

Executive Summary

The following report estimates and examines the illicit flow of money into and out of the Philippines over the 52-year period from 1960 through 2011, the most recent year for which comprehensive data are available.

The study finds **that between 1960 and 2011, illicit financial outflows from the Philippines totaled \$132.9 billion**, while **illicit inflows amounted to \$277.6 billion**. Thus, over the 52-year time-span, cumulative illicit financial flows into and out of the Philippines totaled \$410.5 billion.

The vast majority of money flowing illicitly into and out of the Philippines is accomplished through the misinvoicing of trade, rather than through hot money flows such as unrecorded wire transfers. Of the \$132.9 billion that flowed illicitly out of the nation, \$95.2 billion (or roughly 72 percent) was via trade misinvoicing.

The dominance of trade misinvoicing as a conduit for illicit flows is even more apparent when examining illicit inflows. Of the \$277.6 billion in illicit financial inflows over the years, \$267.8 billion (or roughly 96 percent) is attributable to trade misinvoicing.

Moreover, the report conclusively finds that both illicit inflows and illicit outflows are harmful to the Philippines. Illicit outflows drain money from the domestic Philippine economy, they facilitate income tax and customs duty evasion, and they are found to deplete domestic savings. As such, it is concluded that illicit outflows hamper sustainable economic growth over the long-run.

Interestingly, illicit financial inflows are perhaps an even bigger drain on the Philippine economy. Most of the \$267.8 billion in illicit inflows due to trade misinvoicing is the result of under-invoicing imports. It is so widespread in the Philippines that **over the past decade, 25 percent of the value of all goods imported into the Philippines– or 1 out of every 4 dollars– goes unreported to customs officials**.

Import under-invoicing is generally driven by a desire to reduce or eliminate the costs of customs duties and tariffs. As taxes on international trade constitute 22 percent of total taxes in the Philippines, such widespread under-invoicing has a severely damaging effect on government revenues.

The report finds that **the Philippine government has lost at least \$19.3 billion since 1990 in tax revenue due to customs duties evasion through import under-invoicing alone**. Combined with an additional \$3.7 billion in tax revenue lost through export under-invoicing, **the Philippine government has lost at least \$23 billion in customs revenue due to trade misinvoicing since 1990**.

Since 2000, illicit financial flows have cheated the government of an average of \$1.46 billion in tax revenue each year. To put this in perspective, the \$3.85 billion in lost tax revenue in 2011 was more than twice the size of the fiscal deficit and equal to 95 percent of the total government expenditures on social benefits that same year.

While illicit inflows through trade misinvoicing cheat the government of customs duties, the proceeds of those inflows are not found to benefit the official economy. Rather, they are found to drive the underground economy, leading to a further deterioration in governance.

The study estimates the size of the underground economy at roughly 35 percent of GDP and finds that total illicit financial flows correlate nearly perfectly with the World Bank's "Control of Corruption" Governance indicator.

Over the period of 1960-2011, trade misinvoicing relative to total trade increased by 3 percent per annum on average in the case of Philippines and declined by 4 percent per annum in the case of South Korea. This difference in experience highlights the role of governance, which deteriorated significantly in the Philippines and strengthened markedly in South Korea.

The study is the most methodologically rigorous analysis conducted by GFI to date on the role of illicit financial flows into or out of any country.