

# (Illicit) Financial Flows in the Mining Sector in South Africa: Implications for Industrialisation

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# Introduction

- Industrialisation ensures that manufacturing becomes a source of value to an economy (Malan, Steenkamp, Rossouw and Viviers, 2014).
- At the core of industrialisation is the development of productive capabilities in manufacturing that would result in increased productivity, quality and design of products (Roberts, 2014)
- South Africa's approach to industrial development is set out in National Industrial Policy Framework (NIPF), and the Industrial Policy Action Plan (IPAP) as the implementing mechanism.
- However, due to high levels of surplus taken out of the country, much of it illegally, South Africa suffers low levels of domestic investment that is required for there to be any prospect for development policy to be successfully implemented (Ashman, Fine, Padayachee and Sender, 2014)
- The expansion of firms, as does the entry of new firms requires investment, and even a movement towards a more labour-intensive production technology may require additional capital (Rankin, 2014)

# Industrialisation and the Mining Economy in South Africa

- Historically, the minerals revolution of the 19th century laid the foundation for the emergence of the modern South African industrial state (see, for instance; De Kock 1924, Lumby 1983, Jones and Müller 1992).
- Even post-1994, South Africa's industrial developments still remained to be dominated by what Fine and Rustomjee (1996) termed the 'minerals-energy complex'.
- Such that those sectors which have been identified to have weak linkages to the minerals-energy complex are inadequately developed (Mohamed 2007)
- Still, South Africa's natural resources and its diversified mining economy continue to present real opportunities for resource-based industrialisation in the country.
- By optimising the fiscal, production and consumption linkages within and outside the extractive sectors, South Africa, can successfully develop its industrial base.

## Industrialisation and the Mining Economy in South Africa (cont)

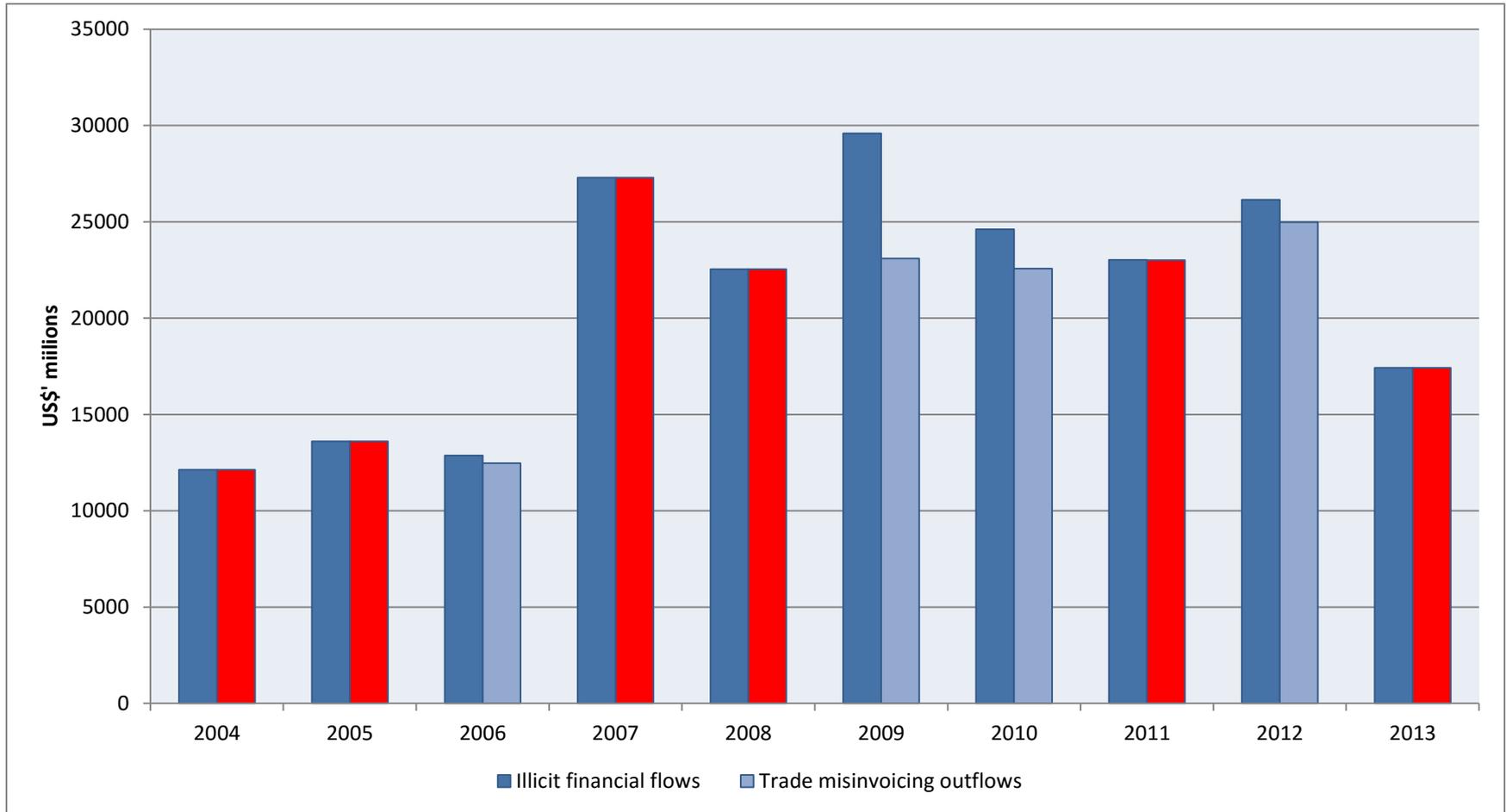
- **Fiscal linkages** relate to the resource rents, collected by governments from the commodities sectors in the form of corporate and income taxes and royalties - they can potentially serve to promote industrial development in the other sectors of the economy.
- **Production linkages** include forward or upstream (*processing and transforming extractive produce into manufactured products*) and backward or downstream (*producing inputs that will be utilised in commodity production*) - are more likely to stimulate the development of a more diversified economy.
- **Consumption linkages** are associated with the demand for outputs produced by other economic sectors resulting from the expenditures incurred by the extractive sector.

# Illicit Financial Flows in the Mining Sector in South Africa

- The 'minerals-energy complex' that has dominated South Africa's industrial developments had embraced the processes of financialisation in which the ( illegal) export of domestic capital has played a leading role (Ashman, Fine and Newman, 2011).
- Illicit financial flows (IFFs) are defined as the money that is illegally earned, transferred or utilised (Kar and Spanjers, 2015).
- In the 2015 Global Financial Integrity Report, South Africa was ranked 7<sup>th</sup> place globally among the top ten source economies for illicit financial flows.
- During 2004-2013, South Africa's cumulative IFFs amounted to US\$ 209,220 million.
- In this period trade mis-invoicing accounted for 95% of the IFFs from South Africa.
- Example of trade mis-invoicing is when exporters understate the export revenue on their invoices (under-invoicing), and importers overstate import expenditures (over-invoicing).

# Illicit Financial Flows in the Mining Sector in South Africa (cont)

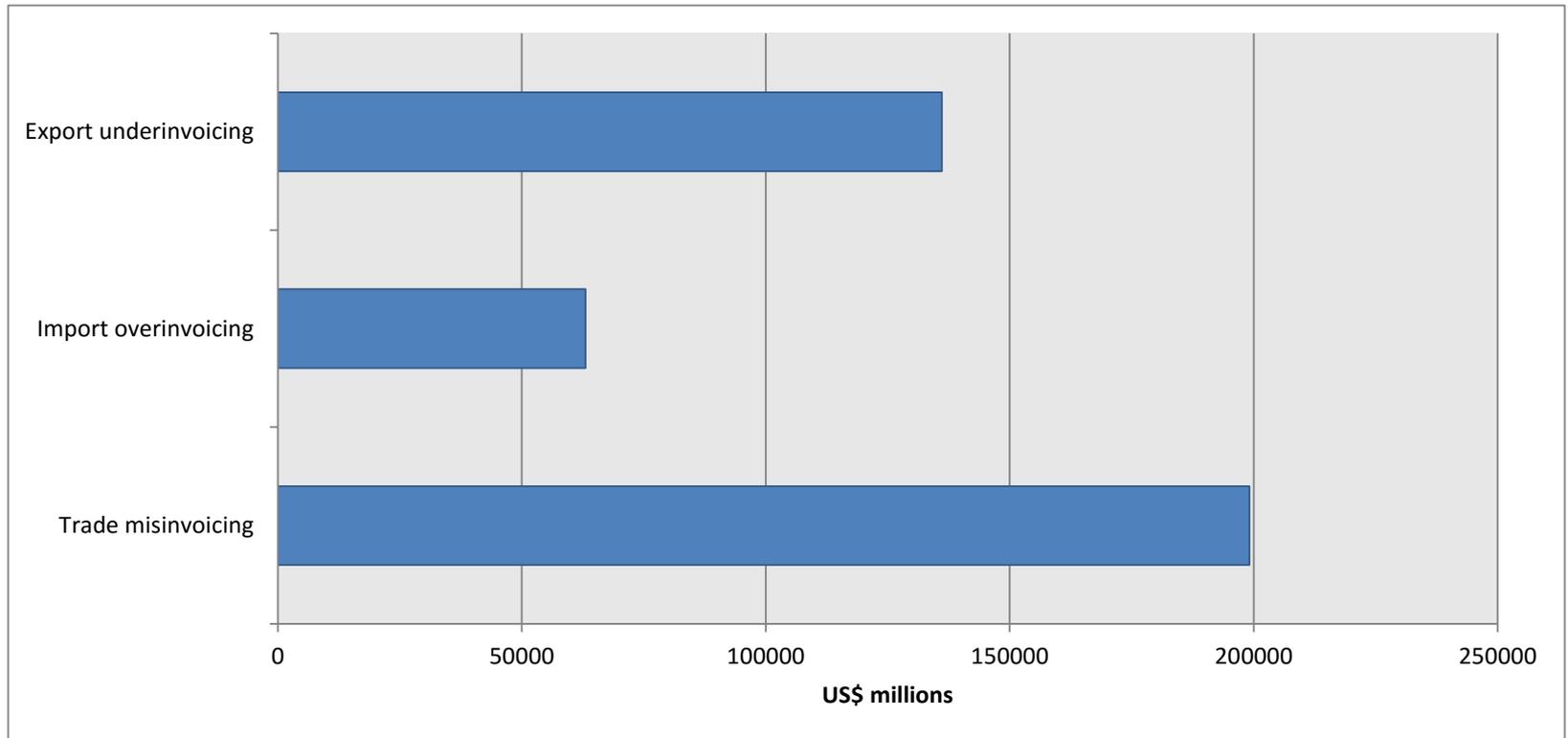
## Illicit Financial Flows from South Africa, 2004-2013



Source: Global Financial Integrity data

# Illicit Financial Flows in the Mining Sector in South Africa (cont)

The components of trade mis-invoicing outflows from South Africa, 2004-2013

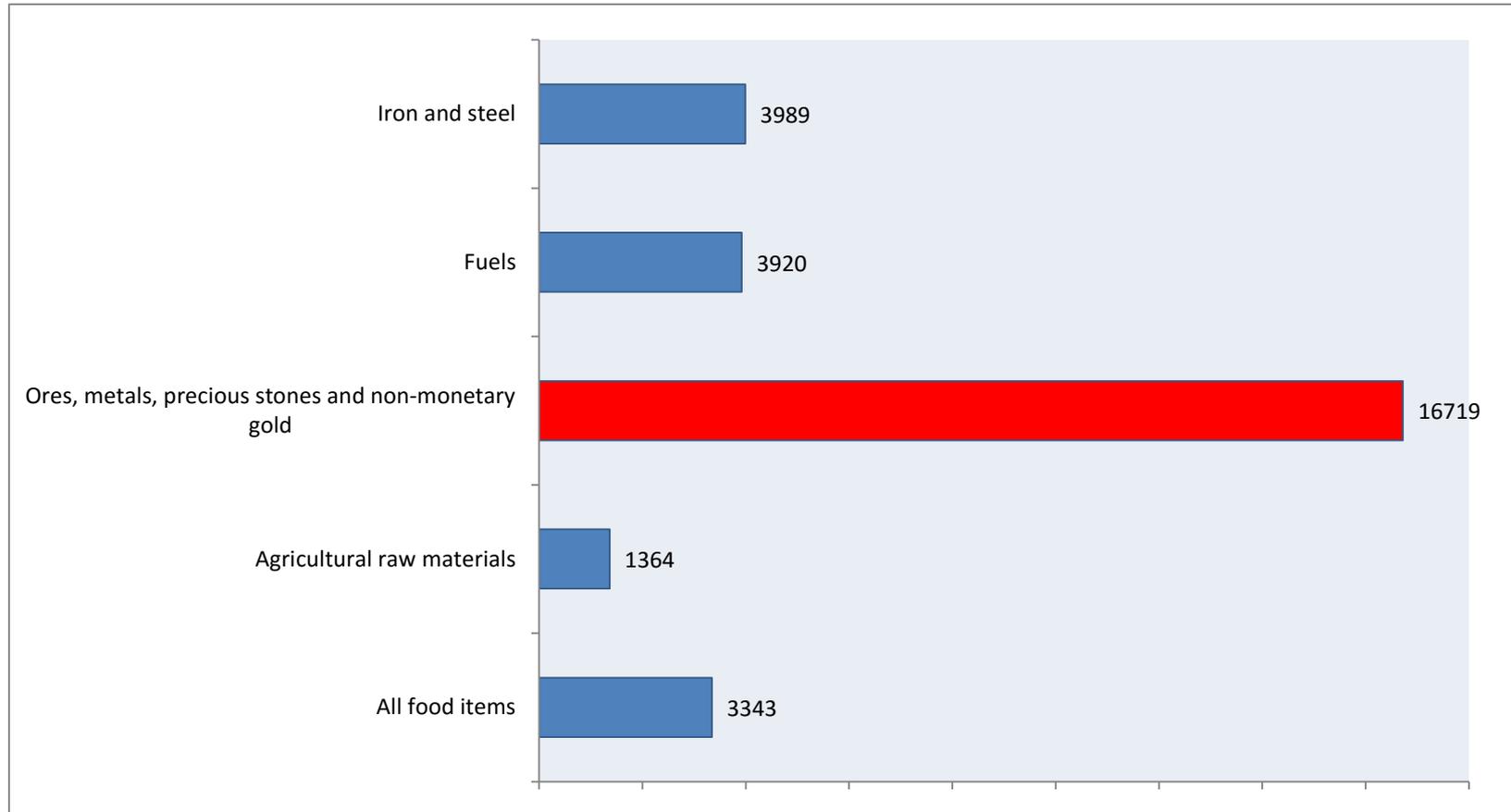


Source: Global Financial Integrity data

Export under-invoicing accounted for 68% of the trade mis-invoicing outflows from South Africa.

# Illicit Financial Flows in the Mining Sector in South Africa (cont)

Trade mis-invoicing outflows by sector during 1995-2006 (US\$ ' millions)



Source: Ashman et al., (2011)

The vast majority of trade mis-invoicing outflows from South Africa occur in and around the mining sector.

# Implications for industrialisation

- IFFs in the mining sector in South Africa are a threat to industrialisation:
- By draining the economy of a potentially rich resource, domestic investment, which is required to promote industrial development in the country. (**Fiscal linkages**)
- Arguably it could be that the capital that illicitly exists South Africa from the mining sector could be reinvested for beneficiation/processing of raw materials into intermediate and finished products and in the improvement of productive capacities in manufacturing and/or firm expansion. (**Production linkages**)
- And for South Africa to benefit from **consumption linkages** it is imperative that it develops its industrial base.

# Conclusions

- As asserted by Jill Nattrass, in 1986 “mining appears to provide an almost perfect means of transferring the investible surpluses that are generated within the economy supplying the mineral... until these surpluses can be re-directed for use within the region itself, little economic development is likely to take place”. For South Africa and equally for much of Africa, this has particular significance.
- It is therefore essential that strategic mechanisms and programmes aimed at curbing illicit trading are strengthened, with a particular focus on export trade under-reporting, to ensure that the surplus generated from the South African mining sector is reinvested back into the economy.
- Furthermore an examination of how illicit trading impacts on South Africa’s trade policy prescriptions or evaluations is also critical - especially because trade policy is widely used as an instrument to promote industrial development.