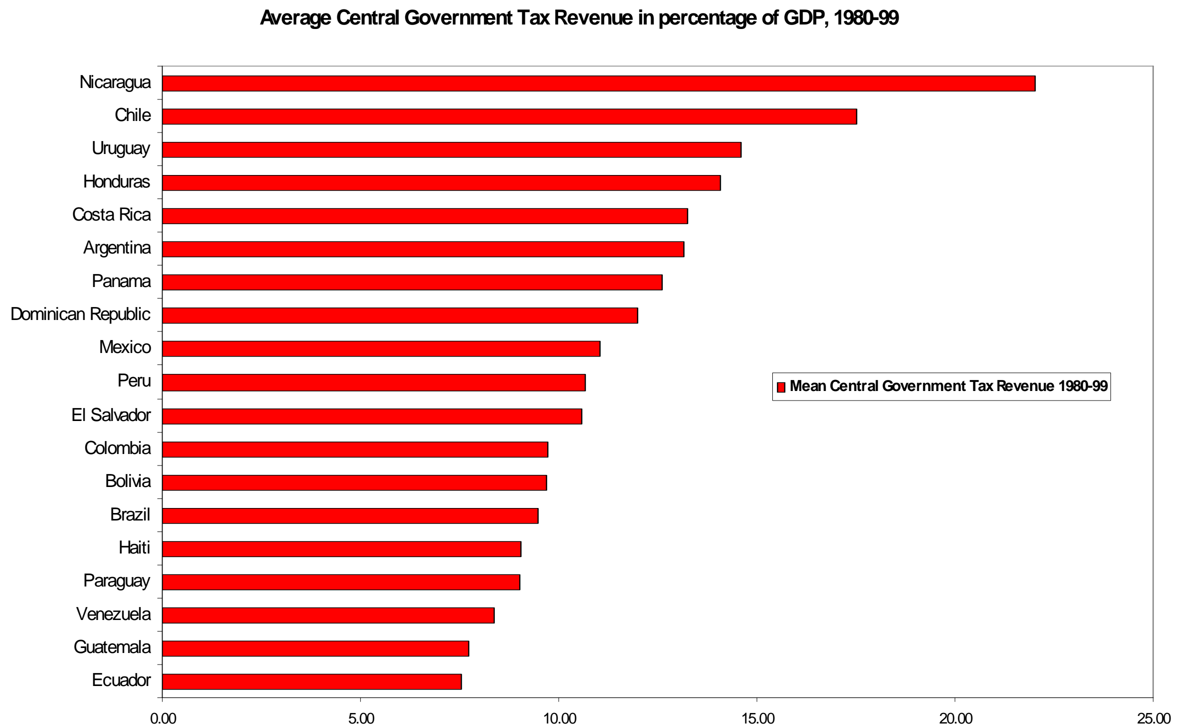
- Taxes on externalities
- Direct Tax from domestic actors
- Direct Tax from foreign actors
- Indirect Tax revenue
- Natural resource and license rents
- Aid money
- New Borrowing

Uses of Money

- Servicing debt
- Social spending (pro poor)
- Spending such as cash transfers and subsidies

- Other public expenditure
- Co-financing aid
- Increasing Reserves

Key issues in Public Finances – Tax revenues are lagging which reduces scope for providing pro development financing



- Tax policy
- Progressive taxation?
- Redistribution?
- Tax competition
- Tax avoidance (domestic / cross-border)
- Tax evasion (domestic / cross-border)
- Corruption
- Capital flight

The Tax System is becoming increasingly regressive in most developing countries

Redistributive Impact of Taxes in some countries of the World			
	Gini Coefficient		
Country	Before-Tax	After-Tax	Difference
Brazil	56.2	55.3	-0.9
Czech Republic	28.3	22.1	-6.1
Ecuador	51.5	43	-8.5
Estonia	36.2	37.6	1.4
Hungary	26.9	22.4	-4.5
India	40.5	30.9	-9.6
Indonesia	42.7	36.6	-6.1
Mauritius	45.7	39.6	-6.1
Mexico	52.5	51	-1.5
Pakistan	33.5	31.2	-2.3
Peru	49.3	42.8	-6.6
Russia	29.8	45.5	15.7
Singapore	38.7	34	-4.7

- Capital vs. Labour
- Direct vs. Indirect
- Tax Competition
- Tax Avoidance
- Tax Evasion
- Redistributive?
- Impact on growth and employment
- Foreign vs. Domestic
- Extractive Sector

Key Redistributive Policies

- Those that help skew the pre-tax incomes towards the poor such as
  - the development of agriculture
  - the development of rural infrastructure
  - the introduction of a minimum wage
  - or provision of guaranteed employment schemes etc

- Those that help skew post-tax incomes towards the poor such as
  - a relatively high zero tax slab for income
  - a progressive structure of income tax
  - a rate for capital gains tax that fits within the income tax structure
  - provision of tax credits for women, the poor, the vulnerable and the aged
  - tackling tax evasion by rich individuals and corporations
  - a relatively low level of value added taxes with exemptions for essentials
  - a progressive financial transaction tax regime such as the CMPF
  - a fair and robust natural resource royalty and tax scheme etc

- Those that help skew expenditure towards the poor such as
  - prioritizing the free provision of education and healthcare
  - providing free school meals for poor children
  - using conditional cash transfer programs of the kind used in Mexico
  - targeting backward areas for infrastructure provision etc
  - provision of public pensions or citizens income

Resource Flight – Some examples

Items	Prices
Plastic Buckets	$ 972.98/unit
Toilet/Facial Tissue	$ 4121.81/kg
Tweezers – Base Metal	$ 4896.00/unit
Razors	$ 113.20/unit

Natural resource sector

- In 2004, nickel was imported from Chile to the US at a price just over one-thousandth of the world price. The US company paid the Chilean company US$219,883 for the nickel – the median world price would have been US$125 million. This means that the Chilean treasury lost out on nearly US$125 million of taxable income.

- Also in 2004, over 400,000 tonnes of platinum was imported into the US from the Dominican Republic; at a price that was only just over three-thousandths of the world price. Had the median price been paid, the Dominican treasury would have charged tax on more than US$4.5 million of export income.

While the problem of capital flight and illicit financial flows exists across all sectors of the economy, it is especially acute in the extractive and natural resource sector. This is due a number of factors some of which are:

- such resources usually belong to the 'public commons' and hence it is not in the interest of any single individual or organization to act as a watchdog to ensure that they are properly managed
- natural resources such as oil, minerals, forests and fisheries etc have the potential to generate huge amounts of revenue and cash flow
- the potential for large revenues means that means that licences, concessions and rights conferred by the government have substantial monetary value. This makes them susceptible to misuse by corrupt authorities who can issue these in exchange for upfront bribes from unethical firms.
- the remote geography often associated with some natural resources such as forest resources (logging), fisheries (trawling) and artisan mining (especially gold and diamonds) etc makes policing especially difficult
- mis-reporting the amount, quality, origin and nature of natural resources extracted and exported allows capital to flee easily
- the massive rents that can be extracted by controlling natural resources makes them a good target for groups involved in violent conflict
- In a country rich in natural resources, it is easier for the government to generate revenue from natural resource exploitation than it is to collect taxes from citizens. Thus citizens have fewer incentives to hold the government to account and the government has less incentive to look after the needs of its citizens. This can weaken accountability and democratic structures.

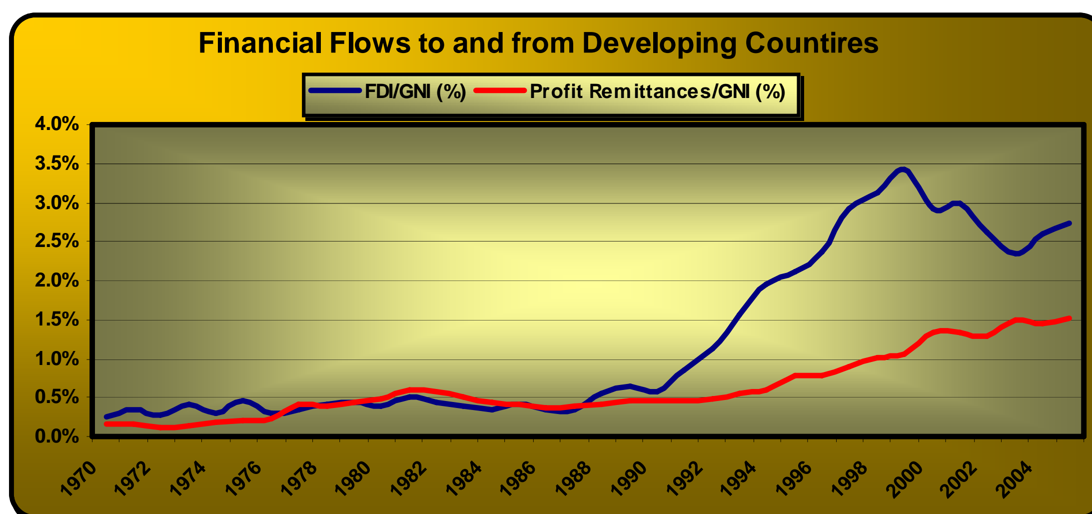
Zambia copper mining example

	2002	2003	2004
Royalties	696,540	2,112,825	209,249
Taxes	7,433,480	6,029,157	8,058,590
Total revenue from mining companies	8,130,020	8,141,982	8,267,839
Value of production	526,238,020	598,416,624	1,089,954,240
Royalties as % of production	0.1	0.4	0.02
Tax as % of production	1.4	1.0	0.7
Total revenue as % of production value	1.5	1.4	0.7

Sources: tax contribution calculated as 11.6 per cent of total corporate tax take (figures from Bank of Zambia following FIAS 2003); royalty figures from Bank of Zambia; production values from yearly total production multiplied by average export price of Zambian copper as reported by the IMF (www.imf.org/external/pubs/ft/scr/2006/cr0639.pdf)

Foreign Direct Investment

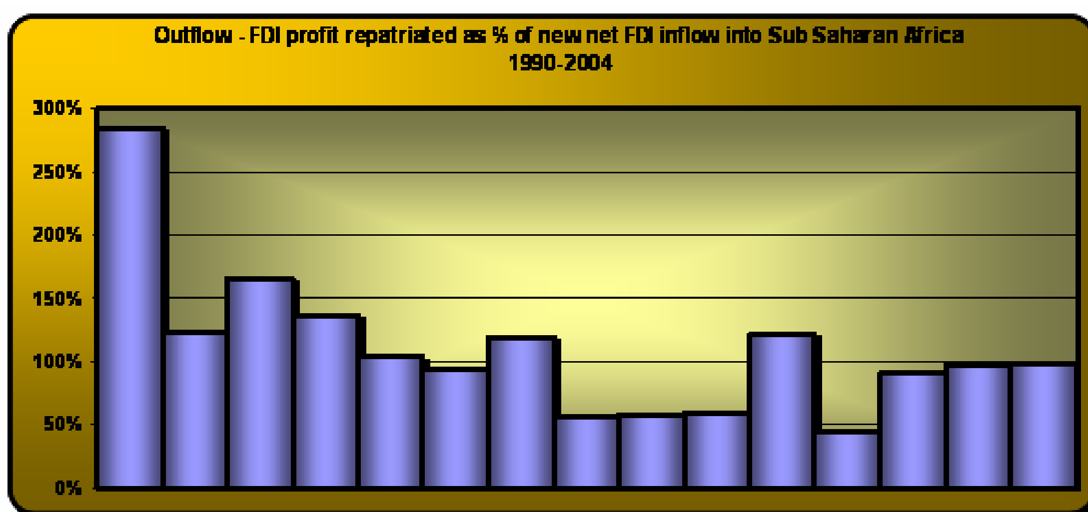
- The new mantra – can be very beneficial
- Largest component of private capital flow
- Net FDI to developing countries reached a $325 billion or about 2.9% GNI in 2006
- However there are many caveats relevant to interpreting the impact of this headline figure on Financing for development
- Inward net FDI flows were matched by outward profit remittances until 1990



- External/Fiscal/Trade/Development impacts of FDI are far from obvious. They are not unambiguously positive
- Lag period/variability of profits/high profits – there is a lag period between new FDI coming in and profits being taken out so large inflows of today will translate into large profit outflows 5-10 years down the line and continue to generate outflows over a long period of time. Capital flight, profit laundering and tax incentives undermine the fiscal contribution of FDI which is supposedly one of the key benefits. Profit remittances on FDi are far less variable than new inflows so even in a bad year for inflows profits are expected to be stable thus making the external balance negative

- Stocks under-reported, inflows over-reported, outflows under-reported – there are very serious gaps in FDI data and headline figures alone are highly misleading.
- My work suggests for examples that FDI stocks in developing countries is at least double of what is reported (higher potential for outflows).
- Cross border inflows of new money are only about half of what is reported in World Bank and UNCTAD statistics
- Outflows in terms of profit remittances are heavily under-reported especially because profit laundering and related capital flight are not captured.

The following graph provides the unadjusted figures for Sub Saharan Africa and shows that in most years profit remittances exceeded net inflows of new FDI thus generating a negative external balance. Once these figures are adjusted for the shortcomings listed above the situation becomes significantly worse.



Foreign Direct Investment – some new facts and figures

- The official estimate of FDI Stocks – 30% GNI – is Not True – Calculation problems – Data methodology is problematic etc
- Inflows are over-reported – Reinvested earnings and Round Tripping distort the picture – In 2005 – 2.74% of GNI was the headline figure for net FDI – However of this only1.4% was new inflows – 1.34% was merely Reinvestment which does not generate positive cross border inflows – 1.5% was profit repatriation which thus exceeds net new inflows. So even in a good year FDI generated more outflows than inflows of money
- Profits on FDI are high – Rate of Return in the range of – 15%-35% - Thus Flows can quickly become negative – plus future potential disinvestment when FDI is taken out – and transfer mis-pricing, tax competition., thin capitalization., tax avoidance etc make the real picture significantly worse
- British Virgin Island -5487% GNI inward FDI and 12056% outward
- Cayman Islands -2983% inward and 2406% outward
- Liberia one of the biggest sources of FDI???? 531% inward and 520% outward

The development impact of capital flight

Capital flight undermines

- investment, economic growth and sustainable development
- government revenue, social expenditure and meeting the MDG targets
- a fair distribution of wealth
- good governance in both the public and private sector
- the development of systems of accountability and a vibrant democracy

The sustainable development of a country is only possible if it mobilises and retains sufficient resources domestically. These resources are needed for spending on social and welfare programmes, and for investment to help increase the stock of productive capital. Capital flight undermines sustainable development by increasing dependence on external resources such as aid that are needed to replace the gap left by the fleeing of domestic capital.

Where resources stay within a country, they can be locally consumed or invested to promote economic activity. The escape of such funds depresses economic activity and has a negative impact on long-term growth rates.[xi]

The flight of domestic resources abroad undermines the development of an accountable and participative relationship between the state and its citizens. This is reached when citizens' resources are mobilised to fulfil domestic needs – in other words, citizens pay taxes and then hold their governments to account to ensure that the money is utilised properly towards priorities defined by them. If a large amount of such wealth is transferred offshore, incentives to participate in the establishment of a just and functioning domestic society diminish significantly.

Much of the capital that flees a country is untaxed, this reduces the tax base by shifting wealth and resources beyond the government's reach. Thus capital flight depresses both budget revenues, which are needed to finance the provision of essential services such as health and education, and the investments needed to meet the MDGs and the country's overall development. It also worsens the distribution of income by shifting the tax burden away from capital and onto less mobile factors, especially labour and consumption.

The infrastructure that facilitates capital flight by allowing vast amounts of capital to flow across borders unchecked and in secret, is also vulnerable to being used by terrorist and criminal networks and thus puts our collective and individual security at great risk.

This infrastructure also makes it easier to engage in corrupt behaviour, especially through the payment of bribes to, and the diversion of funds by, domestic political and business elites. Such funds are usually stashed offshore, protected by secrecy and privacy which makes detection difficult and hence increases the rewards that can be earned by engaging in corrupt behaviour.

Their actions increase within country inequality, reinforce power imbalances, undermine democracy and the rule of law and lead to a deteriorating economic and social situation under which ordinary law-abiding citizens suffer.

Capital flight from developing countries deprives their citizens of a future. The poorest and most vulnerable are those most affected when resources that could otherwise have been used for life-saving and life-sustaining expenditure on basic healthcare and other essential services are illicitly taken out of a country.

Quick Policy discussion

• **Exposing the myth** on many FfD issues can help bring about a much more informed analysis as we have seen in the case of FDI where scratching the surface exposes many very important and commonly held misconceptions which distort policy decisions for both developing and developed countries. This analytical lens can be used as an entry point into other channels for outflows and inflows

• **Plugging the leaks** can help being about a quantum change in the amount of resources available for development and also help solve many of the most serious governance problems. It can also help shift the political balance in favour of developing countries and change the prevailing development paradigm

• **Mapping the complex relationships** between some of the main issues discussed here – for example between capital flight and illegitimate debt or trade and FDI etc can help us get a clearer understanding of the main development financing issues and help avoid the pitfalls of unintended consequences of policy decisions

• **This analysis can help put aid in a broader context** and hopefully correct and change the doctrine o charity that dominates development thinking

• There are caveats though – this does not mean that all the money that is retained by plugging the leaks will be or can be used for financing development – nor does this mean that aid is not needed anymore. Aid plays and important role and will continue to do so especially in the poorest countries but a better informed analysis is needed to maximise its beneficial impact as well as increase positive development outcomes by mobilizing other resources better

• **In the end a lot of development financing is about Domestic Resource Mobilization, Domestic Resource Retention, Domestic Resource Recovery and supplementing Domestic Resources**

• **This is just a taster and there is a lot more analysis, data, anecdotes and understanding where this came from….**

---

i The Economist, *Quiet Flows the Dosh: A piece on capital flight out of Russia*, 7 December 2000.

[ii] Simon J Pak et al, *Estimates of Capital Movements from African Countries to the US through Trade Mispricing*, 2006.
iii The Economist, *Quiet Flows the Dosh: A piece on capital flight out of Russia*, 7 December 2000

iv J D Gramlich and J E Wheeler, 'How Chevron, Texaco and Indonesian government structured transactions to avoid billions in US income tax', *Accounting Horizons,* Vol 17(3) (2003) pp 107-122.
[v] 'Microsoft to hide Irish tax haven data of subsidiaries that have saved it billions of dollars in US taxes', *Finfacts Ireland Business News*, 9 March 2006; 'American ingenuity, Irish residence', *New York Times*, 17 November 2005; Neil Callanan, 'Top 100 companies make €20bn',*Irish Sunday Business*, 18 December 2005; Wearing of the Green: Irish Subsidiary Lets Microsoft Slash Taxes in U.S. and Europe, The Wall Street Journal, Nov 7, 2005; Microsoft Unit in Ireland Tops List, The Wall Street Journal, Dec 20, 2005; Plan Would End Use of Tax Havens for Patents, The Wall Street Journal, Feb 8, 2006

[vi] Jeffrey Robinson, *The Sink: Terror, Crime and Dirty Money in the Offshore World*, 2004 pp101-102; US Senate Permanent Subcommittee on Investigations hearings, *Private Banking and Money Laundering: A Case Study of Opportunities and Vulnerabilities*, 1999
[vii] For example *"from 1993 to 1997, Guinea reported 2.6 million carats of official diamond exports at an average of US$96 per carat to Belgium. However, Belgium, through the Diamond High Council reported imports from Guinea of 4.8 million carats at an average of US$167 each"* Greg Campbell, *Blood Diamonds: Tracing the Deadly Path of the World's most Precious Stones,* 2004
[viii] Jeffrey Robinson, *The Sink: Terror, Crime and Dirty Money in the Offshore World*, 2004, also http://news.bbc.co.uk/1/hi/world/africa/211324.stm and www.dcmsoft.com/zuba/zuba/maryam.htm
[ix] http://www.guardian.co.uk/france/story/0,11882,1083784,00.html
[x] Xioa, Ging 'Peple's Republic of China's Round-Tripping FDI: Scale, Causes and Implications
xi Donald R Lessard and John Williamson, *Capital Flight and Third World Debt*, Washington: Institute for International Economics, 1987.