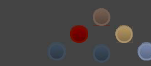


Illicit Financial Flows: Case Study of Lebanon

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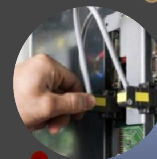
Under developed countries



Illicit Financial Flows



Weakness of Laws



Lack of Control



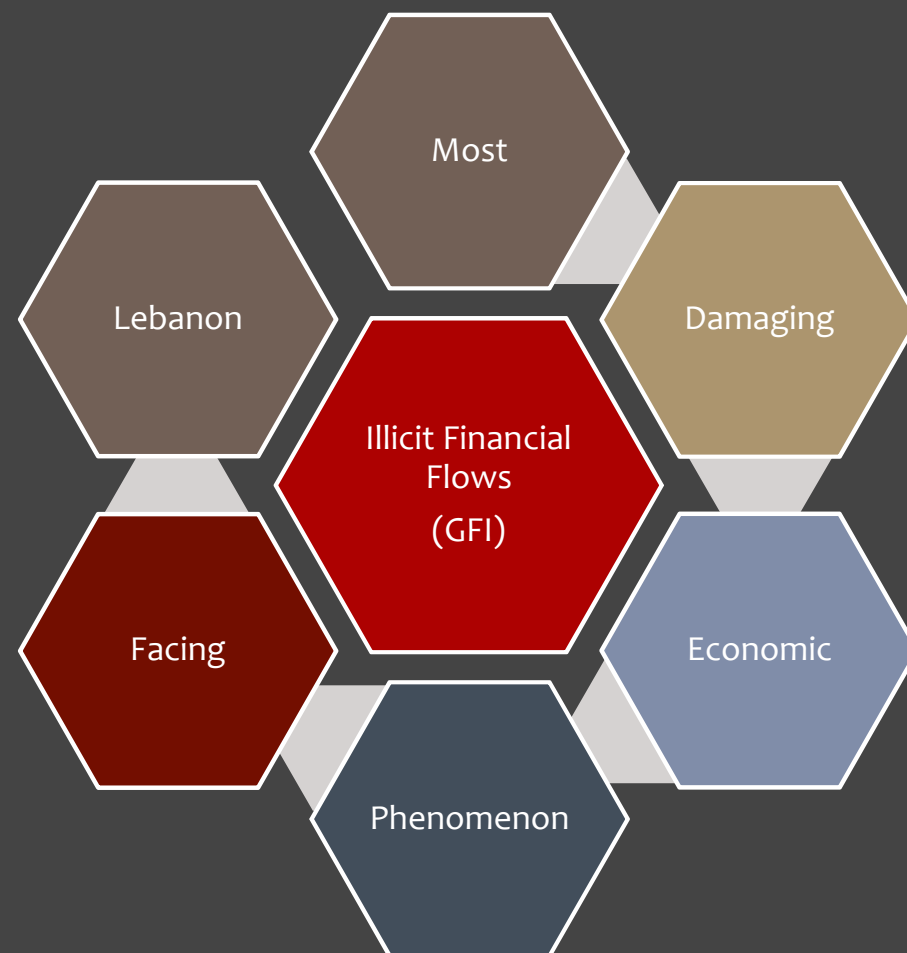
Corruption



Greed

Agenda

- Introduction
- State of Art
- Analysis
- Recommendations



Introduction

- Economic goals:
 - Efficiency: Situation in which it is impossible to generate a larger welfare total from the available resources
 - Freedom: Individuals are free to secure and protect their human resources, labor and private property
 - Growth: Increase in a country's productive capacity, as measured by comparing gross national product (GNP) in a year with the GNP in the previous year
 - Stability: Economic system of a nation that displays only minor fluctuations in output growth and exhibits a consistently low inflation rate.
 - Equity: fair distribution of wealth and income in a society (not assistantship)
- All this leads to an optimization in using the available resources

Introduction

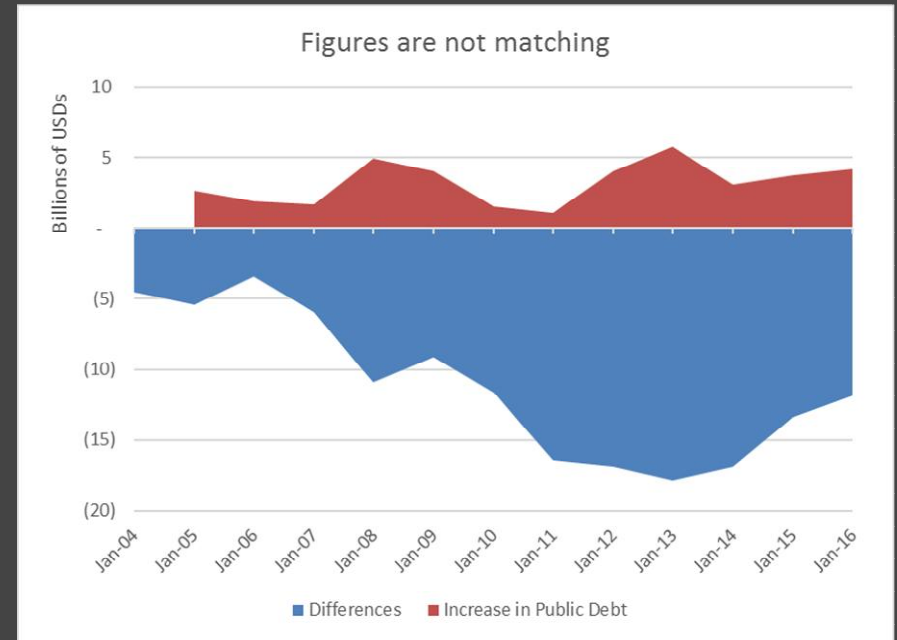
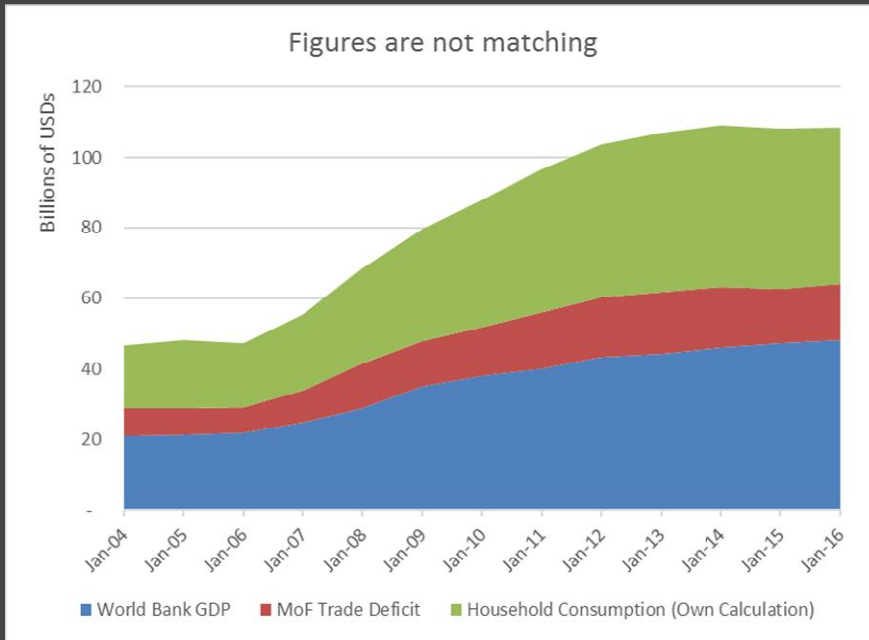
- Problem: Some resources could be out of use by mis-scheduling or by bad intention
- Illicit Financial Flows is a bad intention to monopolize financial resources for personnel enrichment against the well being of whole economy
- Developing countries are the most who suffer from the IFF
- Lebanon, is one of these countries and the size of the IFFs starts to be a major issue for the Lebanese economy
- IFF deprives Lebanon from a huge potential of investment that is crucial for the Lebanese economy

State of Art

- 3Cs: Corruption, Commerce and Crime
- Large informal sector → 36% of the Lebanese economy
- Economic indicator shows a huge lack in controlling the business transactions → legal issue, technical issue, cultural issue
- Corruption constitutes the main tool that IFFs' operators use to facilitate their mission in Lebanon
- USD 10 Billions is the cost of corruption per year for the Lebanese Government including IFFs, Tax Evasion... in addition to the cost of opportunities

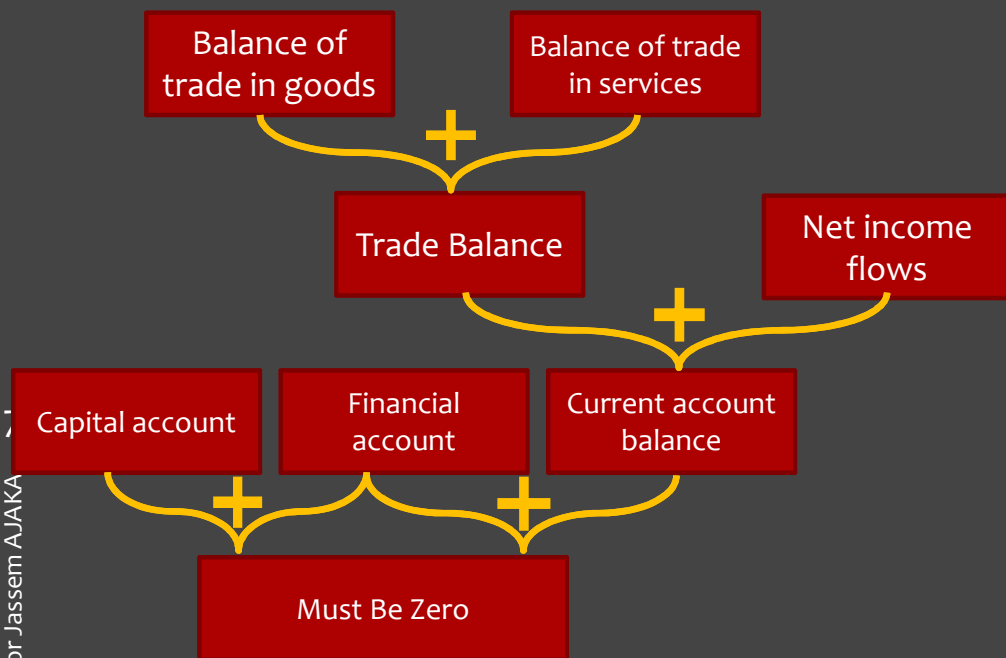
State of Art

Figures do not match

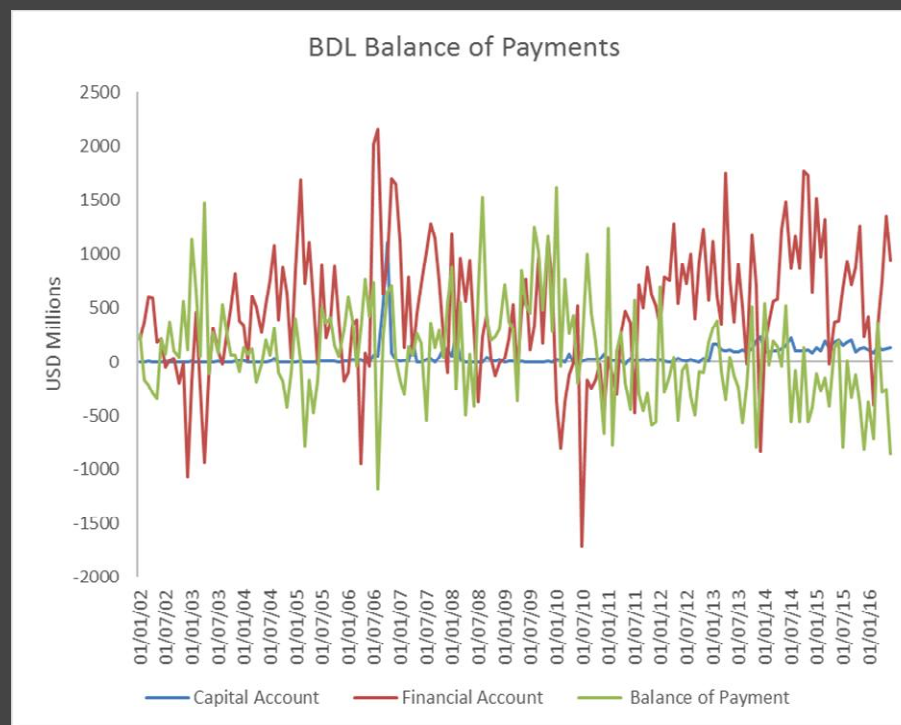


State of Art

Balance of Payments

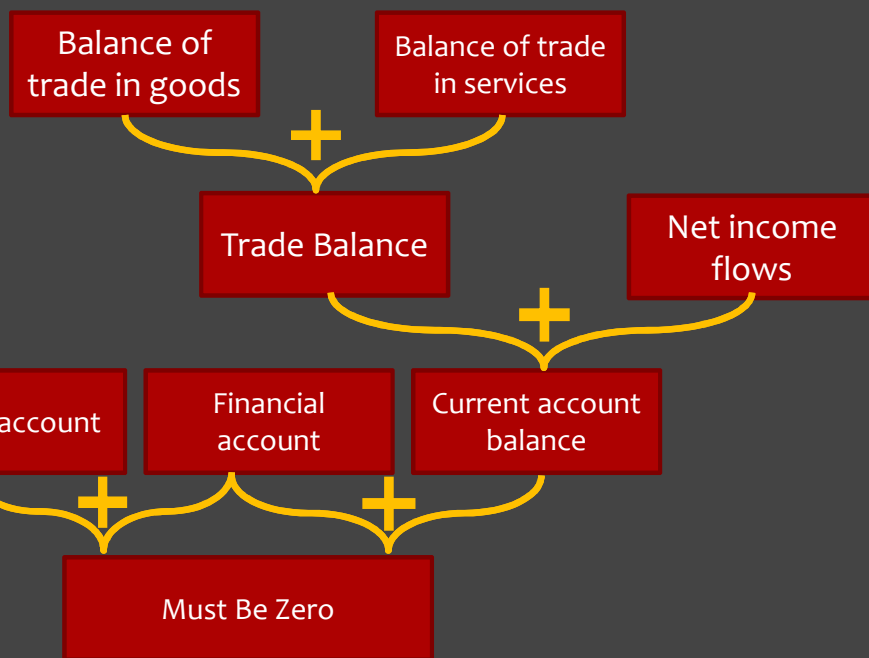


No Matching

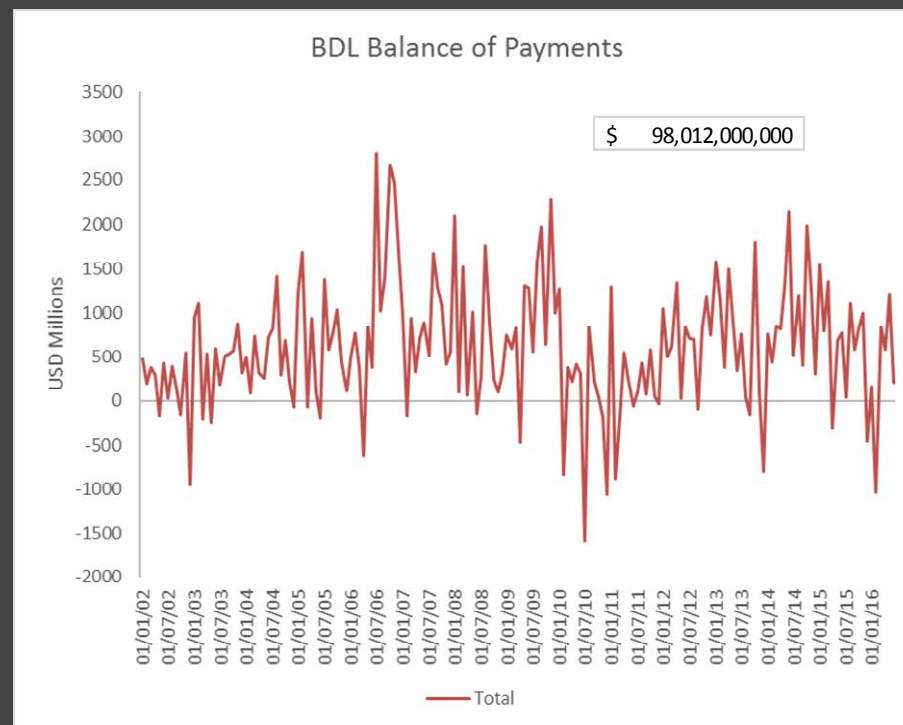


State of Art

Balance of Payments



No Matching



State of Art

- Import Under-Invoicing (Inflow)
- tax evasion
- Type of Commodities

| | Export to Italy (000's USD) | | | Import from Italy (000's USD) | | |
|--------|-----------------------------|--------------|----------|-------------------------------|--------------|--------------|
| | ITC | LB Customs | Cus-ITC | ITC | LB Customs | Cus-ITC |
| Apr-14 | 1543 | 1543 | 0 | 167812 | 166976 | -836 |
| May-14 | 1770 | 1770 | 0 | 156952 | 155920 | -1032 |
| Jun-14 | 2180 | 2180 | 0 | 164754 | 164333 | -421 |
| Jul-14 | 5468 | 5468 | 0 | 119311 | 119310 | -1 |
| Aug-14 | 4620 | 4620 | 0 | 144632 | 144065 | -567 |
| Sep-14 | 4303 | 4303 | 0 | 134322 | 134260 | -62 |
| Oct-14 | 6037 | 6037 | 0 | 99404 | 99266 | -138 |
| Nov-14 | 4084 | 4084 | 0 | 106268 | 106225 | -43 |
| Dec-14 | 1528 | 1528 | 0 | 109459 | 109446 | -13 |
| Jan-15 | 2727 | 2727 | 0 | 80177 | 80177 | 0 |
| Feb-15 | 3920 | 3920 | 0 | 80152 | 79957 | -195 |
| Mar-15 | 2112 | 2112 | 0 | 119445 | 118619 | -826 |
| Apr-15 | 3639 | 3639 | 0 | 91450 | 91229 | -221 |
| May-15 | 5590 | 5590 | 0 | 128383 | 127441 | -942 |
| Jun-15 | 3905 | 3905 | 0 | 132482 | 132401 | -81 |
| Jul-15 | 5087 | 5087 | 0 | 148861 | 148832 | -29 |
| Aug-15 | 2769 | 2769 | 0 | 139783 | 139630 | -153 |
| Sep-15 | 2691 | 2691 | 0 | 77581 | 77512 | -69 |
| Oct-15 | 6134 | 6134 | 0 | 92686 | 92475 | -211 |
| Nov-15 | 2216 | 2216 | 0 | 95848 | 95840 | -8 |
| | | Total | 0 | | Total | -5848 |

State of Art

- Services represent an important Inflow of money !

| US Dollar thousand | Exported Services | Imported Services | EX-IM |
|--------------------|-------------------|-------------------|-------------------|
| 2005 | 10,864,100 | 7,890,190 | 2,973,910 |
| 2006 | 11,672,800 | 8,730,540 | 2,942,260 |
| 2007 | 12,758,500 | 9,983,180 | 2,775,320 |
| 2008 | 17,635,600 | 13,458,700 | 4,176,900 |
| 2009 | 16,909,900 | 14,042,700 | 2,867,200 |
| 2010 | 16,040,100 | 13,034,000 | 3,006,100 |
| 2011 | 19,672,600 | 12,963,300 | 6,709,300 |
| 2012 | 14,615,900 | 11,444,900 | 3,171,000 |
| 2013 | 15,101,166 | 12,853,400 | 2,247,766 |
| 2014 | 13,761,000 | 12,521,100 | 1,239,900 |
| | | total | 32,109,656 |

State of Art

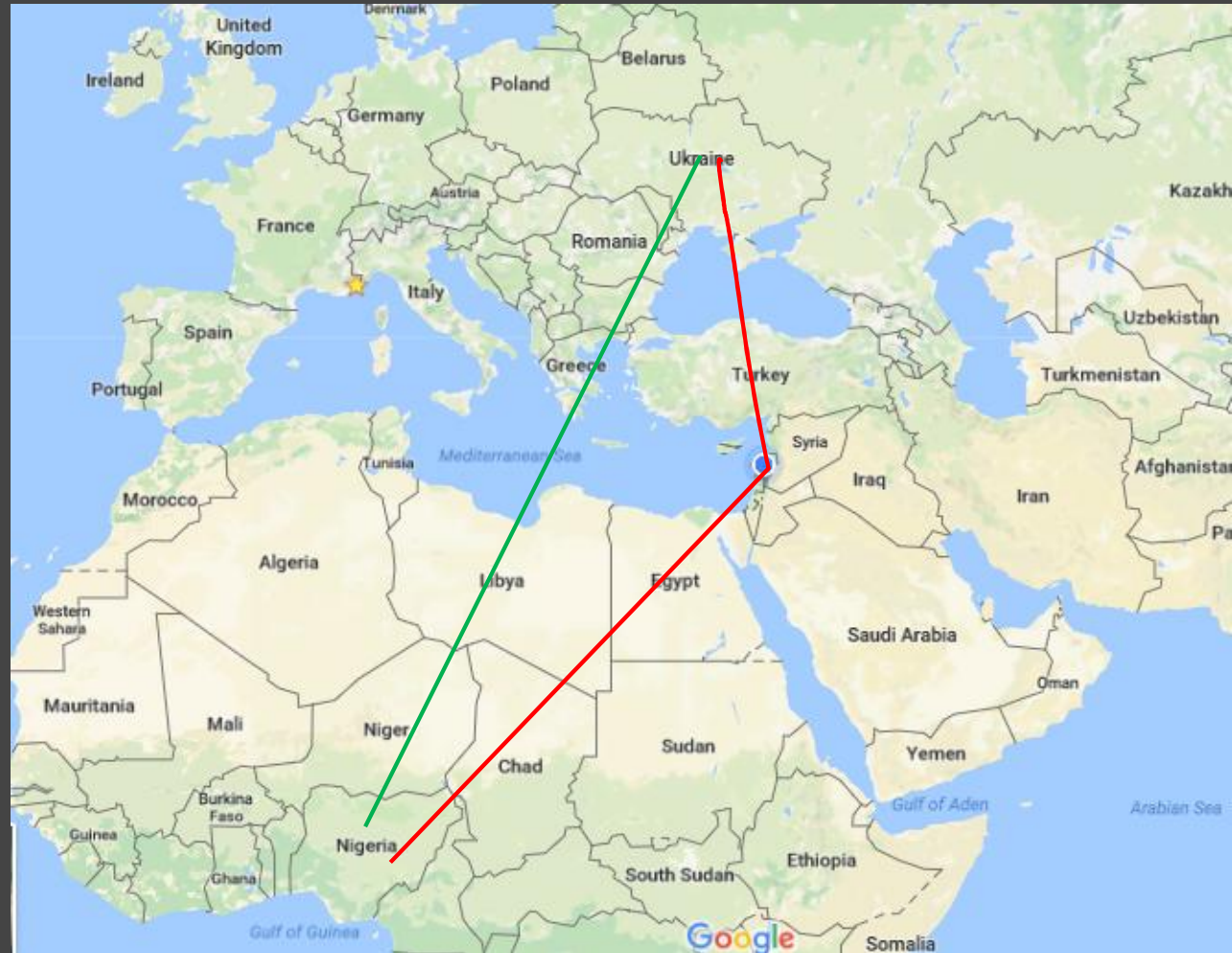
| Code | Label | Imported value in 2012 | Imported value in 2013 | Imported value in 2014 |
|------|--|------------------------|------------------------|------------------------|
| S | All services | 11444900 | 12853400 | 12521100 |
| SOX | Memo item: Commercial services | 11424921 | 12828208 | 12500879 |
| 4 | Travel | 4199450 | 4387750 | 4998640 |
| 10 | Other business services | 2671180 | 3901830 | 3171780 |
| 3 | Transport | 2233600 | 2280080 | 1939610 |
| 7 | Financial services | 594220 | 581195 | 1035200 |
| 9 | Telecommunications, computer, and information services | 548558 | 542673 | 433711 |
| 6 | Insurance and pension services | 428824 | 600025 | 308120 |
| 5 | Construction | 431810 | 270825 | 290064 |
| 11 | Personal, cultural, and recreational services | 276237 | 313327 | 283737 |
| 8 | Charges for the use of intellectual property n.i.e. | 32816 | 28121 | 34702 |
| 12 | Government goods and services n.i.e. | 19979 | 25192 | 20221 |
| 2 | Maintenance and repair services n.i.e. | 12785 | 11963 | 7593 |

State of Art

| Code | Service label | Exported Value in 2012 | Exported Value in 2013 | Exported Value in 2014 |
|------|---|------------------------|------------------------|------------------------|
| S | All services | 14615900 | 15101166 | 13761000 |
| SOX | Memo item: Commercial services | 14483531 | 15051300 | 13725462 |
| 4 | Travel | 6327480 | 5872360 | 6272250 |
| 10 | Other business services | 3564780 | 4702290 | 2963250 |
| 7 | Financial services | 1587630 | 1508720 | 1785210 |
| 3 | Transport | 1148430 | 1127570 | 976853 |
| 9 | Telecommunications, computer, and information services | 645904 | 595873 | 689491 |
| 5 | Construction | 589149 | 743244 | 629283 |
| 11 | Personal, cultural, and recreational services | 316499 | 228108 | 275494 |
| 6 | Insurance and pension services | 174444 | 185338 | 69856 |
| 1 | Manufacturing services on physical inputs owned by others | 114912 | | 36896 |
| 12 | Government goods and services n.i.e. | 132369 | 49866 | 35538 |
| 8 | Charges for the use of intellectual property n.i.e. | 2659 | 75865 | 18367 |
| 2 | Maintenance and repair services n.i.e. | 11620 | 11932 | 8569 |

Analysis

- Services represents, by excellence, a source of IFF since we can't prove the effective execution of the business transaction
- Example: Lebanese offshore acting as an intermediary between an Ukrainian Wood Company and an African country



Analysis

- Main Vehicles for IFFs in Lebanon are:
 - Services,
 - Oil & Gas,
 - Vehicles,
 - pearls and precious metals,
 - Pharmaceutical products,
 - Electrical machines

Analysis

- Government Request for Proposal constitutes also a vehicle for outflow money from Lebanon to the bank account of the decision makers.
- The openness of the borders between Lebanon and Syria, leads to make from Lebanon a window for IFFs coming from and to Syria, Iraq and Turkey
- Corruption in Lebanon is a catalyzer for the IFFs
- ...

Analysis

The screenshot shows the EViews software interface. The main window displays a list of variables on the left and a list of 8 equations in the center. The equations are:

- Eq1: $\log r = F(\log gdp, \log p, \log phi)$
- Eq2: $\log g = F(\log p, \log phi, \log y)$
- Eq3: $\log m = F(\log g, \log mult, \log r)$
- Eq4: $\log p = F(\log m, \log mp, \log pi, \log y)$
- Eq5: $\log ttax = F(\log p, \log phi, \log ttaxrate, \log y)$
- Eq6: $pi = F(\log p, pi)$
- Eq7: $\log u = F(\log p, \log phi, \log t0, \log ttax, \log u)$
- Eq8: $\log phi = F(\log gini, \log p, \log t0, \log u, \log y)$

Two red arrows point from the text "The model" to the equation list in the screenshot.

Government Revenues:

$$\log R_t = -a_0 + a_1 \log GDP_t + a_2 \log P_t + a_3 \log \psi_t$$

Government Expenditures:

$$\log G_t = b_0 + b_1 \log Y_t + b_2 \log P_t + b_3 \log \psi_t$$

Broad Money Supply:

$$\log M_t = k_0 + k_1 \log Mult_t + k_2 \log G_t - k_3 \log R_t + k_4 \log E_t$$

Price Level:

$$\log P_t = -c_0 + c_1 \log Y_t + c_2 \log \pi_t - c_3 \log (M/P)_{t-1} + c_4 \log M_t$$

Total Taxes Collected:

$$\log TTax_t = d_0 + d_1 \log Y_t + d_2 \log TTaxrate_t + d_3 \log P_t + d_4 \log \psi_t$$

Expected Rate of Inflation:

$$\pi_t = \delta \Delta \log P_t + (1 - \delta) \pi_{t-1}$$

Underground Economy:

$$\log U_t = e_0 + e_1 \log P_t + e_2 \log \psi_t - e_3 \log TTax_t + e_4 \log U_{t-1} + e_5 \log TO_t$$

Illicit Outflows:

$$\log \psi_t = w_0 + w_1 \log P_t + w_2 \log U_t + w_3 \log Gini_t + w_4 \log Y_t + w_5 \log TO_t$$

The model

Analysis

- Marco-Econometric model to estimate the flow of IFFs: GFI book “Illicit Financial Flows: The Most Damaging Economic Condition Facing the Developing World”
- Data has been reconstructed (with considerable errors) from 1993-2016 using available data from different sources and spline interpolation for missing data
- Our estimation: **IFF represents more than 7% of the nominal GDP**

Recommendations

- Establish a unique database within Lebanon between the customs, ministry of finance and ministry of economy and trade
- Establish a national unit to coordinate actions against IFFs and corruption and not subject to bank secrecy
- Establish mandatory information exchange mechanism inter-country between national IFFs fighting units
- Set a new law for making commercial transactions more transparent and making the IFFs illegal and punished by the Lebanese authorities

Recommendations

- Make all transactions with value greater than 3000 USD, electronically paid through checks, Credit Card or any other electronic payment
- Set a specific law for multinational and offshore companies for better transparency
- Enhance the role of customs
- Thanks for the **ESCWA** for raising this problem

Thank
you