COMBATTING ILLICIT FINANCIAL FLOWS (IFFs) FROM AFRICA

Highlights of the HLP Report

by

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Background

- Africa is estimated to be losing more than $50bn annually in IFFs.

- IFFs are a huge drain on Africa’s resources and of serious concern given:
  - Inadequate growth – average growth of 5% annually is encouraging at best.
  - High levels of poverty – number of people living on less than $1.25/day increased from 290 million in 1990 to 414 million in 2010.
  - Africa’s resource needs – set to have largest youth population.
  - Changing global landscape of Official Development Assistance – ODA resources are stagnating due to domestic fiscal challenges of partners.
High Level Panel on IFFs

- The Panel is chaired by H.E, Thabo Mbeki, former President of the RSA.
- Comprises of nine other members from within and outside the continent.
- Panel’s Mandate was to:
  - Determine the nature and patterns of illicit financial outflows from Africa;
  - Establish the level of illicit financial outflows from the continent;
  - Assess the complex and long-term implications of IFFs for development;
  - Raise awareness among African governments, citizens and international development partners of the scale and effect of such financial outflows on development; and
  - Propose policies and mobilize support for practices that would reverse such illicit financial outflows.
Panel’s Methodology and Approach

- Focus on research

- Country level case studies (6 countries) as well as Mauritius (small islands) and South Africa (experience).

- Advocacy strategy: “IFF: Track it; Stop it; Get it”

- Policy Dimensions
Understanding IFFs

- Illicit financial flows can be defined as “money illegally earned, transferred or used”.

Origins of illicit financial flows

- Laundering proceeds of crime
- Abuse of power
- Market/regulatory abuse
- Tax abuse

United Nations Economic Commission for Africa
How IFFs take place

I. Commercial Activities

- Intent - to hide wealth, avoid taxes and dodge customs duties/levies.

These include:

- Abusive transfer pricing;
- Trade mispricing;
- Mis invoicing of services and intangibles
- Unequal Contracts
II. Criminal Activities

• Intent – keeping transactions from the view of law enforcement agencies or revenue authorities.

• These include:
  
  ➢ trafficking of people drugs and arms;
  
  ➢ smuggling;
  
  ➢ financial fraud, e.g. unsecured loans, money laundering, etc.
  
  ➢ organized crime
III. Corruption as Abuse of Entrusted Power

- Treated as a cross-cutting issue
- Affecting all three components of IFFs
- Not only public sector corruption but also private sector corruption
Estimating IFFs from Africa

- Difficulties in estimating IFFs due to:
  - their hidden nature
  - Unverifiable nature of the accuracy of existing data

- Existing work has examined:
  - discrepancies in recorded capital or trade flows
  - gross figures vs netted out illicit inflows

- ECA study looked at gross outflows focusing on trade mispricing

- Study informed mainly by:
  - availability of data
  - UN Comtrade data allowed use of detailed trade data
• Estimates of IFFs from Africa tell only part of the story...


Source: Based on Ndikumana and Boyce (2008), Kar and Cartwright-Smith (2010), Kar and Freitas (2011) and ECA’s calculations.
The Mosaic of Actors

- Some of these actors are implicated as perpetrators while others are actively engaged in combating IFFs.

I. African governments - Policies, law enforcement and regulatory agencies (both perpetrators and combatants)

II. The private sector - multinational corporations, international banks, and international legal and accounting firms.

III. Civil Society Organizations (CSOs) - advocacy campaigns, naming and shaming perpetrators, undertaking research and proposing policy solutions

IV. Criminal Networks - criminal and terrorist activities and its use in the more insidious moves to capture state structures
• CSOs have campaigned against IFFs from Africa and other parts of the world…

Source: http://www.actionaid.org/sites/files/actionaid/imagecache/637px_wide/image/90264scr_0.jpg
Global Actors:

I. Non-African governments - Apart from helping to set a global norm against illicit financial flows, non-African governments have a key role to play in assisting African countries to acquire the capacities to fight the scourge.

II. International organizations - Different entities such as the OECD, World Customs Organization, and Financial Action Task Force are working on different aspects of illicit financial flows and from different perspectives.
Drivers & Enablers of IFFs

- Illicit financial flows are driven by a number of ‘push’ and ‘pull’ factors.

- **Push & Pull Factors:**
  1. Poor governance
  2. Weak regulatory structures
  3. Tax incentives
  4. Weak capacities
  5. Double Taxation Agreements (DTAs)
  6. Financial secrecy jurisdictions and/or tax havens
On-going Efforts to Curb IFFs

National and Regional Efforts:

- AU: The adoption of the HLP Report on IFFs as a declaration during the 24th AU Summit
- AU Convention on Preventing and Combating Corruption
- APRM (African Peer Review Mechanism)
- Efforts to recover frozen assets
- GIABA: Inter-Governmental Action Group against Money Laundering in West Africa (GIABA)
Challenges at the national and regional levels include:

- inadequate regulatory framework;
- inadequate funding and over-reliance on unpredictable foreign assistance;
- lack of technical and human capacity to deal with crime perpetuated by sophisticated individuals;
- the involvement of top government officials in corruption cases;
Global Efforts:

• One key principle that is emerging with regard to tackling IFFs at the global level is improving transparency

• Other key items relate to transparency;
  I. arm’s length principle;
  II. automatic exchange of information
  III. country-by-country and project-by-project reporting;
  IV. public registries of beneficial ownership
  V. asset recovery;
Global Initiatives:

- The Global Forum on Transparency and Exchange of Information for Tax Purposes (OECD);
- Multilateral Convention on Mutual Administrative Assistance in Tax Matters (OECD);
- Extractive Industries Transparency Initiative;
- Article 1504 of the Dodd-Frank Act (United States of America);
- Foreign Account Tax Compliance Act (United States of America);
- G20-OECD work on base erosion and profit shifting;
- Automatic Exchange of Information (OECD, G8, G20);
- Public register (United Kingdom);
Challenges for Africa at the global level include:

- The expected distribution of benefits between African countries and developed countries that are implementing these measures are not well known or clearly defined
- Access to information by African countries is made conditional
Impact of IFFs (I)

Weakening Governance –

• Weak public institutions

• Compromise of government officials

• Debasement of values & misalignment of incentives

• Corruption & criminal activities

• Conflict & insecurity
Figure 2.2
Overview of illicit financial flows and security linkages

Financial capacity gives rise to IFF

- Laundering criminal proceeds
  - Drug trafficking
  - Human trafficking
- Corruption
  - Bribery of officials
  - Theft of state assets
- Tax abuse
  - Corporate
  - Individual
- Market abuses
  - Conflicts of interest
  - Regulatory abuse

"Illegal capital" IFF

- Most urgent threats:
  - Conflict
  - State illegitimacy
  - Rent-seeking

"Legal capital" IFF

- Most urgent threats:
  - Basic service provision
  - Inequality
  - Effective political representation
  - Rent-seeking

Impact of IFFs (II)

Development Consequences -

• Loss of multiplier effect for growth & job creation

• Africa’s capital stock would have expanded by 60% & GDP per capita of 15%

• Rate of domestic investment to GDP would have risen from 19% to 30%

• Leveraging effect of state intervention
  - Infrastructure

Fiscal effects & austerity
Illicit financial flows and their impact on child mortality rates

IFF (1-15% OF GDP)

COUNTRY RESOURCES (GDP PC PPP) AND ITS DISTRIBUTION

Government revenue, governance, control of corruption, government efficiency

Household resources: access to food, shelter, education, sanitation, healthcare, including vaccination indicators, and water/information resources available in home

Child mortality including under-five mortality rate (indicator 4.1) and infant mortality rate (indicator 4.2)
Impact of IFFs (III)

• Discouraging Transformation and Transparency - by discouraging value creation, IFFs impact negatively on African aspirations for structural transformation.

• Straining Africa’s capacities – there is great concern over the risk African countries face in making unbalanced tax concessions.

• Undermining International Development Cooperation - global efforts to promote partnerships for aid effectiveness and development effectiveness are undercut by illicit financial flows.
Findings (I)

• IFFs are an African problem with Global solutions...

Heat map of illicit financial flows by country as a percentage of GDP
Findings (II)

1) IFFs from Africa are large and increasing.
2) Success in addressing IFFs is ultimately a political issue.
3) Transparency is important for tackling IFFs.
4) Commercial routes of illicit financial flows need closer monitoring.
5) African countries depend on mainly on their extractive industries.
Findings (III)

6) New and innovative means of generating illicit financial flows are emerging.

7) Tax incentives granted by African countries are not usually guided by cost-benefit analyses.

8) Corruption and abuse of entrusted power still remains a continuing concern.

9) Stimulating and expediting the asset recovery and repatriation

10) Money laundering continues to require attention.
Findings (IV)

11) Weak national and regional capacities in Africa impede efforts to curb illicit financial flows

12) Absence of a global and continental frameworks for addressing IFFs that speaks to African interests

13) Financial secrecy jurisdictions must come under closer scrutiny.

14) Development partners have an important role in curbing IFFs from Africa

15) IFF issues should be incorporated and better coordinated across UN processes and frameworks.
A. The commercial component of IFFs

1) Trade Mispricing: African countries should ensure they have clear and concise laws against mis-stating the price, quantity, quality or other aspect of trade in goods and services in order to move capital to another jurisdiction or avoid taxation.

2) Transfer Pricing: African countries should establish or strengthen transfer pricing units of their countries of operation.

3) Base Erosion and Profit Shifting: African countries should establish arrangements for exchange of tax information between them as well as with global partners.

4) Regional integration arrangements should be used to introduce accepted standards for tax incentives.

5) Institutional support for these measures: African States should establish or strengthen the independent institutions and agencies responsible for preventing IFFs.
B. The criminal component of IFFs

1) Training and empowerment of investigators responsible for identifying the criminals engaged in illicit (criminal) activities by African governments is critical.

2) Each African country’s financial intelligence unit should share information with other African financial intelligence units.

3) Request that the United Nations Office on Drugs and Crime (UNODC) extend its work on transnational organized crime in West and Central Africa to the rest of the continent.
C. The corrupt component of IFFs

1) IFFs should be integrated as a specific component in the African Union Convention on Preventing and Combating Corruption.

2) African states should ensure that the public can access national and subnational budget information.

3) African countries should adopt best practices in open contracting to reduce IFFs through government procurement processes.

4) African governments can regularly publish lists of Politically Exposed Persons (PEPs) as well as any asset declarations filed by PEPs and information about whether the country’s laws prohibit or restrict the ability of their PEPs to hold financial accounts abroad.
D. Additional strategic measures by African states

1) African countries should adopt a normative instrument in the form of a declaration to commit to combat IFF.

2) CSOs and related institutions should be given the operating space and legal freedoms required for advocacy, activism, and research in this area.

3) The African Peer Review Mechanism (APRM) should incorporate issues of IFFs in its questionnaires for the country review process.

4) Study should be undertaken of potential methodologies and reforms available globally and regionally and to individual African countries to facilitate taxation of multinational corporations in accordance with where their economic activities occur.

5) ECA should produce a practical document available to all African countries on operational measures to adopt policies against IFFs as well as support advocacy actions detailing the dangers to the economic, social and political lives of African countries.
E. **Further responsibilities by African partners**

1) The Bank for International Settlements publish the data it holds on international banking assets by country of origin and destination.

2) The global community in all of its institutions, including parliaments, should take all necessary steps to eliminate secrecy jurisdictions, introduce transparency in financial transfers and crack down on money laundering.

3) Transparency of ownership and control of companies, and other legal entities that can hold assets is critical.

4) Stronger collaboration and consistent engagement between Africa and global players such as the US, EU, G8 and G20 to help ensure greater transparency in the international banking system.
Processes and Follow-up

- Presentation of Progress Report to Conference of Ministers
- Presentation of Report to AU Summit
- Adoption of Special Declaration on IFF
- Follow up on Research, Advocacy and Capacity
Thank You


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