Zimbabwe Economic Policy Analysis and Research Unit

POLICY BRIEF

Capital Flight and Trade Misinvoicing in Zimbabwe

1. Introduction and Background

This paper estimates trade misinvoicing in Zimbabwe from major trading partners using the Morgenstern (1963) methodology. Trade misinvoicing is done for several reasons such as tax evasion, quota avoidance, smuggling, money laundering, or for other unknown reasons. Zimbabwe is an interesting case due to its changing macroeconomic environment, which presented opportunities for capital flight. It has witnessed episodes of stable growth (1980–98) as well as periods of international isolation, negative and positive economic growth (1999–2008). The country has gone through multiple currencies and implemented the Indigenization and Economic Empowerment policy (2009–14). These episodes present an opportunity to explore the influence of local specific factors such as the institutional framework, macroeconomic context, and mineral resource endowment on capital flight from Zimbabwe.

The study track trade misinvoicing with respect to each of the main minerals exported by Zimbabwe across major trading partners, namely gold, diamond, platinum, ferro-chrome alloys, nickel, and asbestos. Despite Zimbabwe exploiting about 30 different types of minerals, selection of minerals was based on major contributors to total trade based on ZimTrade 2013 report.

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The trading partners with the highest trade misinvoicing are Italy, UK, and the US. This trend reversed beginning in 1992 as capital started flowing back into these economies through trade misinvoicing. In the early 2000, the other driver of trade misinvoicing might be a change in government policy, such as the Look East policy of 2003 that shifted the focus to the Asian countries. However, even with countries like China there was capital flight from 2010.

Among three groups of minerals (ores, slag and ash; copper and articles, and nickel and articles), the highest capital flight is through nickel. Since the figures represent total trade misinvoicing, the results show that Zimbabwe witnessed the highest misinvoicing in nickel, which was among the top exported and imported minerals in Zimbabwe (International Trade Centre, 2008).

For unsorted diamonds, Zimbabwean exporters under-reported trade transactions with the UK and South Africa from 2004 to 2013. This scenario is observed for non-industrial diamonds for Belgium, China, South Africa, and the US. The same occurs for gold in other unwrought forms for Italy, Germany, and the US. The results suggest high export misinvoicing of those minerals largely controlled by multinational companies. This supports the finding of Jordan et al. (2012) that foreign ownership is a driver of trade misinvoicing. Diamond export misinvoicing which lead to capital flight largely occur with the UK, China and South Africa. Export overinvoicing is only experienced in trade with Belgium, a situation which shows illicit capital inflows into the country since Zimbabwe used to have diamonds marketed in Belgium through auctions in Antwerp.

As for trade misinvoicing of gold, Zimbabwean exporters are bringing in unrecorded capital from South Africa. This might suggest that the majority of Zimbabwe mining companies are from South Africa, hence they largely want to bring illegal capital to expand their businesses. The data show small values of export misinvoicing of gold, suggesting stringent control by the Reserve Bank in the marketing of gold.

4. Conclusion and Policy Implications

Export misinvoicing dominates import misinvoicing, hence there is a need to put in place strict measures to monitor marketing activities of both local and foreign-owned mining companies to curb capital flight. The results also show that during the period of macroeconomic stability, the contribution of the mining sector to economic growth increased and capital flight was lower. This suggests that macroeconomic stability is needed to prevent capital flight.

The results show that unrecorded capital outflows occur through trade with different countries including Italy, United States, Germany, and China, while unrecorded capital inflows into Zimbabwe are mainly from South Africa, Belgium, and Australia. Trade misinvoicing occurs mostly in exports of diamonds, gold, and nickel. Generally, foreign companies are driving trade misinvoicing, as witnessed by high export underinvoicing from countries that have large numbers of multinational companies operating in Zimbabwe. Further, the results show that trade misinvoicing increased during the crisis period. This indicates that foreign companies largely took their capital out of Zimbabwe during the crisis period. The implications are that ensuring macroeconomic and political stability and enacting clear policies on how multinational companies operate are key to curbing capital flight.

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Some of the measures that were undertaken in Zimbabwe to curb capital flight are as follows:

- Amendment of the Mines and Minerals Act (Chapter 21:05) gazetted in 1961. The mining policy requires that every individual should have a license to search for and exploit mineral resources;
- Since 1983, all mineral exports, except gold, have been marketed by the Minerals Marketing Corporation of Zimbabwe (MMCZ) in regional and international markets. This eliminated transfer pricing;
- In the gold sector, a policy was adopted requiring gold to be sold to the Reserve Bank of Zimbabwe (RBZ) through a gold refinery in 1989; and
- In an effort to redistribute the economic wealth from the mining sector, the Community Share Ownership Trust was introduced under the Indigenization and Economic Empowerment policy (2007).

2. Study Rationale

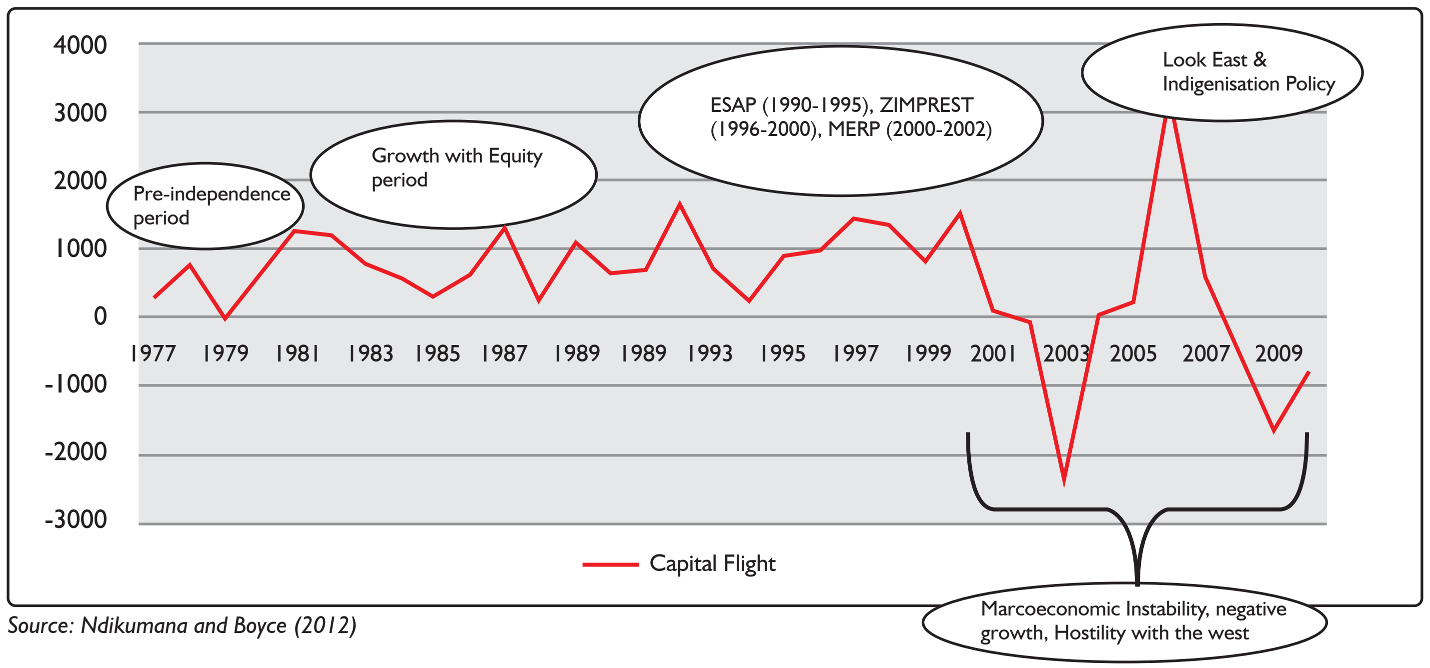
The main objective of the study was to investigate the relationship between natural resources, particularly mineral resources and capital flight, taking into account the institutional environment of Zimbabwe. The second objective of the study was to estimate capital flight through trade misinvoicing. The rationale for this study is because Zimbabwe is endowed with abundant mineral resources, which have great potential to contribute to economic development. According to a Zimstat 2014 report, the mining sector contributed only around 3-4% to economic growth despite the fact that Zimbabwe accounts for about 9 percent of the world's diamond production, 6 percent of the world's platinum production and about 4 percent of the world's palladium output (Mobbs (2014). Further, most of the metals and minerals are exported, presenting fertile ground for trade misinvoicing, given that most of the companies in the mining sector are foreign-owned. The prevalence of foreign ownership is due to the huge capital requirements and technical expertise required in mining exploration and exploitation. Thus foreign companies dominate in most of the mining activities, with South Africa, Canada, Australia, and the United Kingdom as the main players in mining activities in Zimbabwe. However, import misinvoicing is not expected to be high since Zimbabwe is largely endowed with minerals and therefore an exporter in their raw form.

3. Key findings

3.1 The Macroeconomic, Institutional Environment and Capital Flight

The analysis of capital flight over the past four decades shows that some developments in the macroeconomic policy and institutional environment may have influenced the behavior of capital flight. From a long-term perspective, capital flight fluctuated around a relatively low and stable level up until the end of the 1990s, when it started to fluctuate drastically (Figure 1). The most drastic change in the pattern of capital flight occurred in 1999 when it declined systematically, reaching a negative value of US$65.4 million in 2003. But capital flight rose again substantially from there on, reaching a peak of US$3.1 billion in 2006, after which it declined again. The volatile pattern of capital flight is closely associated with the heightened macroeconomic instability during that period.

Figure 1: Capital flight from Zimbabwe, 1977–2010 (constant 2010 US$m)



Source: Ndikumana and Boyce (2012)

Zimbabwe has had extended episodes of hyperinflation and massive exchange rate depreciation, leading to the complete collapse of the value of the national currency and the adoption of a multi-currency system in 2009. These developments may have influenced capital flight directly or indirectly since the study shows that capital flight, inflation, and the exchange are positively correlated. High inflation has been associated with both higher levels and higher fluctuations in capital flight in the 2000–12 period. Long periods of depreciation of local currency against foreign currency signals high currency risk which then lead to a high level of capital flight.

The perceived lack of clarification on the Indigenization and Economic Empowerment Act introduced in 2007, which calls for a 51 percent local ownership and 49 percent foreign ownership, and seeks to ensure that local people have more stake in natural resource exploitation might have an impact on capital flight. The debate about the introduction of the Indigenization and Economic Empowerment (IEE) Act started in the year 2006, ironically, the year when Zimbabwe reached its peak in terms of capital flight. Zimbabwe also has large number of unregistered small-scale miners (400,000 unregistered small-scale miners in gold production) which provides a fertile ground for capital flight in the mining sector, given that unregistered miners may not be able to sell their minerals through formal markets (Zimbabwe Miners Federation, 2014).

3.2 Trade Misinvoicing and Capital Flight

The study calculates trade misinvoicing at different levels of aggregation of the Harmonised System (HS) at 2, 4, and 6 digits, using data from the United Nations Commodity Trade Statistics Database (UNCOMTRADE), 1980 to 2014. Trade misinvoicing is calculated at the trading partner level for all minerals (ores and metals) combined and at the product-trading partner level. The results show that unrecorded capital outflows occur through trade with different countries including Canada, China, Germany, Greece, Italy and United States. These countries were used as gateways of capital out of Zimbabwe. The highest capital flight through trade misinvoicing was done through Italy with a total amount of approximately US$120 million from 2008 to 2013. During this period, the Indigenization and Economic Empowerment policy might have scared investors. Investment risk might have continued to be present even during the multi-currency period. On other hand, unrecorded capital inflows into Zimbabwe are mainly from South Africa, Belgium, Australia, United Kingdom and Zambia. The highest illegal inflows come from South Africa.

A disaggregation of minerals reveals that trade misinvoicing for pearls and precious metals is largely driven by export misinvoicing rather than import misinvoicing. The import misinvoicing was a channel for unrecorded capital inflows into the country. This may indicate a misclassification of processed mineral products as raw materials/minerals to evade taxes. The import misinvoicing is positive for South Africa from 2008, indicating capital flight, as importers overestimate the value of their imports and record it as loans, to be exempted from capital controls when paying back.