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## Illicit Financial Flows

Report of the High Level Panel  
on Illicit Financial Flows from Africa

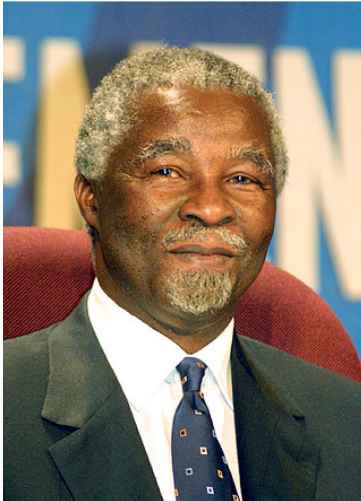
Commissioned by the AU/ECA Conference of Ministers of Finance, Planning and Economic Development



# **Illicit Financial Flow**

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# Foreword



The 4<sup>th</sup> Joint African Union Commission/United Nations Economic Commission for Africa (AUC/ECA) Conference of African Ministers of Finance, Planning and Economic Development was held in 2011. This Conference mandated ECA to establish the High Level Panel on Illicit Financial Flows from Africa. Underlying this decision was the determination to ensure Africa's accelerated and sustained development, relying as much as possible on its own resources.

The decision was immediately informed by concern that many of our countries would fail to meet the Millennium Development Goals during the target period ending in 2015. There was also concern that our continent had to take all possible measures to ensure respect for the development priorities it had set itself, as reflected for instance in the New Partnership for Africa's Development. Progress on this agenda could not be guaranteed if Africa remained overdependent on resources supplied by development partners.

In the light of this analysis, it became clear that Africa was a net creditor to the rest of the world, even though, despite the inflow of official development assistance, the continent had suffered and was continuing to suffer from a crisis of insufficient resources for development.

Very correctly, these considerations led to the decision to focus on the matter of illicit financial outflows from Africa, and specifically on the steps that must be taken to radically reduce these outflows to ensure that these development resources remain within the continent. The importance of this decision is emphasized by the fact that our continent is annually losing more than \$50 billion through illicit financial outflows.

This Report reflects the work that the High Level Panel on Illicit Financial Flows has carried out since it was established in February 2012, particularly to:

- Develop a realistic and accurate assessment of the volumes and sources of these outflows;
- Gain concrete understanding of how these outflows occur in Africa, based on case studies of a sample of African countries and;
- Ensure that we make specific recommendations of practical, realistic, short- to medium-term actions that should be taken both by Africa and by the rest of the world to effectively confront what is in fact a global challenge.

It would not have been possible for our Panel to do its work without the enthusiastic support of all our interlocutors as we worked to discharge our mandate. I would like to take this opportunity to convey our sincere and warm thanks to all those for everything they did to contribute to the success of the work of our Panel. Here I am referring to:

- The heads of state and government and the governments of all the African countries we visited, as well as the president and government of the United States;

- Leaders of the legislatures in many of these countries;
- The leadership and staff of the international organizations with which we interacted, these being:
  - The United Nations, at its New York Headquarters, as well as the United Nations Member States;
  - The World Bank and the International Monetary Fund at their headquarters in Washington, DC;
  - The World Customs Organization at its headquarters in Brussels, Belgium;
  - The Organisation for Economic Co-operation and Development at its headquarters in Paris, France;
- The European Parliament in Brussels, Belgium;
- Civil society, including the business community, in the African countries we visited, as well as in the United States; and,
- Members of the media in many of these countries

We also extend our sincere thanks to the leadership and staff of ECA for their excellent contribution in providing our Panel with absolutely vital expert intellectual and logistical support.

I am also privileged to convey my heartfelt gratitude to my fellow panellists, drawn from all regions of Africa, as well as the committed and principled friends of Africa from the United States and Norway, who formed the outstanding collective responsible for this Report.

All these eminent persons, members of the Panel, have worked with great dedication, honesty and determination to serve the people of Africa.

Objectively, it is practically impossible to acquire complete information about illicit financial flows, precisely because of their illicit nature, which means that those responsible take deliberate and systematic steps to hide them. This also means that ECA and everyone concerned should continue to carry out research on this matter, including making generally available all new relevant information that will inevitably emerge.

Despite the challenges of information gathering about illicit activities, the information available to us has convinced our Panel that large commercial corporations are by far the biggest culprits of illicit outflows, followed by organized crime. We are also convinced that corrupt practices in Africa are facilitating these outflows, apart from and in addition to the related problem of weak governance capacity.

All this should be understood within the context of large corporations having the means to retain the best available professional legal, accountancy, banking and other expertise to help them perpetuate their aggressive and illegal activities. Similarly, organized criminal organizations, especially international drug dealers, have the funds to corrupt many players, including and especially in governments, and even to “capture” weak states.

All these factors underline that the critical ingredient in the struggle to end illicit financial flows is the political will of governments, not only technical capacity.

Further, illicit financial outflows whose source is Africa end up somewhere in the rest of the world. Countries that are destinations for these outflows also have a role in preventing them and in helping Africa to repatriate illicit funds and prosecute perpetrators. Thus, even though these financial outflows present themselves to us Africans as our problem, united global action is necessary to end them. Such united global action requires that agreement be reached on the steps to be taken to expedite the repatriation of the illicitly exported capital. This must include ensuring that the financial institutions that receive this capital do not benefit by being allowed to continue to house it during periods when it might be frozen, pending the completion of the agreed due processes prior to repatriation.

It also means that concrete steps should be taken to give general universal application to such best practices as might have developed anywhere in the world. This includes the relevant actions and initiatives that have been taken by such institutions as the OECD, the G8 and G20, the European Parliament and the African Tax Administration Forum.

Correctly, the United Nations is leading the process to engage the international community to design the Post-2015 Development Agenda, the successor programme to the Millennium Development Goals. As was foreseen in the Millennium Development Goals, giving credibility to the Post-2015 Development Agenda will require realistic expectations about the availability of resources to finance this agenda—a new and real commitment to the objective of financing for development.

Our Panel is convinced that Africa's retention of the capital that is generated on the continent and should legitimately be retained in Africa must be an important part of the resources to finance the Post-2015 Development Agenda.

We do not say this to support the entirely false and self-serving argument against capital transfers from the rich to the poor regions of the world, including Africa—a historically proven driver of equitable global development.

Rather, we are arguing that there exists a very significant and eminently practical possibility to change the balance between the volumes of domestic and foreign capital required for meaningful and sustained African development.

The radical reduction of illicit capital outflows from Africa, short of ending them, is precisely the outcome Africa and the rest of the world must achieve to produce this strategically critical new balance.

As a Panel we are convinced that the goals of ending poverty in the world, reducing inequality within and among nations, and giving practical effect to the fundamental objective of the right of all to development remain vital pillars in the historic process to build a humane, peaceful and prosperous universal human society.

We commend this humble Report to our immediate Principals, the African Finance, Planning and Economic Development Ministers, all the other African authorities and the people of Africa, as well as to the rest of the world, as a contribution to what must be an honest, serious, concerted and sustained African and global effort to build a better world for all.

**Thabo Mbeki**  
Chairperson

# Acknowledgements

The Panel would like to thank the governments, civil societies, business communities and members of the media in all of the African countries visited. The government of the United States. The leadership and staff of the United Nations (UN), The World Bank, the International Monetary Fund, The World Customs Organization, The Organisation for Economic Co-operation and Development, and the European Parliament. It also wishes to acknowledge the contributions and work of Former members of the Panel, Abdoulie Janneh, former Executive Secretary of the ECA; Ingrid Fiskaa, State Secretary for International Development, Norwegian Ministry of Foreign Affairs, 2012; and Arvinn Gadgil, State Secretary for International Development, Norwegian Ministry of Foreign Affairs, 2012-2013.

The panel would also like to thank the Technical Committee of the High Level report beginning with its Chairperson, Abdalla Hamdok, Deputy Executive Secretary of the Economic Commission for Africa (ECA). Said Adejumobi; Adeyemi Dipeolu; Adam Elhiraika; Advocate Mojanku Gumbi; Stephen Karingi; René Kouassi; and Harald Tollan.

The panel acknowledges the work of the Secretariat of the HLP headed by Adeyemi Dipeolu, which worked on the report. Its members included Adeyinka Adeyemi; Gamal Ibrahim; Souad Aden-Osman; Allan Mukungu; Simon Mevel; William Davis; John Kaninda and Oladipo Johnson. Other ECA staff who also contributed to the work of the Panel included Gedion Gamora; Lia Yeshitla; Rebecca Benyam; Selamawit Hailu; Aster Zewde; and Loule Balcha.

We would also like to acknowledge the work of other former ECA staff members who contributed to the Panel's report but have since moved on to new assignments. These include Professor Emmanuel Nnadozie; Siope 'Ofa; Samson Kwalingana and Ariam Abraham. The panel expresses thanks to all consultants who undertook country and technical studies during the development of the report; Prof. Olu Ajakaiye; Prof. Geegbae Geegbae; Francis Mwenga; Maria Mitadenga, and Floribert Ntungila-Nkama. Finally, the panel would like to thank other consultants who contributed to the Panel's work. These include Alex Cobham and Alice Lépissier of the Center for Global Development, Alex De Waal; Bruce Ross-Larson; Carolina Rodriguez; Giacomo Frigerio; Valentina Frigerio; Pauline Stockins; Saba Kassu; Tsitsi Mtetwa as well as the entire team of the Publications Section of ECA.

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# Glossary

**Arm's-length principle.** The arm's-length principle is an international standard that compares the transfer prices charged between related entities with the price in similar transactions carried out between independent entities at arm's length.

**Automatic exchange of tax information.** The sharing of tax information between countries in which individuals and corporations hold accounts. This exchange of information should be automatic and not require a request from tax or law enforcement officials in one jurisdiction to those in the jurisdiction where the account is held. Also referred to as "routine exchange," automatic exchange of tax information is one of the five recommendations of the Financial Transparency Coalition (FTC).

**Beneficial owner.** The real person or group of people who control(s) and benefit(s) from a corporation, trust, or account. The FTC advocates that beneficial ownership information be collected and made publicly accessible. Transparency of beneficial ownership is one of the five FTC recommendations.

**Base erosion and profit shifting.** According to the OECD (2013), base erosion and profit shifting refers to "tax planning strategies that exploit gaps and mismatches in tax rules to make profits 'disappear' for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low resulting in little or no overall corporate tax being paid." The base erosion and profit shifting project coordinated by the OECD, which also involves the G20 countries, seeks to reform international tax standards that have become open to exploitation by multinational firms.

**Country-by-country reporting.** A proposed form of financial reporting in which multinational corporations report certain financial data—such as sales, profits, losses, number of employees, taxes paid and tax obligations—for each country in which they operate. Currently, consolidated financial statements are the norm. This is also one of the FTC recommendations.

**Dodd-Frank Wall Street Reform and Consumer Protection Act.** A broad financial reform bill enacted into law by the United States in July 2010.

- **Dodd-Frank Section 1502.** Requires companies selling or manufacturing products made with minerals originating from designated conflict countries to disclose to a public database where the minerals came from and what steps the company has taken to ensure that purchase or processing of the minerals has not financially benefited armed militia groups in those countries.

- **Dodd-Frank Section 1504.** Requires oil, gas and mining companies to publicly disclose all payments to governments in each jurisdiction in which they operate.

**Double taxation.** Where a company or individual incurs a tax liability in more than one country, the two countries' claims on the taxing rights can overlap, resulting in double taxation of the same declared income. Some tax avoidance strategies exploit international tax instruments in ways that were not intended, for example by ensuring that the right to tax a transaction is allocated to a country that levies no or low taxation on it.

**Double tax avoidance agreement (DTAA)/Double taxation treaty (DTT).** Agreements between states (usually in the form of bilateral treaties) that are designed to prevent an individual from being taxed on the same income (or other forms of wealth, e. g., an estate or a gift) by two different countries. The OECD suggests that countries often suffer from "double non-taxation" as a result of abuse of these treaties.

**False invoicing.** The practice of falsely declaring the value of goods imported or exported to evade customs duties and taxes, circumvent quotas or launder money. The value of goods exported is often understated, or the value of goods imported is often overstated, and the proceeds are shifted illicitly overseas. Most estimates of trade-based illicit financial flows focus on this mechanism.

**Financial Action Task Force (FATF).** An intergovernmental body housed at the OECD whose purpose is the development and promotion of international standards to combat money laundering, terrorist financing and the proliferation of weapons of mass destruction. FATF has published 40 recommendations on terrorist financing and related guidance documentation in order to meet this objective.

**Foreign Corrupt Practices Act (FCPA).** A US law passed in 1977 that makes it illegal for US citizens, US corporations and certain non-US corporations to bribe foreign officials.

**Hawala transactions.** *Hawala* is an informal system of money transfer between entities in different countries. Brokers use handshake deals and/or agreements with counterparts in other countries to move money without physically transferring funds (especially across borders) or using bank transfers. Often extremely difficult to monitor, hawala transactions are used primarily in the Middle East, East Africa and South Asia.

**Illicit financial flows (IFFs).** Money that is illegally earned, transferred or utilized<sup>1</sup>. These funds typically originate from three sources: commercial tax evasion, trade misinvoicing and abusive transfer pricing; criminal activities, including the drug trade, human trafficking, illegal arms dealing, and smuggling of contraband; and bribery and theft by corrupt government officials.

**Secrecy jurisdiction.** Secrecy jurisdictions are cities, states or countries whose laws allow banking or financial information to be kept private under all or all but few circumstances. Such jurisdictions may create a legal structure specifically for the use of non-residents. The originators of illicit financial flows may need to prevent the authorities in the country

<sup>1</sup> [www.gfintegrity.org/wp-content/uploads/2014/09/GFI-Analytics.pdf](http://www.gfintegrity.org/wp-content/uploads/2014/09/GFI-Analytics.pdf).

of origin from identifying them (e. g. if the money is the proceeds of tax evasion), in which case the flow will be directed to a secrecy jurisdiction. Because those directing IFFs seek out low taxes and secrecy, many tax havens are also secrecy jurisdictions, but the concepts are not identical.

**Shell bank.** A bank without a physical presence or employees in the jurisdiction in which it is incorporated.

**Stolen Asset Recovery Initiative (StAR).** A partnership between the World Bank and the United Nations Office on Drugs and Crime that supports international efforts to end safe havens for corrupt funds. In the fall of 2011 StAR released the landmark report, “The Puppet Masters: How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do about It,” which focused on the adverse impact of legal structures that enable IFFs.

**Tax avoidance.** The legal practice of seeking to minimize a tax bill by taking advantage of a loophole or exception to tax regulations or adopting an unintended interpretation of the tax code. Such practices can be prevented through statutory anti-avoidance rules; where such rules do not exist or are not effective, tax avoidance can be a major component of IFFs.

**Tax evasion.** Actions by a taxpayer to escape a tax liability by concealing from the revenue authority the income on which the tax liability has arisen. Tax evasion can be a major component of IFFs and entails criminal or civil penalties.

**Tax havens.** Jurisdictions whose legal regime is exploited by non-residents to avoid or evade taxes. A tax haven usually has low or zero tax rates on accounts held or transactions by foreign persons or corporations. This is in combination with one or more other factors, including the lack of effective exchange of tax information with other countries, lack of transparency in the tax system and no requirement to have substantial activities in the jurisdiction to qualify for tax residence. Tax havens are the main channel for laundering the proceeds of tax evasion and routing funds to avoid taxes. Also see *Secrecy jurisdictions*.

**Tax treaties.** Formally known as tax conventions on income and capital, bilateral tax treaties between countries were originally referred to as double taxation treaties. By concluding them, countries reach a negotiated settlement that restricts their source and residence taxation rights in a compatible manner, alleviating double taxation and allocating taxing rights between the parties. Treaties also harmonize the definitions in countries’ tax codes, provide mutual agreement procedures that can be invoked if there are outstanding instances of double taxation and establish a framework for mutual assistance in enforcement. A treaty between a developing country and a country from which it receives investment will shift the balance of taxing rights away from the developing country. Such treaty provisions create opportunities for treaty shopping by foreign investors.

**Trade misinvoicing.** The act of misrepresenting the price or quantity of imports or exports in order to hide or accumulate money in other jurisdictions. The motive could, for example, be to evade taxes, avoid customs duties, transfer a kickback or launder money.

- **Abusive transfer pricing.** A transfer price may be manipulated to shift profits from one jurisdiction to another, usually from a higher-tax to a lower-tax jurisdiction. This is a well-known source of IFFs, although not all forms of transfer pricing abuse that result in IFFs rely on manipulating the price of the transaction.
- **Trade-based money laundering.** A technique where trade mispricing is used to hide or disguise income generated from illegal activity.

**Transfer pricing.** The price of transactions occurring between related companies, in particular companies within the same multinational group. Governments set rules to determine how transfer pricing should be undertaken for tax purposes (since, for example, the level of transfer pricing affects the taxable profits of the different branches or subsidiaries of the firm), predominantly based on the arm's-length principle (this is also explained in the glossary; see above). Much of the debate on tax-motivated IFFs revolves around the formulation and enforcement of transfer pricing regulations, their shortcomings and the way in which they are abused for tax evasion and tax avoidance purposes.

All amounts of money are expressed in US dollars.

# Chapter

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Tackling illicit financial  
flows from Africa



# 1.1 Background

## 1.1.1 Illicit financial flows as a development challenge for Africa

Over the last 50 years, Africa is estimated to have lost in excess of \$1 trillion in illicit financial flows (IFFs) (Kar and Cartwright-Smith 2010; Kar and Leblanc 2013). This sum is roughly equivalent to all of the official development assistance received by Africa during the same timeframe.<sup>2</sup> Currently, Africa is estimated to be losing more than \$50 billion annually in IFFs. But these estimates may well fall short of reality because accurate data do not exist for all African countries, and these estimates often exclude some forms of IFFs that by nature are secret and cannot be properly estimated, such as proceeds of bribery and trafficking of drugs, people and firearms. The amount lost annually by Africa through IFFs is therefore likely to exceed \$50 billion by a significant amount.

These outflows are of serious concern, given inadequate growth, high levels of poverty, resource needs and the changing global landscape of official development assistance. Although African economies have been growing at an average of about 5 per cent a year since the turn of the century, this rate is considered encouraging but inadequate. It is, for example, below the double-digit growth that has propelled transformation in parts of Asia. Further, the benefits of this growth have mostly been confined to those at the top of the income distribution and it has not been accompanied by an increase in jobs. Aside from the equity issues that this raises, it also means that this growth may not be sustainable due to possible social unrest. The global commodity super-cycle that has contributed to Africa's growth is coming to an end, while macroeconomic factors such as debt reduction might be a once-off effect.

Poverty remains of serious concern in Africa in absolute and relative terms. The number of people living on less than \$1.25 a day in Africa is estimated to have increased from 290 million in 1990 to 414 million in 2010 (United Nations, 2013). This is because population growth outweighs the number of people rising out of poverty. Moreover, GDP per African was around \$2,000 in 2013, which is around one-fifth of the level worldwide (IMF, 2014). Poverty in Africa is also multidimensional, in the sense of limited access to education, healthcare, housing, potable water and sanitation. This situation puts the loss of more than \$50 billion a year in IFFs in better perspective.

The resource needs of African countries for social services, infrastructure and investment also underscore the importance of stemming IFFs from the continent. At current population trends, Africa is set to have the largest youth population in the world. By 2050 the median age for Africa will be 25 years, while the average for the world as whole will be about 36 years (United Nations Population Division, 2012). Infrastructure constraints also act as a brake on growth, just as do the low savings and investment rates of the continent. In 2012 gross capital formation rates in Nigeria and South

<sup>2</sup> Some \$1.07 trillion of official development assistance was received by Africa between 1970 and 2008 (OECD 2012a).

Africa were 13 per cent and 19 per cent, respectively, as compared to a rate of 49 per cent in China and 35 per cent in India (United Nations Statistics Division, 2014; World Bank, 2014). Yet Africa is estimated to need an additional \$30–\$50 billion annually to fund infrastructure projects (Foster and Briceño-Garmendia, 2010; African Development Bank, 2014).

The Panel considered that when these needs are coupled with the changing landscape of official development assistance, Africa cannot afford to remain sanguine about the problem posed by IFFs. Current developments in the global arena in fact make the challenge posed by IFFs more acute. The resources that Africa receives from external partners in the form of official development assistance are stagnating due to the domestic fiscal challenges of partners, who in response are seeking to reduce such expenditures. Africa will therefore need to look within the continent to fund its development agenda and reduce reliance on official development assistance.

IFFs are also of concern because of their impact on governance. Successfully taking out these resources usually involves suborning of state officials and can contribute to undermining state structures, since concerned actors may have the resources to prevent the proper functioning of regulatory institutions

### 1.1.2 Context

Cognisant of the detrimental effects of IFFs on Africa, the 4th Joint Annual Meeting of the AU/ECA Conference of Ministers of Finance, Planning and Economic Development adopted Resolution 886 mandating the establishment of a High Level Panel on Illicit Financial Flows from Africa.

The Panel is chaired by H. E. Thabo Mbeki, former President of the Republic of South Africa, and comprised nine other members both from within and outside the continent.

### 1.1.3 Mandate

The Panel's Terms of Reference called for it to:

1. Determine the nature and patterns of illicit financial outflows from Africa;
2. Establish the level of illicit financial outflows from the continent;
3. Assess the complex and long-term implications of IFFs for development;
4. Raise awareness among African governments, citizens and international development partners of the scale and effect of such financial outflows on development; and
5. Propose policies and mobilize support for practices that would reverse such illicit financial outflows.

The Panel's work has been dedicated to achieving these goals.



## 1.2 Definition of illicit financial flows

To determine its scope of work and come to grips with the subject matter, the Panel spent a considerable amount of time gaining a proper understanding of the phenomenon of IFFs. We observed that IFFs have often been linked to capital flight in discussion of the problem, with both terms often used interchangeably.

We felt that it was important to distinguish IFFs from capital flight because capital flight, which is sometimes driven by macroeconomic and governance factors, could be entirely licit. For the purposes of our work, we agreed on a definition of IFFs as money illegally earned, transferred or used. This definition avoids complicated explanations of what qualifies as IFFs and debates about whether investors should be allowed to respond rationally to economic and political risk. Moreover, we believe that our preferred definition addresses the issue of IFFs across the entire breadth of financial transactions.

## 1.3 The Panel's approach and methodology

Since there was already extensive academic work on IFFs, the Panel decided that its work would add value only by taking a different approach in accordance with its Terms of Reference. We accordingly placed our emphasis on matching original research with advocacy and inclusive consultations while exploring the policy dimensions of IFFs.

### 1.3.1 Research

To place its work on a firm footing, the Panel commissioned a background paper, "Scale and Development Challenges of Illicit Financial Flows from Africa". The paper examined the nature, magnitude and development challenges of IFFs from Africa, based on disparities in national income accounts and trade data (trade mispricing). (Details of the empirical study are contained in annex III of this Report.)

We also explored the extent to which financial secrecy among Africa's trading partners exposes African countries to the risk of IFFs through trade mispricing or misinvoicing. This analysis is included in annex IV.

The HLP also commissioned country studies on IFFs from Africa to obtain empirical country-level evidence of the phenomenon and its manifestations. Given that it could not cover all the countries on the continent, the HLP concentrated on studies of six countries. The criteria for choosing the six countries included subregional coverage, the importance of the extractive sector in their economies, and the situation in post-conflict countries. The countries chosen using these criteria were Algeria, the Democratic Republic of Congo, Kenya, Liberia, Mozambique and Nigeria. The Panel also visited Mauritius as a representative of a small island economy and South Africa to gain an understanding of how its institutions and processes are geared to mitigate illicit financial outflows (box 1).

### Box 1.1 Information on Countries Selected as Case Studies

#### → ALGERIA

With the second-largest oil reserves in Africa and the ninth-largest reserves of natural gas in the world, Algeria is one of the main exporters of petroleum and natural gas products from Northern Africa and is also headquarters for the largest oil company in Africa. The country's current GDP is estimated at \$273.59 billion, its GDP per capita is estimated at \$6,978, and its annual GDP growth averages 3.0 per cent. Algeria is projected to have lost approximately \$25.7 billion of its national revenue through IFFs between 1970 and 2008. This substantial figure reflects the fact that countries highly dependent on natural resources are among the most severely affected by the problem of IFFs.

([http://www.Africaneconomicoutlook.Org/fileadmin/uploads/aeo/2014/PDF/E-Book\\_African\\_Economic\\_Outlook\\_2014.pdf](http://www.Africaneconomicoutlook.Org/fileadmin/uploads/aeo/2014/PDF/E-Book_African_Economic_Outlook_2014.pdf); <http://www.u4.no/publications/extractive-sectors-and-illicit-financial-flows-what-role-for-revenue-governance-initiatives/>)

#### → DEMOCRATIC REPUBLIC OF CONGO.

In terms of annual carats produced, the Democratic Republic of Congo is the second-largest diamond-producing nation in the world as well as the largest exporter of cobalt ore. A combination of such highly sought resources and recent political struggles have made the Central African nation one of the most affected by the illegal exploitation of its resources. Several Congolese commissions and UN panels of experts have documented illegal mineral exploitation and exports, some of which finance armed groups in the Democratic Republic of Congo. ECA currently estimates the country's GDP at just more than \$57 billion, with GDP per capita of \$854 and annual GDP growth averaging 6.4 per cent. Moreover, conflicts within the Democratic Republic of Congo have reduced national output and government revenue and even in its post-conflict status, years of unchecked and ongoing IFFs out of the Democratic Republic of Congo still affect the country's national revenue to this day. The Democratic Republic of Congo is an especially relevant case in the fight against IFFs because its mining sector is regarded as the economic foundation for the country's post-conflict reconstruction.

([http://www.Africaneconomicoutlook.Org/fileadmin/uploads/aeo/2014/PDF/E-Book\\_African\\_Economic\\_Outlook\\_2014.pdf](http://www.Africaneconomicoutlook.Org/fileadmin/uploads/aeo/2014/PDF/E-Book_African_Economic_Outlook_2014.pdf))

## → KENYA

Coupled with its recent development of an extractive industry, this East African nation has in recent years maintained steady economic growth with a current GDP of \$79.66 billion, GDP per capita of \$1,796, and an average GDP growth rate of 4.8 per cent a year. Kenya is believed to have lost as much as \$1.51 billion between 2002 and 2011 to trade misinvoicing. The role of IFFs and their adverse effect on the country's GDP cannot be ignored. A recent study funded by the Danish government on five of its priority countries (Ghana, Kenya, Mozambique, Tanzania and Uganda) shows that Kenya's tax loss from trade misinvoicing by multinational corporations and other parties could be as high as 8.3 per cent of government revenue, hampering economic growth and resulting in billions in lost tax revenue.

([http://www.Africaneconomicoutlook.Org/fileadmin/uploads/aeo/2014/PDF/E-Book\\_African\\_Economic\\_Outlook\\_2014.pdf](http://www.Africaneconomicoutlook.Org/fileadmin/uploads/aeo/2014/PDF/E-Book_African_Economic_Outlook_2014.pdf); [http://iff.gfintegrity.org/hiding/Hiding\\_In\\_Plain\\_Sight\\_Report-Final.pdf](http://iff.gfintegrity.org/hiding/Hiding_In_Plain_Sight_Report-Final.pdf))

## → LIBERIA

Currently, the West African nation of Liberia is rebuilding its infrastructure, especially in and around its capital, Monrovia, since the end of the civil war of 1989–1996. Richly endowed with water, mineral resources and forests, and with a climate favourable to agriculture, Liberia has been an attractive market for multinationals and similar foreign stakeholders. Timber and rubber are currently the country's main exports. However, foreign investment is still relied on to increase its GDP, estimated at \$3.3 billion in 2012. GDP per capita is approximately \$767, and Liberia's GDP growth rate averages 7.8 per cent. As with most post conflict nations, the focus on redevelopment leaves much room for foreign investors to try to take advantage of the country's situation. This can lead to issues of tax dodging as well as the use of the country as a hub for offshore banking and as a tax haven.

([http://www.Africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/E-Book\\_African\\_Economic\\_Outlook\\_2014.pdf](http://www.Africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/E-Book_African_Economic_Outlook_2014.pdf); <http://allafrica.com/stories/201306210889.html>)

## → MOZAMBIQUE

While there is still room for progress, the economy of Mozambique has developed in the last decade since the end of its civil war. The Southern African country has also seen dramatic improvements in its growth rate, with its GDP growing to \$29.975 billion in 2012. Its GDP per capita grew approximately to \$1,160, and its growth rate averages 7.3 per cent. Although agriculture is central to the country's workforce, investment projects in titanium extraction are expected to help strengthen the economy. Similar to its Kenyan counterpart, however, Mozambique also faces the challenges of trade and tax related malpractices.

([http://www.Africaneconomicoutlook.Org/fileadmin/uploads/aeo/2014/PDF/E-Book\\_African\\_Economic\\_Outlook\\_2014.pdf](http://www.Africaneconomicoutlook.Org/fileadmin/uploads/aeo/2014/PDF/E-Book_African_Economic_Outlook_2014.pdf); <http://www.gfintegrity.org/report/report-trade-misinvoicing-in-ghana-kenya-mozambique-tanzania-and-uganda/>)

## → NIGERIA

The most populous country in Africa has seen rapid economic growth recently. Its GDP has almost tripled to \$490.857 billion. Its GDP per capita is \$2,827, and its GDP growth averages 6.7 per cent. Oil exports remain a major contributor to Nigeria's economy, but the telecoms industry accounts for

more than a quarter of its 2014 GDP growth. Other drivers include manufacturing and film-making, which account for an estimated 7 per cent and 1.5 per cent, respectively. Agriculture is also a rapidly growing sector in the country. Having such a large economy inevitably increases the risks of IFFs, and the nation’s reliance on its petroleum industry for exports and government revenue further increases this risk.

([http://www.Africaneconomicoutlook.Org/fileadmin/uploads/aeo/2014/PDF/E-Book\\_African\\_Economic\\_Outlook\\_2014.pdf](http://www.Africaneconomicoutlook.Org/fileadmin/uploads/aeo/2014/PDF/E-Book_African_Economic_Outlook_2014.pdf); <http://www.economist.com/news/finance-and-economics/21600734-revised-figures-show-nigeria-africas-largest-economy-step-change>)

Note: GDP and GDP per capita estimates are based on purchasing power parity in US dollars; annual GDP growth rates are averages for 2005–2013.

Figure 1.1  
Promotional banner used for IFF regional consultation



### 1.3.2 Advocacy

From its inception, the Panel saw advocacy as an essential part of its work. We accordingly framed a communications strategy that included the creation of a website, publication of a brochure on the Panel’s work, and development of a fact sheet on IFFs as well as related slogans and promotional banners (see figure 1.1). The Panel also adopted the mobilizing slogan “Illicit Financial Flows from Africa: Track it. Stop it. Get it” to underpin its advocacy efforts. The Chair, Panel members and the Technical Committee continue to be invited to make presentations and interact at various forums on the question of IFFs.

### 1.3.3 Inclusive consultations

From the outset, the Panel was committed to obtaining insights and inputs from governments, the private sector, civil society organizations and regional and international organizations with interest in the subject. We held wide-ranging consultations with a variety of stakeholders with the purpose of sensitization, gaining first-hand knowledge and placing the matter firmly on the regional and global agenda.

The Panel visited the six countries for which case studies were commissioned and held meetings with Heads of State and Government, ministers responsible for the economy, parliamentarians, the police and the judicial authorities, and heads of various financial institutions, including central banks, customs agencies, internal revenue services and

anti-corruption agencies. We also met leading civil society organizations, academics and members of the media and related non-governmental organizations. At all stages, we explained that the purpose of the country studies was to gain empirical perspectives and insights on the manifestation of IFFs in various jurisdictions.

Subregional consultations for East and Southern Africa were held in Lusaka, Zambia, while consultations in West and Central Africa took place in Accra, Ghana. The consultations for North Africa took place in Tunisia. The need for subregional consultations was informed by the realization that stakeholders from all parts of the continent could make invaluable contributions to the work of the Panel by providing information and sharing knowledge that would not otherwise be available. More than 200 people from 48 African countries drawn from a wide cross-section of stakeholders participated in the subregional consultations.

The Panel also reached out to the rest of the world in the course of its assignment. We met with US government agencies, the Secretariat and Member States of the United Nations and the Organisation for Economic Cooperation and Development. Useful meetings were held with the World Customs Council, the European Parliament, the World Bank and the International Monetary Fund. In the United States, policy seminars also took place in the Brookings Institution and the Corporate Council for Africa.

#### 1.3.4 Policy dimensions

The Panel's work is ultimately focused on helping governments formulate appropriate policies to combat IFFs. The present Report accordingly focuses on identifying the key actors involved in IFFs, characterizing the nature of such flows and their drivers and enablers, and proposing possible policy responses nationally, regionally and internationally.

## 1.4 Progress Report to the Conference of Ministers of Finance, Planning and Economic Development

The Panel presented a Progress Report to the Seventh Joint Annual Meetings of the ECA Conference of African Ministers of Finance, Planning and Economic Development and African Union Conference of Ministers of Economy and Finance in March 2014 in Abuja, Nigeria. The Report provided an update of the Panel's work and its emerging findings.

The Ministerial Statement issued after this meeting reported as follows:

*"20. We deplore the unfortunate situation whereby Africa loses \$50 billion a year in illicit financial flows. These flows relate principally to commercial transactions, tax evasion, criminal activities (money laundering, and drug, arms and human trafficking), bribery, corruption and abuse of office. Countries that are rich in natural resources and countries with inadequate or non-existent institutional architecture are the most at risk of falling victim to illicit financial flows. These illicit flows have a negative impact on Africa's development efforts: the most serious consequences are the loss of investment capital and revenue that could have been used to finance development programmes, the undermining of State institutions and a weakening of the rule of law.*

*"21. We pledge to take the necessary coordinated action nationally, regionally and continentally to strengthen our economic governance institutions and machinery, focusing especially on tax administration, contract negotiations, and trade-related financial leakages. In addition, we will engage with the international community, in the context of the ongoing discussions on the reform of global economic governance, in order to highlight our concerns regarding illicit transfers, including the question of tax havens."*

## 1.5 Structure of the Report

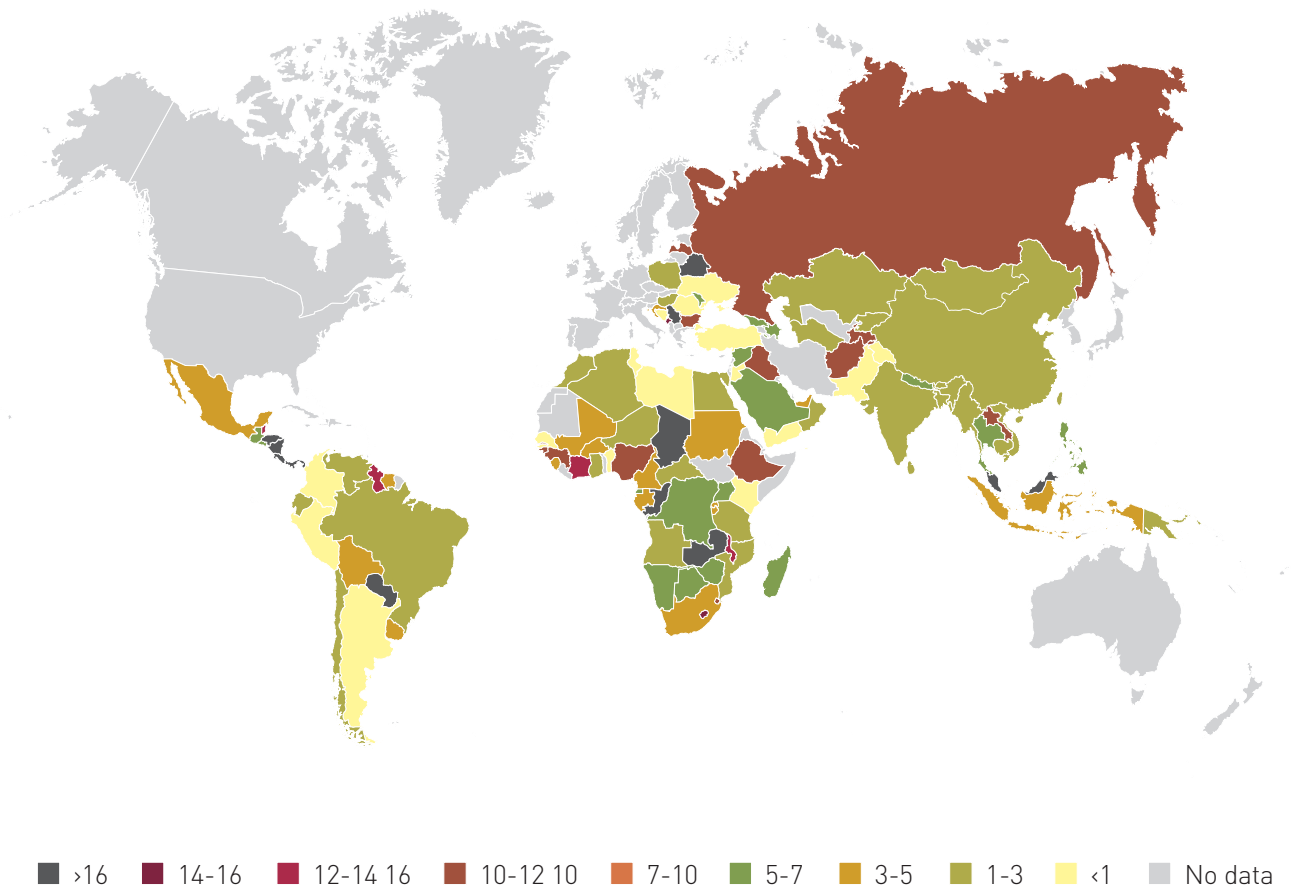
The rest of this report is structured as follows. Chapter 2 outlines the framework for analysing IFFs from Africa, including estimates, actors, drivers, enablers and means by which IFFs take place. Chapter 3 highlights the development dimension of IFFs, while Chapter 4 contains the findings of the Panel. The Panel's recommendations are contained in Chapter 5.

## 1.6 Main messages of the Report

IFFs are not only an African problem but are indeed a matter of global governance that calls for a wide range of actions, including at the level of the global financial architecture. IFFs are a potential source of domestic resource mobilization for the continent, which if tapped will have positive impacts for the 2015 development agenda of Africa and beyond, especially in the context of global economic developments that mean that dependence on development assistance is no longer a sustainable option (figure 1.2).

The Report also maintains that successfully combating IFFs will generate positive impacts for the governance landscape of Africa, resulting in sustainable improvements and enhancements for the local business and private sector development environment.

**Figure 1.2**  
Heat map of illicit financial flows by country as a percentage of GDP



Source: Green, 2013.

# Chapter

.....

Understanding the  
phenomenon of illicit  
financial flows from  
Africa

# 2

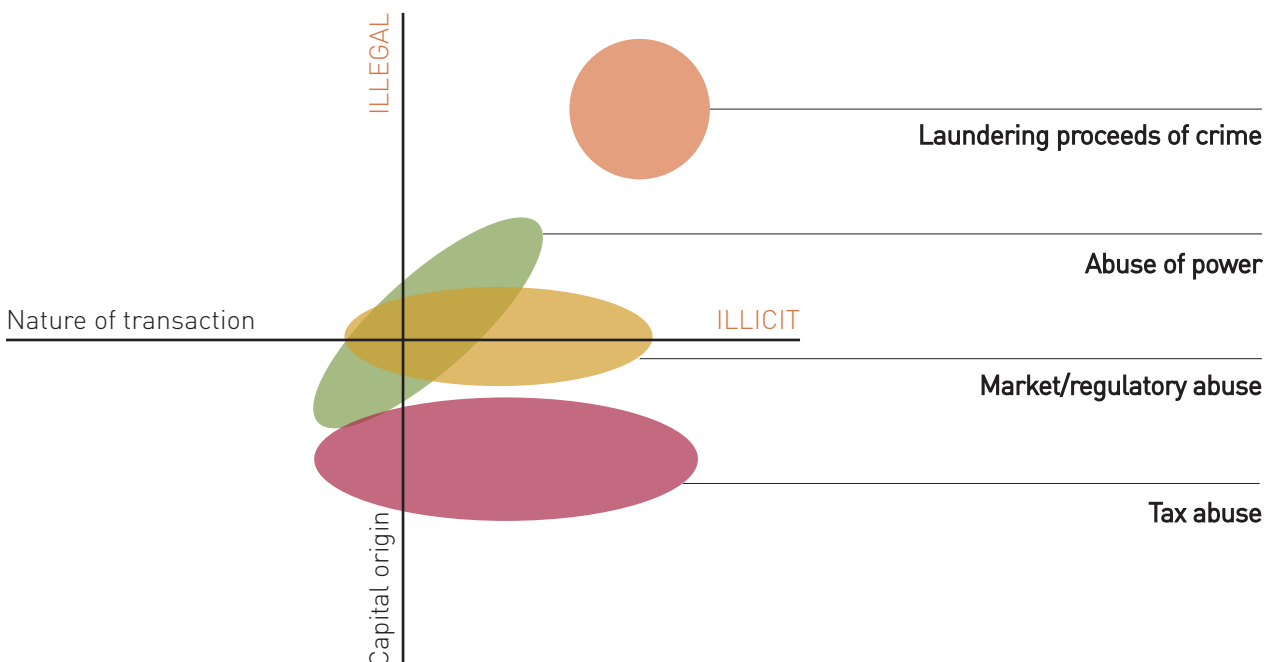


As a starting point and to gain a full understanding of the various dimensions of illicit financial flows (IFFs) and their impact on Africa, the Panel reviewed existing literature, commissioned research, used case studies and undertook wide-ranging consultations. We felt that it was necessary to have a clear definition of IFFs and to understand how they take place in Africa. We also estimated the extent of IFFs from the continent and examined the roles of different actors, considering that solutions stemming from such outflows would depend on their cooperation or compliance. Some drivers and enablers of IFFs were studied for the same reasons. The Panel also sought to examine policies and steps that had been taken in Africa and elsewhere to tackle IFFs.

## 2.1 Defining illicit financial flows

We defined IFFs as “money illegally earned, transferred or used” to enable us come to grips with our assignment, in line with the work of other organizations on this subject (see, for example, Reuter 2012, Baker 2005, and Kar 2011). In other words, these flows of money are in violation of laws in their origin, or during their movement or use, and are therefore considered illicit. We placed emphasis on illegality across any stages of such outflows to show that a legal act in one geographical location does not nullify the intent and purpose of such outflows, which is to hide money even if legitimately earned. We also felt that the term “illicit” is a fair description of activities that, while not strictly illegal in all cases, go against established rules and norms, including avoiding legal obligations to pay tax. Our purpose in doing so was to establish the nature of such outflows, given the harm that they cause to African economies. Figure 2.1 maps a range of transactions against their origin as capital.

Figure 2.1  
Origins of illicit financial flows



## 2.2 How illicit financial flows take place

We determined that the convention of breaking IFFs into the three components of commercial activities, criminal activities and corruption was substantially correct in the case of Africa. We took note of existing estimates, which assess commercial activities as accounting for 65 per cent of IFFs, criminal activities for 30 per cent and corruption for around 5 per cent, but we decided to take a more nuanced view based on the information available to us in the African context (Kar and Cartwright-Smith, 2010).

### 2.2.1 Commercial activities

The commercial component of IFFs arises from business-related activities. These are complex to determine in terms of the dividing line between the fair use of policy incentives and their abuse and the range and scope of economic activities from which such outflows can emanate (see annex II). The interpretation of such outflows has important implications for a sector that is expected to invest in productive activities, create jobs and impart managerial and technological skills. The business sector also has relative strengths in interpreting laws and rules and being able to avoid compliance with them because of the legal, accounting and finance assistance that it can draw upon (figure 2.2).

IFFs originating from commercial activities have several purposes, including hiding wealth, evading or aggressively avoiding tax, and dodging customs duties and domestic levies. Some of these activities, especially those linked to taxation, are described from a more technical perspective as “base erosion and profit shifting” especially within the ambit of the OECD. The various means by which IFFs take place in Africa include abusive transfer pricing, trade mispricing, misinvoicing of services and intangibles and using unequal contracts, all for purposes of tax evasion, aggressive tax avoidance and illegal export of foreign exchange.

Figure 2.3, from the *New York Times*, shows how companies shift profits among jurisdictions to evade or avoid paying due taxes.

**Figure 2.2**  
**Overview of illicit financial flows and security linkages**

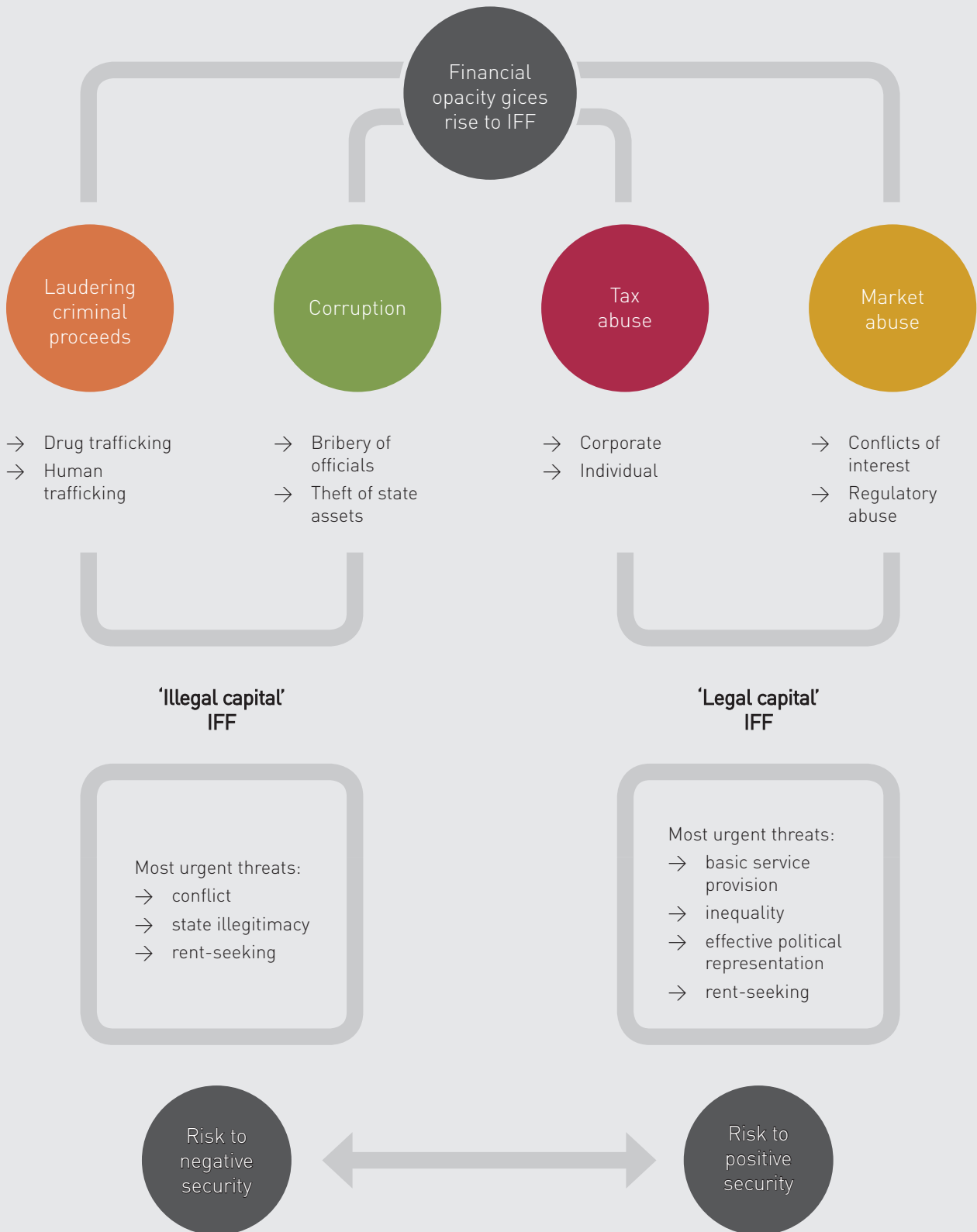
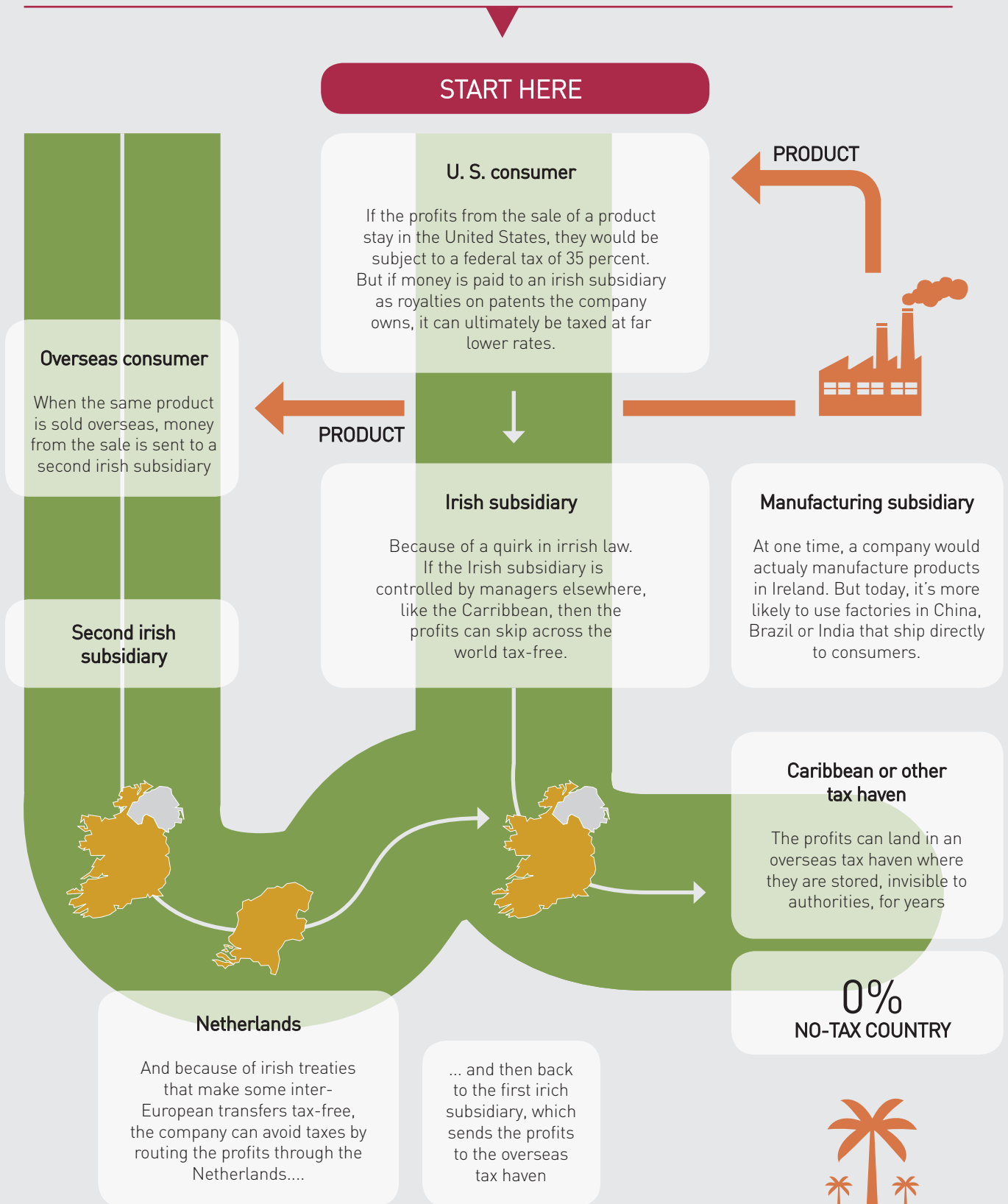


Figure 2.3  
The “Double Irish” system of tax evasion

# ‘DOUBLE IRISH WITH A DUTCH SANDWICH’

Numerous companies take advantage of loopholes in international laws to move profits around the world, avoiding taxes. Many of these techniques rely on transferring profits on patent royalties to places like Ireland. Here is one technique typical of what Apple and others pioneered.



*Abusive transfer pricing* occurs when a multinational corporation takes advantage of its multiple structures to shift profit across different jurisdictions. While it is not wrong for trade to take place between companies that are part of a single group, they would have to comply with the “arm’s-length principle” for them not to be considered to be engaging in base erosion and profit shifting. We found evidence that abusive transfer pricing was occurring on a substantial scale in Africa. In a particularly telling example, an African President informed the Panel that a multinational corporation in his country had never paid taxes over a 20-year period because it consistently reported making losses. He was certain that this could only have been due to profit shifting, since no business entity could remain in operation if it were making losses for such a long time.

Another example of abusive transfer pricing was reported by the South African Revenue Service (box 2.1). Research undertaken by Action Aid International and other civil society organizations showing that abusive transfer pricing was going on in several African countries was also brought to the Panel’s attention.

We were particularly concerned that only three African countries had transfer pricing units in their internal revenue services. Given the widespread nature of such activities even in developed countries involving well-known companies, we noted that African countries lacking any official monitoring capacity must be very vulnerable to IFFs stemming from transfer mispricing.

### Box 2.1 Aggressive tax avoidance by multinational corporations being curtailed in South Africa

The South African authorities informed the Panel about a case in which a multinational corporation was found to have avoided \$2 billion in taxes by claiming that a large part of its business was conducted in the United Kingdom and Switzerland, which at that time had lower tax rates for their business, and moving the legal site of their business to these jurisdictions. When the South African authorities investigated the case, they found that the UK and Swiss subsidiaries/branches had only a handful of low-paid personnel with relatively junior responsibilities, and that these offices did not handle any of the commodities in which the company dealt (nor were they legally able to take title to those commodities). The company’s customers were often in South Africa, but for each transaction, a paper trail was created that would route the transaction through the Swiss or UK offices to give the impression that these offices were critical to the business. The South African authorities were able to reclaim the tax that was avoided because it was clear that the substance of the company’s activities was conducted in South Africa.

*Trade mispricing* is the falsification of the price, quality and quantity values of traded goods for a variety of purposes. These could range from the desire to evade customs duties and domestic levies to the intent to export foreign exchange abroad. The overinvoicing of imports has been practiced by a variety of importers for a number of years, which is why several African countries have introduced pre-shipment inspection to detect such practices. We established that underinvoicing of exports was quite common

in Africa, and particularly in the natural resource sector. The intention of such practices is to reduce the amount of money to be remitted to the exporting country from such sales.

The Panel was told in Mozambique that exported shrimp were often declared to be of a lower quality than was actually the case. Reports of under-declaration of quantities exported were present in all countries studied or visited; for example, the Panel heard such reports in relation to crude oil in Nigeria, minerals from the Democratic Republic of Congo and South Africa, and timber from Mozambique, the Democratic Republic of Congo and Liberia. According to a report by Chatham House, Nigeria's oil is being looted on an industrial scale, with the quantities lost estimated to be about 100,000 barrels a day [Katsouris and Sayne, 2013]. Mozambican records for 2012 showed a total export of 260,385 cubic metres of logs and sawn timber to the world, while records from China alone showed that 450,000 cubic metres of the same products were imported from Mozambique.

Similar concerns caused Liberia to introduce the tagging of timber exports. This measure was found to be quite effective, as a result of which the Panel brokered contact between Liberia and the Democratic Republic of Congo, which was facing challenges in the same area. The Panel was informed by US authorities that they had apprehended a company guilty of fishing illegally in South African waters, seized the funds and returned them to the South African authorities.

We were particularly concerned that most African countries lacked the means to verify the quantities of natural resources produced, relying instead on exporter declarations. Self-regulation is the rule, and African countries resort to a variety of incentives to encourage accurate reporting. In one case, a partial refund of tax expenses was used as an incentive to encourage filing of accurate returns.

Another widespread means to effect IFFs from Africa is the *misinvoicing of services and intangibles* such as intra-group loans and intellectual property and management fees. Such practices are making an increasing contribution to IFFs. This is partly due to the increasing share of services in global trade. Other contributing factors are changing technology and a lack of comparative price information. The growth in information and communications technologies has made it possible to transfer huge sums of money at the click of a mouse while also enabling innovative forms of misinvoicing. It is easier to use the arm's-length principle to determine the proper price of merchandise than it is for intellectual property such as use of a brand name. It is similarly quite difficult to limit the advisory services that related companies can render to one another or to determine the maximum amount that they can lend one another.

We learned of instances in which intragroup loans were so large that they would substantially reduce the tax payments of the companies involved. In a case researched by a leading civil society organization that came to our attention, the intragroup loan level to capital of an African subsidiary was higher than a banker would countenance. A particularly intriguing example of the increasing use of services for IFFs was that of the telecommunications sector in numerous African countries (box 2.2). One country was estimated to be losing up to \$90 million every year from the theft of minutes in the telecommunications sector. This fraud involved diverting international calls and transforming them into local calls, with operators then making fake declarations of incoming international call minutes to reduce the tax payable to the government. Other examples of services being overinvoiced were payments for overseas education, medical tours and foreign insurance.

## Box 2.2 SIM box fraud and its effects on the African mobile sector

If you have ever received an international call while in Africa with significantly poor quality and the number calling you appears as a local number rather than an international one, chances are that you have been a victim of SIM box fraud. It is common belief that poor quality during mobile phone calls stems from a defective wireless network. However, it could also be the mobile operator's poor business strategy. In SIM box fraud, individuals or organizations buy thousands of SIM cards offering free or low-cost calls to mobile numbers. The SIM cards are then used to channel national or international calls away from mobile network operators and deliver them as local calls, costing the operators revenue (see illustration on next page). Formerly an issue that was only prevalent in Europe and other parts of the world, African governments are now also suffering losses of potential tax revenue from this scam with the massive growth of the mobile industry on the continent. In Kenya alone, the approximately \$440,000 per month worth of taxable revenue is lost to SIM box fraud. Recently the government of Ghana also reported that SIM box fraud has cost \$5.8 million in stolen taxes alone. The Democratic Republic of Congo is also estimated to lose about \$90 million in tax revenue a year from the embezzlement of telephone time. The government of the Democratic Republic of Congo levies a tax on each international call minute, and the fraud involves diverting international calls to a SIM box and transforming them into local calls. By diverting these incoming calls using the SIM box, pirates pay three times less tax, since international calls are presented as local calls.

Illegal SIM box fraud has been identified in many other African countries, including Côte d'Ivoire, Madagascar, Sierra Leone, Somalia, Sudan, Tanzania and Uganda. In some cases, SIM cards were generating up to 10 cents a minute for more than 20 days a month, costing an operator up to \$3,000 per SIM card a month in lost revenue.

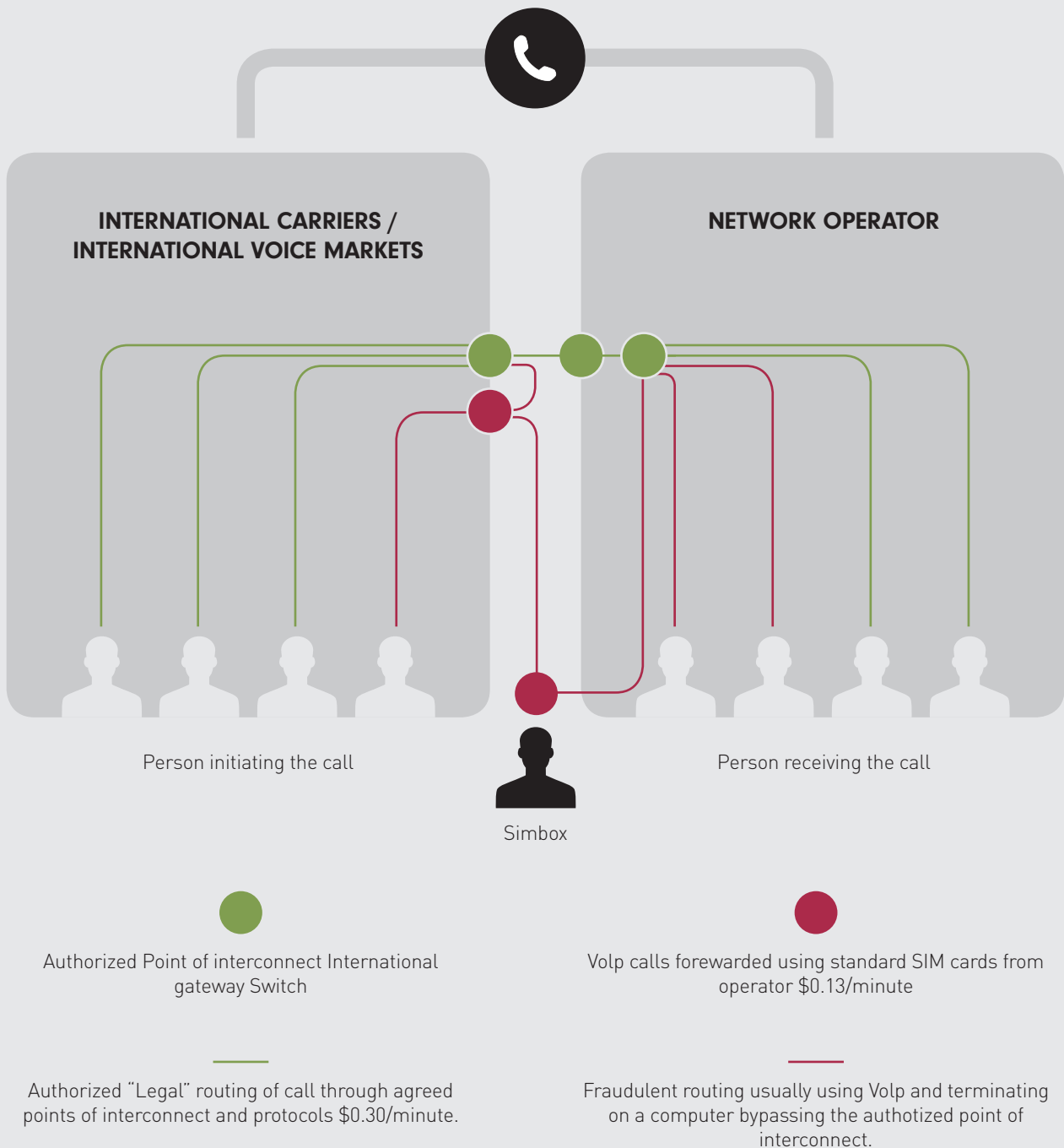
Steps are now being taken to curtail this problem though with the use of SIM box fraud tracking services, and Airtel Ghana has recently announced the introduction of short code, 919, which customers can use to report SIM card fraud. Such measures indicate how widespread SIM box fraud has become.

Source: HumanIPO, 2012; Communications Africa, 2011.

# TRAFFIC SCENARIO

## International SIM Box Fraud

Operator suffers a loss of \$0.17 per minute being the difference between international termination charge of \$0.30 and local call of \$0.13 per minute





While there is increasing awareness of the use of services and intangibles for IFFs, existing tools do not seem to provide the required solutions. African governments are not entirely helpless in responding to this challenge; they sometimes require registration of management fees or put caps on them as a percentage of turnover. Governments are, however, hampered by lack of information, the difficulty of establishing comparables for intellectual property and the lack of remuneration for first-rate lawyers, accountants and financial experts. We feel that this is an area requiring closer attention and formulation of effective policy responses.

*Unequal contracts* are another commercial means used to facilitate IFFs. Concern was expressed to the Panel about resource extraction contracts that are shrouded in secrecy and fuelled by bribes in order to circumvent existing legal provisions for the payment of royalties and taxes. Also of concern in this regard is the asymmetry of information between African countries and the multinationals, which often have more information about the quantity and quality of the mineral deposits for which such contracts are being signed. Several examples of unequal contracts were found during the Panel's consultations and in its case studies and existing literature.

The case of iron ore mining concessions in Guinea illustrates the problem of unequal contracts. While the ore from one of the mines is estimated to be able to generate revenues of up to \$140 billion over the next twenty years, a concession was granted in 2008 by the government at the time to a multinational for only \$165 million. A new government terminated this concession for reasons which included allegations of corruption, after it was discovered that half of the rights to the concession had been sold to another multinational for \$2.5 billion. Since then, the Guinean government has re-awarded the concessions for \$20 billion to another three mining firms. The disparity in the values illustrates the potential losses of financial flows from unequal contracts in the extractive sector.

In another case, a company in a post-conflict country was as a result of the provisions of a secret contract paying a corporate tax of only 1.43 per cent—in effect, \$10 million in tax on revenues of more than \$700 million. In another instance, a hidden contract set the royalty rate for the extraction of a major mineral at 20 per cent of the rate established by law. This is an important factor in a continent where natural resources are the main source of government revenues and foreign exchange earnings.

A new practice in developed countries, and one that bears watching in African countries, is *tax inversion*. This practice involves a large company undertaking a cross-border merger with a smaller one in a more “tax friendly” jurisdiction. The motive is clearly to reduce the tax burden on the large company. Up to 15 such transactions are said to have taken place in the United States in the last two years (*Economist*, 21 June 2014).

### 2.2.2 Criminal activities

IFFs are often driven by criminal activities with the purpose of keeping the transactions from the view of law enforcement agencies or revenue authorities. We learned of criminal activities in Africa, ranging from trafficking of people, drugs and arms to smuggling, as well as fraud in the financial sector, such as unauthorized or unsecured loans, money laundering, stock market manipulation and outright forgery.

*Money laundering* has received the most global attention as a result of anti-money laundering and counter-terrorist financing regimes put in place,

principally through the recommendations of the Financial Action Task Force. We felt that this was probably due to the political interest in the matter arising from the desire to choke off financing to terrorist organizations. The case studies and country consultations showed that while progress has been made, significant weaknesses still exist with regard to stemming money laundering in African countries. Most of the countries studied or visited had established financial intelligence units or were in the process of doing so. Some, such as Mozambique, had just put the institutional infrastructure in place, while others, such as the Democratic Republic of Congo, had yet to act for a variety of reasons relating to capacity constraints or distractions due to ongoing conflict.

We learned from United States authorities about a case of money laundering totalling \$480 million involving Lebanese banks in which sales of second-hand cars were used to launder drug money, with a paper trail going across Benin and Togo to European countries and Lebanon. The banks involved in facilitating these transactions paid fines of up to \$102 million. Evidence was also presented of large-scale cash smuggling across land borders and through airports, notably on private and chartered aircraft. The case of a former governor of a state in Nigeria who used different shell companies, multiple bank accounts and the movement of money through several jurisdictions to launder ill-gotten wealth was a notorious example that came up in the course of the Panel's work. This particular case spoke to issues of governance as well as the role of the banks in facilitating such suspicious transactions (Rayner, 2012).

Although we were not able to delve deeper into the shadowy world of *organized crime* in Africa, the Panel was alarmed at the extent of the problem, which became evident from information obtained from a variety of sources. In addition to trafficking of drugs, arms and people, the evidence pointed to large-scale smuggling networks trading in counterfeit goods or trading with the intent to avoid paying duties and domestic levies. The main purpose of such criminal activity might not be to generate IFFs, but criminality contributes substantially to such outflows because of the desire to hide the proceeds.

### 2.2.3 Corruption and the Abuse of Entrusted Authorities

Corruption was one area greatly debated by the Panel. While there was agreement that it facilitated all other aspects of IFFs, there was some debate about the extent of its importance. While research indicated that money acquired through bribery and abuse of office by public officials accounted for around 5 percent of IFFs globally, some believe that this may not necessarily be the case for Africa (Kar and Cartwright Smith, 2010). The situation was further compounded by the outcome of questionnaires administered in the course of the case studies in which most respondents felt that corruption was the greatest source of illicit financial outflows from their countries.

The fact is that most people conflate any untoward act in the public sphere with corruption. It is also pertinent to note that corruption cases are a staple of daily news and are therefore in the consciousness of most citizens. This is partly due to the work of anti-corruption advocates in civil society and state anti-corruption agencies, but it can also be attributed to increased global attention to the problem arising from the adoption of global and regional instruments such as the United Nations Convention against Corruption and the African Convention on Preventing and Combating Corruption.

We also noted that corruption was not limited to the public sphere, since we learned of cases of corruption emanating from the private sector. We noted that there are both demand and supply sides to bribery, which is why the legislation in some developed countries against the giving of bribes by

companies makes an important contribution to stemming corrupt practices in Africa. We agreed that corruption was better understood as the abuse of entrusted power as defined in various anti-corruption instruments, which makes a cross-cutting contribution to IFFs without the officials concerned necessarily exporting their illegally acquired wealth.

## 2.3 Estimating illicit financial flows from Africa

We emphasized that it was important to estimate the extent of IFFs from Africa in a credible and evidence-driven manner. We noted, however, that arriving at such an estimate was not a simple matter due to the difficulties inherent in calculating such flows, the various approaches that have been used in previous research, and the purposes for which the calculations are made.

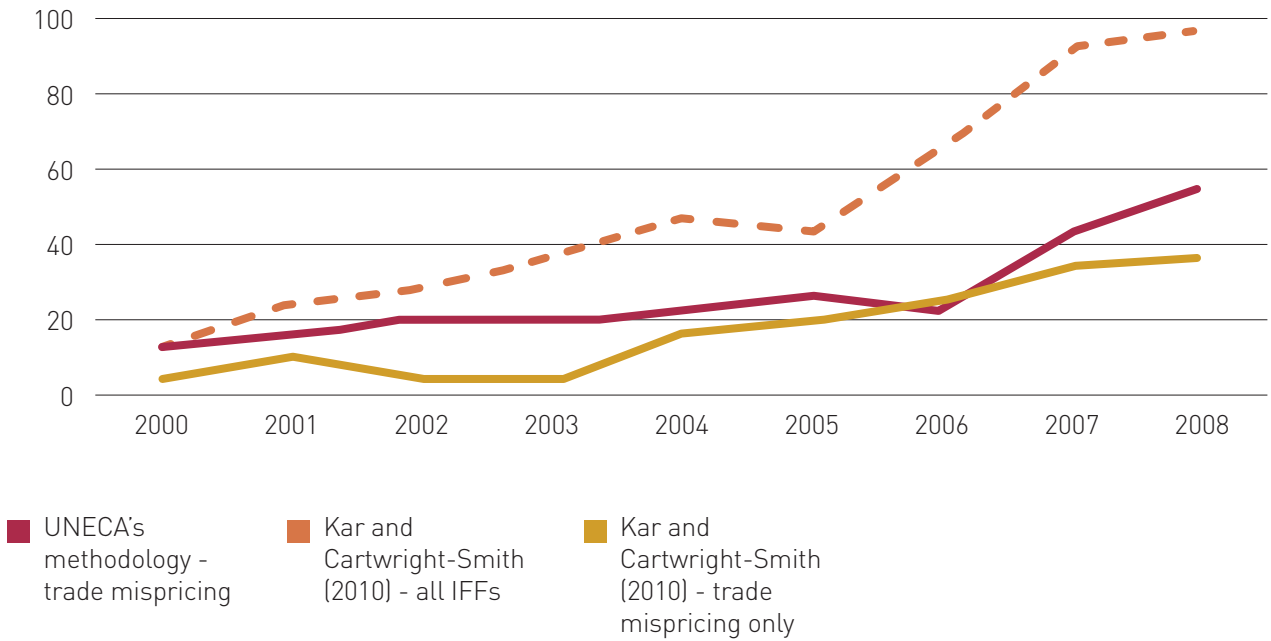
The difficulties in estimation arise from the very nature of IFFs, which by definition are mostly hidden and therefore difficult to track. As a result, data are not usually available nor can the accuracy of existing data be easily verified due to additional and well-known difficulties of generating good statistics on the continent. We nonetheless felt that there was enough scope to track IFFs based on existing work and on discrepancies in economic transactions recorded between Africa and the rest of the world.

Existing work on IFFs has mainly examined discrepancies in recorded capital flows or discrepancies in recorded trade flows. In taking one of these approaches, researchers have worked on the basis of gross figures or netted out illicit inflows into Africa. The motives of the researchers determined which approach was taken. Those intent on showing the direct economic effect of IFFs preferred to use the net approach. Others preferred to work on gross outflows because, as one researcher famously said, “there is no such thing as ‘net crime’” (Kar and Freitas, 2012).

Taking these factors into account as well as results from other research, we commissioned the Economic Commission for Africa of the United Nations (ECA) to provide us with an estimate. The study undertaken by ECA looked at gross outflows focusing on trade mispricing. This was informed mainly by reasons of availability of data and the fact that United Nations Comtrade data enable the use of detailed trade data and accordingly for a more nuanced approach. The results of the study undertaken by ECA (see annex III ) show that in 2001–2010 African countries lost up to \$407 billion from trade mispricing alone.

We compared the results of our study with other existing research, particularly the work of Kar and Cartwright-Smith under the auspices of Global Financial Integrity and that of Ndikumana and Boyce. Figure 2.4 shows that the trend of IFFs has been high and rising since 2000, with a remarkable similarity in the trend lines between the studies of Kar and Cartwright-Smith and of ECA. The cumulative amount differed substantially, with the GFI approach showing illicit outflows of \$242 billion from trade mispricing alone in the period studied by ECA. The difference was undoubtedly due to the use of different datasets. Ndikumana and Boyce using a different approach, but similarly estimated high IFFs from Africa from 33 African countries amounting to \$353.5 billion between 2000 and 2010.

Figure 2.4  
Evolution of IFFs from Africa, 2000–2008 (US\$ Billion)



Source: Based on Ndikumana and Boyce (2008), Kar and Cartwright-Smith (2010), Kar and Freitas (2011) and ECA's calculations.

The implications of all these studies are that IFFs from Africa range from at least \$30 billion to \$60 billion a year. These lower-end figures indicated to us that in reality Africa is a net creditor to the world rather than a net debtor, as is often assumed (see also African Development Bank, 2013). We also observed that the increasing trend of illicit financial outflows coincided with a period of relative high economic growth in Africa, and that IFFs are therefore negating the expected positive impact of increased growth on the continent.

We believe that these estimates of illicit financial outflows tell only part of the story, in the sense that it takes a combination of actors and set of conditions to enable them to happen. We proceeded to examine the roles of different actors in IFFs and their drivers and enablers.

## 2.4 The mosaic of actors

It is obvious that there are different sets of actors in the policy sphere of IFFs. These actors have different stakes, with some of them implicated as perpetrators while others are actively engaged in combating the scourge. They also have different capacities with regard to responding to the policy and regulatory requirements of IFFs and have different levels of information at their disposal. It is important to get a better understanding of the respective roles, motives and incentives of these actors, as well as of the complex interrelationships between them.

Some of the actors involved from opposite ends of the IFFs from Africa are governments within and outside the continent, the private sector, civil society organizations, criminal networks and global actors, including international financial institutions.

*African governments* have a political interest in IFFs because these flows impact their national development aspirations and encroach on state structures. They therefore have law enforcement and regulatory agencies whose duties include preventing IFFs. Among these are the police, financial intelligence units and anti-corruption agencies. Governments also have customs and revenue services and other agencies whose purposes are thwarted or hindered by IFFs.

We believe that most African governments have a strong interest in stemming IFFs, including through obtaining the cooperation, compliance and commitment of other actors. They seek to stop IFFs in order to maximize tax revenues, keep investible resources within their countries, prevent state capture and impede criminal and corrupting activities. This much was evident from the level and range of government officials with whom we interacted during our country visits and subregional consultations.

We found, however, that there was a relative lack of knowledge about the true nature of IFFs in government circles except for a few pockets of specialized agencies dealing with such matters. African governments also lack various requisite capacities in law and finance to tackle IFFs effectively, with unbalanced institutional capabilities in some countries. For instance, several African countries had set up or were moving to establish anti-corruption agencies, but very few of them had transfer pricing units in their internal revenue services.

In some African countries we found that the institutional architecture for responding to IFFs was at best uneven or, as in several key instances, non-existent. Lack of transparency, secrecy and the difficulty of obtaining information and systematic data remain key challenges across the board. Even where the institutional set-up is elaborate and extensive, as is the case with Nigeria (box 2.3), we remain concerned about the effectiveness of the relevant institutions, including the lack of cooperation and coherent operations among the various agencies. We also learned of concerns about retaining skilled people in public service in Africa due to the large gap in remuneration between the public and private sectors. We heard reports that large corporations had attempted to recruit skilled accountants and lawyers who had worked for government on cases related to IFFs.

### Box 2.3 Financial institutions in Nigeria and their challenges in combating illicit financial flows

In many African countries, regulatory agencies and institutions have been established with responsibilities that cut across various dimensions of IFFs. In Nigeria, for example, some of the related institutions include:

- Nigerian Ministry of Finance
- Central Bank of Nigeria
- Economic and Financial Crime Commission
- Independent Corrupt Practices and other related Commission
- Federal Inland Revenue Service
- Nigeria Custom Service
- Nigeria Drug Law Enforcement Agency
- Nigeria Extractive Industry Transparency Initiative
- Nigeria's Code of Conduct Bureau
- Special Control Unit against Money Laundering
- Nigerian Financial Intelligence Unit
- Nigeria Police Service

Despite the various institutions and their efforts aimed at curbing IFFs and related problems, the magnitude of the challenges experienced by these institutions overwhelms their implementation capacities. Most of these institutions face problems such as inadequate capacity (including equipment, adequate and relevant skills); shortages of funding (requiring them to rely on unpredictable foreign assistance); and in some cases, inadequate support from the judicial system.

In addition to these constraints, the situation is further complicated by a lack of coherence between the institutions, the duplication of responsibilities among the different agencies, ineffective coordination between them, and insufficient expertise to deal decisively with the IFF phenomenon. In some instances, therefore, tax authorities may not report tax crimes to law enforcement authorities even after they have reclaimed stolen tax funds from the perpetrator.

The *private sector* in Africa consists of large companies, small and medium-scale enterprises and the informal sector. The large companies are engaged in all economic sectors, including agriculture, mining, manufacturing and services. This category includes multinational corporations and international banks, as well as international legal and accounting firms that operate in several African countries and some of which are of African origin.

In terms of the financial flows involved, it is the large companies that engage in IFFs through abusive transfer pricing, trade misinvoicing, misinvoicing of services and intangibles and use of unequal contracts. They exploit the lack of information and capacity limitations of government agencies to engage in base erosion and profit-shifting activities. Given their scale, IFFs will at some point pass through banks and the financial system. The international banks sometimes facilitate IFFs even when they know that the money is tainted, as became evident in several asset recovery cases. Even where banks have an obligation to file suspicious transactions reports, this requirement is often overlooked in some countries in transactions emanating from small, rural branches. Indeed, banks sometimes knowingly establish infrastructure to facilitate IFFs moving to financial secrecy jurisdictions.

In spite of the active involvement of large companies in IFFs, their role is not well known by the general public in Africa. It is the difficulties that some of them have had with tax and revenue authorities in G8 countries that have made more people aware of such activities. We noted that large companies are vulnerable to reputational risk and to pressure from the governments of developed countries. Although large companies wish to continue exploiting the thin dividing line between tax evasion and aggressive tax avoidance, they are also concerned about their brand names and the dangers of falling afoul of the law. When negotiating settlements with tax and revenue authorities they therefore often seek clauses that preserve their anonymity.

Customs authorities reported that small and medium-scale enterprises also engage in illicit financial outflows, mostly through the misinvoicing of imports and exports. They sometimes underinvoice imports in order to reduce customs duties while overinvoicing exports to benefit from export incentives. We believe, however, that small and medium-scale enterprises and the informal sector are, in the main, victims of tax evasion and aggressive tax avoidance by large corporations because they tend to bear the brunt of the tax burden.

Another set of actors that have become noticeable in the fight against IFFs are *civil society organizations* (CSOs). They have campaigned against IFFs from Africa (and other parts of the world) from the perspective of social justice and also because of their effects on development and governance. CSOs have used various means to draw attention to the negative consequences of IFFs, ranging from advocacy campaigns and naming and shaming perpetrators to undertaking research and proposing policy solutions.

The Panel benefited from an exchange of views with CSOs at various stages of its work. CSOs were active participants in consultations and country visits, and their research was invaluable in providing insights on the phenomenon of IFFs. Notable in this regard is the work of Action Aid International, Christian Aid, Chr. Michelsen Institute, Global Financial Integrity, Oxfam, Pan African Lawyers Union, Tax Justice Network and Transparency International (box 2.4).

## Box 2.4 Civil Society Organizations (CSOs) that lend their voices to the fight against illicit financial flows and related practices

Several non-profit organizations actively increase awareness and ultimately help shine a spotlight on financial malpractices globally.

**Action Aid** was created to fight poverty and injustice globally. Among its many objectives are to eradicate poverty and hunger, achieve education for all and strengthen gender equality. With its focus on accountability in governance, Action Aid is also actively involved in the struggle against IFF practices such as tax dodging, trade misinvoicing and bribery. Taking a more direct approach than most, the organization occasionally develops reports and media campaigns that probe the IFF practices of specific multinational corporations or governments. In 2010, the organization led a campaign (which included a detailed report) against a large multinational in Africa.

Source: [https://www.Actionaid.org.uk/sites/default/files/doc\\_lib/calling\\_time\\_on\\_tax\\_avoidance.pdf](https://www.Actionaid.org.uk/sites/default/files/doc_lib/calling_time_on_tax_avoidance.pdf).

**Christian Aid** is the official relief and development agency of 41 British and Irish churches and works to support sustainable development, end poverty, support civil society and provide disaster relief in South America, the Caribbean, the Middle East, Africa and Asia. The organization works globally to encourage profound changes that are in many ways related directly to accountability in government and financial probity in international trade. However, it makes its argument from the standpoint of those affected by IFFs—as, for example, in a Christian Aid report that argues that the lives of at least 1,000 children are being lost daily to disease and poverty in poor countries because of illegal trade-related tax evasion.

Source: <http://www.Christianaid.Org.uk/images/deathandtaxes.pdf>.

**Chr. Michelsen Institute (CMI)**, founded in 1930 is an independent, non-profit research foundation for policy-oriented and applied development research. CMI generates and communicates research-based knowledge relevant for fighting poverty, advancing human rights, reducing conflict and promoting sustainable social development. Its research focuses on local and global challenges and opportunities facing low- and middle-income countries and their citizens. In relation to fighting IFFs, the institute hosts the Anti-Corruption Resource Centre, also referred to as U4. The Centre aims to create a full understanding of corruption and its impact on development, and particularly on the lack of information on the problem and how to address it.

Source: <http://www.u4.no/publications/tax-motivated-illicit-financial-flows-a-guide-for-development-practitioners/>.

**Global Financial Integrity (GFI)** is a non-profit research and advocacy organization that conducts research on national and multilateral policies towards enhancing global development and security. The organization produces analyses of IFFs and promotes pragmatic transparency measures in the international financial system. For instance, GFI asserts that roughly \$1 trillion flows illegally out of developing countries annually due to crime, corruption and tax evasion—close to ten times the amount of foreign aid flowing into these same economies. In a recent report, GFI emphasized the blight of trade misinvoicing within Ghana, Kenya, Mozambique, Tanzania and Uganda and its negative impact on the national revenue of these nations.

Source: [http://iff.gfintegrity.org/hiding/Hiding\\_In\\_Plain\\_Sight\\_Report-Final.pdf](http://iff.gfintegrity.org/hiding/Hiding_In_Plain_Sight_Report-Final.pdf).



**Oxfam** is an international confederation comprising 17 organizations working in approximately 94 countries to find solutions to poverty and what Oxfam considers as injustice around the world. It works with thousands of local partner organizations to find practical and innovative ways for people to lift themselves out of poverty and prosper. Oxfam is also frequently involved in anti-IFF activities as well as the fight against inequality. The organization has been vocal on the issue of multinationals taking advantage of tax loopholes in Africa as well as the necessity for adequate laws that can help the continent recover its losses from IFFs.

Source: <http://www.oxfam.org/en/eu/content/taxing-problem-eu-africa-and-illicit-finance>.

**Pan African Lawyers Union (PALU)** is a continental membership forum and umbrella association for African lawyers and lawyers' associations, which reflects the aspirations and concerns of the African people and promotes their shared interests. As a non-governmental organization focused on upholding legal standards, it works towards the development of the law and the legal profession, the rule of law, human rights and the socioeconomic development of the African continent. This includes ensuring the preservation of financial legality in all sectors. This focus was evident at the PALU General Assembly held in June 2014, whose theme was opposition to IFFs and repatriation of frozen assets. The General Assembly issued a Communiqué on Combating Illicit Financial Flows with recommendations for African Governments, the African Union and relevant international financial institutions.

Source: <http://lawyersofafrica.org/archives/2471>.

**Tax Justice Network (TJN)** is an independent international advocacy group dedicated to research, analysis and advocacy in the areas of tax and aspects of financial regulation internationally. TJN plays an instructional role in analysing and explaining the harmful impacts of tax evasion, tax avoidance, tax competition and tax havens. The African Charter of TJN particularly concentrates on several thematic areas related to IFF and tax competition within the continent. An example of the work that highlights the institution's research is a manual that provides a summary of why African states and citizens should engage in the campaign for tax justice. The manual gives an overview of the sources of tax injustices in Africa, the key actors in framing the tax policy landscape on the continent, the agencies influencing tax policy in Africa and finally a way forward for more tax justice on the continent.

Source: [http://www.taxjustice.net/cms/upload/pdf/tuyc\\_africa\\_final.pdf](http://www.taxjustice.net/cms/upload/pdf/tuyc_africa_final.pdf).

**Transparency International (TI)** monitors and publicizes corporate and political corruption in international development. Consisting of locally established chapters that address corruption in their respective countries, TI seeks to end corruption while promoting accountability and integrity at all levels of society. In line with its mandate, the organization has worked with like-minded organizations, including the United Nations as well as governments, in seeking to curb IFFs as part of its fight against corruption. TI has in the past launched campaigns to this effect, such as one launched early in 2014 on how shedding light on those who benefit illicitly from companies is a key tactic in stopping corruption.

Source: [http://files.Transparency.org/content/download/1326/10289/file/2014\\_PolicyBrief2\\_BeneficialOwnership\\_EN.pdf](http://files.Transparency.org/content/download/1326/10289/file/2014_PolicyBrief2_BeneficialOwnership_EN.pdf).

We wish to stress the invaluable role that CSOs play in the fight against IFFs. However, CSOs often face political pressures and need to be provided with the space and support that would enable them to continue their campaigns.

*Criminal networks* also engage actively in laundering money from Africa, with the motive of hiding their activities, facilitating payment across their illegal supply chains and concealing the resulting illicit wealth. Even so, criminal networks by their very nature minimize contact with law enforcement and tax, customs and regulatory authorities. These networks do not comprise just the “field soldiers” of maritime piracy and narcotics, arms and human trafficking, but include as well sophisticated people who run the operations and related financial transactions out of the public eye. Although the activities of criminal networks are not publicly visible, we noted with concern the use of illicit financial resources to sponsor terrorist activities on the continent and their use as part of insidious moves to capture state structures.

Obviously, there are also *global actors* in IFFs in the African context. Indeed, the more we learned about IFFs from the continent, the stronger became our view that the trend is an African problem with a global solution. We identified two types of beneficial global partners in this regard, namely, non-African governments and international organizations.

Non-African governments have a crucial role to play in stemming IFFs from the continent by ensuring that their jurisdictions are not used as conduits or destinations for IFFs. We found that while some developed countries were taking a firm stance against some aspects of illicit financial outflows, others had put in place institutional mechanisms that encouraged such flows and that could qualify them as financial secrecy jurisdictions. Apart from helping to establish a global norm against IFFs, non-African governments have a key role to play in assisting African countries acquire the capacities to fight the scourge of IFFs.

International organizations have a similar role to play in norm setting. They have established global norms against corruption and criminal activities and should continue to act in concert against these nefarious activities. However, they play a more differentiated role in tackling IFFs from commercial activities. Entities such as the World Customs Organization, United Nations Tax Experts Committee, United Nations Office of Drugs and Crime, Financial Action Task Force and OECD are working on different aspects of IFFs and from different perspectives. We felt that the very important research, policy advice and direct technical support activities of these various bodies is of great help, though better coordination is required to achieve coherence and to support Africa’s limited capacities to cope with IFFs.

## 2.5 Drivers and enablers of illicit financial flows

IFFs are driven by a number of “push” and “pull” factors. The most obvious push factor driving IFFs is the *desire to hide illicit wealth*. In other words, irrespective of the means by which illicit financial transfers take place, the ultimate objective of the actors involved is to hide the proceeds away from the public eye and law enforcement agencies. Related to this is the imperative to conceal the ways and means by which illicit wealth is created and that make it difficult to trace the associated money flow.

*Poor governance* enables IFFs. A poor business environment may encourage IFFs when people find it easier to make money through illicit activities than through legitimate business. Moreover, apart from being one of the sources of IFFs, generalized corruption would also propel such activities by weakening institutions and regulations. Strong legal frameworks and enforcement agencies make it difficult for individuals and companies to move illicit resources. This point is evident from the relative success of developed countries in tackling IFFs compared with the African experience.

*Weak regulatory structures* may also be an important factor in post-conflict countries. This was certainly the case in the Democratic Republic of Congo, which has not been able to establish such institutions as a financial intelligence unit or indeed an anti-corruption agency, owing partly to the distractions of violent conflict. It was also clear that illicit financial outflows are facilitated in areas that are not under the complete control of African governments as a result of conflict and insurgency. Recognition of this problem led to the introduction of the Kimberly Process to stop the trade in “blood diamonds”.

*Double taxation agreements* (DTAs) can also enable IFFs. We acknowledge that DTAs have a positive role in a number of respects. Since double taxation can stifle economic activity and deter foreign direct investment, and agreements between countries to avoid such consequences have a place in necessary policy interventions. However, the benefit of such agreements depends on their provisions. A well-negotiated and balanced DTA will not deter foreign direct investment, and it should not contain provisions that encourage IFFs. Troublesome examples of such provisions came to the Panel’s attention, such as those that seek to remove or lower withholding taxes on management fees and remove limitations on intracompany loans.

The content of DTAs reflects the relative bargaining strength of the partners, and given their weak capacities African countries start out at a disadvantage in negotiating such agreements. We therefore lend our support to the model treaty proposed by the African Tax Administration Forum. We also note that the OECD version does not allow for withholding taxes on royalties and management fees, while the version produced by the United Nations Tax Committee gives stronger rights to taxation at source. The case of DTAs underlines the need for Africa to build capacity to negotiate economic contracts effectively.

*Tax incentives* are another set of instruments with positive intentions that sometimes enable IFFs. Ordinarily, tax incentives are granted to encourage inward investment or the expansion of economic activity in general or in specific sectors. However, they can have a pernicious effect when abused. In this regard, African countries need to establish regional and subregional standards for tax incentives to end the existing “race to the bottom”. At the same time measures should be taken to combat the abuse of incentives such as tax holidays that enable IFFs, notably through the exploitation of rules relating to change of ownership as well as directly through base erosion.

A major enabler or pull factor for IFFs from Africa is the existence of *financial secrecy jurisdictions and/or tax havens*. Strictly speaking, these two things are not the same. Financial secrecy jurisdictions put in place an elaborate framework to attract financial resources irrespective of their provenance, whereas tax havens mainly aim to exploit differences in tax rates across different jurisdictions. Nonetheless, we feel that the distinction is not a vital one for the purposes of our work, especially as the enabling effect of both financial regimes on IFFs is the same in terms of lack of transparency.

We learned of the difficulties that the more powerful developed economies face in curbing the activities of financial secrecy jurisdictions, or even in describing countries as such. We faced similar sensitivities both from within and outside Africa during the course of our work. Since addressing the push factors of IFFs alone would be ineffective, the Panel is of the strong view that it remains vital to ensure that there is nowhere to send or hide illicit financial outflows. We found that several African countries desired to become financial services centres, and, though we understand the reasoning, we feel strongly that African countries should not in the process become financial secrecy jurisdictions sucking resources from the rest of the continent. A situation in which global businesses pay lower taxes than domestic companies, in countries where they have substantial operations, does not inspire confidence in the intentions and outcomes of the financial arrangements put in place to achieve this result.

**The Panel** commissioned research on financial secrecy jurisdictions to help African countries identify places where their trade is purportedly going but that could be a disguise for IFFs. The study (see annex IV) analyses the risk to African countries of IFFs arising from the extent of financial secrecy of the partner jurisdiction. As an example, the intragroup transactions of a multinational company with subsidiaries in Bermuda may contain greater risk of IFFs than those with a subsidiary in Brazil.

## 2.6 Ongoing efforts to curb illicit financial flows

To complement our exploration of issues around IFFs, we also studied the efforts and interventions going on regionally and globally. We recognized that the very fact of the establishment of our Panel was a sign that African countries are seriously concerned about IFFs. Our work has also confirmed the clear imperative to take global action to end the scourge of IFFs.

### 2.6.1 National and regional efforts

Some of the prominent problems at national and regional levels are

- The lack of adequate regulatory frameworks;
- Lack of information and telecommunication facilities, transportation and other relevant infrastructure;
- Lack of adequate funding and reliance on unpredictable foreign assistance;
- Shortage of technical and human capacity to deal with crime perpetuated by sophisticated companies and individuals;
- The involvement in corruption of top government officials operating at different levels of governance; and
- The perception of citizens of resource-rich countries that resource rents are free for all to harvest if given the opportunity.

A particular case that concerned inadequate capacities that resonated with the Panel was one that led to tension between the prosecuting authority and judiciary. The capacity imbalance between the prosecuting authority and the multinational corporation it was prosecuting was such that the latter was able to hire the best internationally available legal and accounting expertise, which the State could not afford. This resulted in the prosecutors almost always losing their cases and leading them to suspect prejudice on the part of the judiciary. Other telling examples were the poaching of staff of government agencies by multinationals, sometimes during ongoing investigations into their tax affairs.

There are also challenges of duplication, overlapping of functions and lack of coordination among different agencies. These problems are more pronounced in countries where there are numerous anti-IFF institutions. Equally, countries also complained about the lack of cooperation from

destinations where IFF money is held, especially in the context of asset recovery. There is a strong view throughout African civil society that the required institutions are weak and that they face the additional challenges of obstructive political interference, ineffective legal frameworks and processes and the lack of political will to deal decisively with IFFs. These are among the areas where much has to be done to enhance Africa's success in fighting against IFFs.

The *whole of government approach* promoted by the Oslo Dialogue of the OECD also attracted the attention of the Panel due to its coverage of a wide range of issues and related institutions pertaining to IFFs, including tax, customs, law enforcement, anti-corruption, financial regulation and prosecuting authorities. We believe that African countries can benefit from the example of improving cooperation between these agencies at the national level and between countries. Key in this regard would be the re-examination of policies which restrict the use of tax information solely for that purpose without the ability to share the information with law enforcement agencies.

The Panel has also noted policy and institutional frameworks established on the African continent with regard to combating corruption through adoption of an Africa-wide instrument (the African Union Convention on Preventing and Combating Corruption) as well as national anti-corruption legislation and institutions.

We have also taken particular note of the progress that has been made with regard to combating money laundering. The regional commitment to the fight against money laundering is evident from membership of the Inter-Governmental Action Group against Money Laundering in West Africa, the Financial Action Task Force, the Global Counterterrorism Forum, the UN Counter-Terrorism Implementation Task Force, the Financial Crimes Enforcement Network, and the Egmont Group of Financial Intelligence Units.

This institutional response is largely the result of the anti-money laundering and counter-terrorist financing regimes that have been put in place, principally through the recommendations of the Financial Action Task Force. The substantial progress made in this area is owing to the political will to choke financing to terrorist organizations. However, significant weaknesses remain in the implementation of the FATF recommendations, with evidence still abounds that major banks and financial institutions continue to receive, transfer and manage illicit outflows from Africa. In this regard, see the important report "Measuring OECD Responses to Illicit Financial Flows from Developing Countries" (OECD, 2014).

The record on efforts to combat commercial sources of IFFs was more mixed. The African Tax Administration Forum, which was established to promote cooperation and collaboration among African revenue services, has made an important contribution on some tax-related aspects of IFFs. It has developed model treaties for double taxation agreements and for the exchange of information that are more suited to the needs of African countries. Our interaction with the African Tax Administration Forum reinforced our view that a major constraint on combating IFFs in Africa is the problem of capacity.

## 2.6.2 Global efforts

At the global level, the Panel looked into existing or emerging practices, principles and frameworks for managing different aspects of IFFs as well as related efforts at institutional cooperation. Some of the key items relate to transparency, which encompasses issues like availability of information relating to compliance with the arm's-length principle, country-by-country reporting, beneficial ownership, automatic exchange of information and asset recovery. We believe that transparency is key to all efforts to arrest IFFs, given that the primary aim of perpetrators is to hide wealth. We agree with the admonition by the late US Justice Louis Brandeis that "sunlight is the best disinfectant".

Observance of the *arm's-length principle* is fairly well established in developed countries as the means by which a company can show that it is not engaged in abusive transfer pricing. By showing that it is using the comparative price of similar goods in conducting intragroup trade, a company can avoid accusations of tax evasion or aggressive tax avoidance. Our observation, however, is that checking on the use of the arm's-length principle is not a simple matter for African countries where transfer pricing units are barely functioning, if they exist at all. We agree with the view of the United Nations Tax Committee that it is difficult and complex to ensure compliance with the arm's-length principle, since doing so requires a huge and expensive database and a high level of expertise. In the case of the rapidly rising trade in services and intangibles, the arm's-length principle does not offer remedies in terms of establishing the quantum of exchange or the appropriateness of the prices used.

We were encouraged by the emergence of discussions on country-by-country reporting of employees, profits, sales and taxes as a means of ensuring transparency in cross-border transactions. Country-by-country reporting, publically available, will help to show where substantial activity is taking place and the relative profits generated and taxes paid. In the absence of a universal tax administration, country-by-country reporting will enable tax and law enforcement agencies to gain a full picture of a company's activities and encourage companies to be transparent in their dealings with African countries.

We consider Section 1504 of the US Dodd-Frank Act, which requires companies in the extractive sector to disclose publicly all their payments to government in the separate jurisdictions in which they operate, to be a good start to country-by-country reporting. Also notable in this regard is the European Union's Accounting and Transparency Directives. We also view the Extractive Industries Transparency Initiative in the same light as improving transparency. At the same time we note its voluntary nature and the fact that reporting payments made to governments tends more to curb corruption than to tackle IFFs from commercial activities. This is because reporting payments to governments alone may not show the full extent of IFFs if there is no profit base with which they can be compared. Moreover, its provisions do not cover undeclared quantities, which are a key source of IFF.

A key principle that is emerging with regard to tackling IFFs is the exchange of tax information among countries. This can either be on request or involve the *automatic exchange of information*, which is finding increasing favour with developed countries in their various forums, including the OECD. We acknowledged that complying with this emerging “gold standard” could be problematic for African countries because of their inadequate human and financial resources and regulatory frameworks. Nevertheless, we believe that it is important for Africa to strive to be part of emerging global frameworks to tackle IFFs. The application of the principle of “common but differentiated responsibilities” would also be appropriate in this regard.

Another key transparency issue relates to the declaration of *beneficial ownership* in companies. The operation of shell companies and allowing the identity of owners to remain secret enable those who wish to hide illicit wealth or launder money to do so without hindrance. To combat these problems, the Panel feels strongly that *public registry* of beneficial ownership is important. It welcomes the passage by the European Parliament of a resolution calling for beneficial owners of companies, foundations and trusts to be listed in public registers and looks forward to the final EU legislation to serve as a model for other jurisdictions. The Panel is of the view that political action is particularly important in this area. We note the virtual disappearance of shell banks once US financial institutions were prohibited from dealing with such non-US entities.

An area of particular concern during the subregional consultations was that of *asset recovery*. This Panel wishes to stress the importance of asset recovery as a means of providing resources for the development of African countries while also serving as a deterrent for those who stash illicit gains abroad. Global schemes for repatriating capital that has been corruptly transferred abroad are well developed, and these also cover Africa. Notable arrangements include incentives for bringing assets held abroad back to their countries of origin, such as amnesties, unilateral domestic legislation in developed countries and multilateral agreements with the same purpose. In this regard, we recognize the importance of the Kleptocracy Asset Recovery Initiative of the United States and the Stolen Assets Recovery Initiative of the World Bank and the United Nations Office on Drugs and Crime.

The Panel is particularly encouraged by the action taken by the US government under its *Kleptocracy Initiative* in early 2014 to freeze and return to Nigeria assets of not less than \$458 million stolen by the late Nigerian dictator Sani Abacha, with another estimated \$100 million also restrained (box 2.5). We feel that such action underscores the imperative for political action by developed countries to fight IFFs. Similarly, we recognize the contribution of the *StAR Initiative*, even as we acknowledge the fact that thus far its accomplishments have been limited. We believe that necessary actions be taken to improve the effectiveness of this important instrument.



## Box 2.5 US Department of Justice freezes millions stolen by Sani Abacha

In March 2014, the US Department of Justice announced that it had summarily frozen more than \$458 million in corruption proceeds stashed in various accounts in the United States and around the world by the late Nigerian dictator Sani Abacha and his conspirators. The seizure was described as the proceeds stashed in or moved through various accounts in the United States.

This recovery was made possible through the department's Kleptocracy Asset Recovery Initiative, which is aimed at seizing/recovering the assets of foreign leaders who steal funds that properly belong to the citizens they are supposed to serve and, where appropriate, return that money to benefit the people harmed by these acts of corruption and abuse of office.

Although it is purported that these illicit funds were laundered through the purchase of bonds using US financial institutions, the department insists that it will not let the US banking system be a tool for dictators to hide their criminal proceeds. The department said it was pursuing additional holdings in the United Kingdom with an expected value of at least \$100 million, but that the exact amount would be determined later.

In an effort to ensure continued transparency and increased information sharing, the Department of Justice also reported in comprehensive detail how the money was stolen from the Central Bank of Nigeria and the role of several Nigerian banks in transferring the stolen funds to accounts operated by General Abacha across the world.

The frozen funds, amounting to more than \$458 million, and the additional assets named in the complaint represent the proceeds of corruption during and after the military regime of General Abacha.

Source: US Department of Justice.

It is our view that existing asset recovery initiatives are hindered by delays, lags and capacity constraints. Countries that have been the most successful in tracing, freezing and repatriating stolen assets have legal frameworks that allow asset forfeiture and civil prosecutions without requiring criminal prosecution of the offender. Also pertinent in this regard are laws that prohibit the giving of bribes and gratuities such as the OECD Foreign Bribery Convention and the Foreign Corrupt Practices Act of the United States.

A matter of particular concern relates to the administration of frozen assets. We believe that frozen assets should not be kept in banks that are complicit in receiving these assets. Rather, they should be kept in an escrow account in regional development banks, which in the case of Africa is the African Development Bank. In addition, countries where illicit financial outflows have been secreted should not have the prerogative of stipulating the conditions for their return. Even at the most mundane level of justice, law enforcement agencies do not ask a person who has been robbed to give guarantees of how the returned resources will be used. Of course, this does not amount to an endorsement of mismanagement of returned/repatriated funds.

While recognizing the global dimension of IFFs, we believe in cases of corruption, African countries and other related actors have to live up to their responsibilities in this area. Corruption has both a demand and supply side, even within the continent. Thus, while public sector agents play an important part in corruption, private sector actors often initiate and benefit from such acts. We therefore wish to underscore the importance of promoting transparency in interactions between Government and business in Africa and suggest the introduction of lifestyle audits as a routine legal requirement when there is evidence of unexplained wealth.

We acknowledge the various efforts to tackle IFFs at the global level and through a number of forums and initiatives (box 2.6). While there is emerging convergence of principles and practices, such as exist among the G8, G20 and OECD states, much more needs to be done to promote and achieve this convergence. Because membership in the forums dealing with IFFs is often limited to developed and emerging economies, the related processes are not universal and reflect the interests of the concerned countries and groupings. The lack of participation of African countries means that their interests are not necessarily being taken into account. Indeed, the complexity of the issues involved and the financial costs of compliance could pose a problem for Africa. We feel that these issues deserve further attention at regional and global levels.

### Box 2.6 Initiatives and forums to tackle illicit financial flows

- The Global Forum for Transparency and Exchange of Information for Tax Purposes (OECD)
- The Multilateral Convention on Mutual Cooperation in Tax Matters (OECD)
- The Extractive Industries Transparency Initiative (EITI)
- Base Erosion and Profit Shifting Project (OECD + G20)
- Sections 1502 and 1504 of the Dodd Frank Act (US)
- The Foreign Account Tax Compliance Act (US)
- Automatic Exchange of Information (OECD, G20, G8)
- Anti-Bribery Convention (OECD)
- Public Registry (UK)
- United Nations Convention Against Corruption (UNCAC)
- The Recommendations of the Financial Action Task Force
- Open Government Partnership
- United Nations Tax Committee



# Chapter

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The governance and  
development impact  
of illicit financial flows



The Terms of Reference of the Panel require it to explore the governance and development impact of illicit financial flows (IFFs), which we discuss in the chapter.

## 3.1 Weakening governance

The occurrence of IFFs is first and foremost a governance problem, since good citizenship is the foundation of good government. Inasmuch as IFFs are driven by the desire to hide wealth and to evade taxes, perpetrators clearly do not respect the obligations of citizenship. It is well established in the literature that there is greater government accountability when the bulk of public sector resources derive from taxpayers, who almost always demand to know how their tax monies are being used.

The widespread occurrence of IFFs in Africa also points to a governance problem in the sense of weak institutions and inadequate regulatory environments. IFFs accordingly contribute to undermining state capacity. To achieve their purposes, the people and corporations behind IFFs often compromise state officials and institutions. Left unchecked, these activities lead to entrenched impunity and the institutionalization of corruption.

Corruption is both a source and enabler of IFFs. The transfer of the proceeds of bribery and abuse of power are one thing, but the role of corruption in enabling IFFs across the board is another. The negative impact of corruption on development is well known, including the debasement of values needed in the development process, misdirection of energies on “rent-seeking” activities and the misalignment of incentives such that private gain no matter how acquired becomes the leitmotif of all economic activity.

Several examples of the role of corruption to fuel IFFs came up at every stage of the Panel’s work. These included bribes paid to customs officers; inducements to tax inspectors, including job offers; and payments to security officers, bankers and judges. Earlier we mentioned that political power is often used to prevent state officials from carrying out their duties. This includes forbidding officials to vet mineral exports or search private planes to prevent smuggling of cash and the cutting of political deals to frustrate prosecution of crimes relating to IFFs.

IFFs can contribute to political discontent, partly due to the reduced ability of governments to provide social services but also as a result of the resentment of corruption arising from IFFs. These factors were evident during the Afro-Arab Spring. Participants in the Panel’s consultations in North Africa were particularly vocal in expressing their anger at the extent of their resources illicitly taken abroad and the cumbersome, lengthy and costly process of repatriation of such funds.

A closely related consideration is the symbiotic relationship between increasing criminal activities and IFFs, especially, but not only, in West and Central Africa.

Given the well-known dependence of several African countries on significant amounts of official development assistance, the loss of resources through IFFs can only serve to deepen reliance on donors. Such dependence is apparent not only in terms of funds to support the social sector and state institutions, but also in terms of development ideas. It is an established fact that despite assertions of ownership, development policy very often reflects the perspectives of creditors or donors. Thus, when strapped for resources, African countries can often find themselves at the receiving end of externally imposed ideas that might not really be in their own perceived interests.

Another governance dimension of IFFs relates to the unequal burden of citizenship imposed on other sectors of society, both in terms of tax fairness and “free-riding”. When large companies, particularly multinational corporations, engage in base erosion and profit-shifting activities, the bulk of the tax burden as a result falls on small and medium-scale enterprises and individual taxpayers. This runs counter to the idea of progressive taxation, in which those who earn more income contribute a larger percentage of tax revenues. Just as pernicious to governance is the “free-riding” that results when entities evade or avoid taxes where they undertake substantial economic activities and yet benefit from the physical and social infrastructure, most of which is still provided by the public sector in Africa.

We would like to draw attention to the fact that in the context of the governance impact of IFFs, the African Peer Review Mechanism (APRM) does not provide for monitoring the processes and impacts arising from IFFs. This should be corrected, as the APRM is a good instrument for the continuous monitoring of IFFs from Africa. We therefore feel that steps should be taken to include IFFs in areas covered by the APRM.

## 3.2 Development consequences

The development consequences of IFFs are quite severe. When monies are illicitly transferred out of African countries, their economies do not benefit from the multiplier effects of the domestic use of such resources, whether for consumption or investment. Such lost opportunities impact negatively on growth and ultimately on job creation in Africa. Similarly, when profits are illicitly transferred out of African countries, reinvestment and the concomitant expansion by companies are not taking place in Africa.

In this regard we have taken due note of various calculations of the impact of IFFs. Some have estimated that Africa’s capital stock would have expanded by more than 60 per cent if funds leaving Africa illicitly had remained on the continent, while GDP per capita would be up to 15 per cent more (Boyce and Ndikumana, 2012). Just as telling is the estimate in the 2012 African Economic Outlook that Africa’s ratio of domestic investment to GDP would increase from 19 per cent to 30 per cent if the stock of capital taken out were available for investment within the continent.

One of the outcomes of the recent global economic and financial crisis has been a slowing in official development assistance. African countries have accordingly had to place more emphasis on domestic resource mobilization to generate the savings and investment required to finance continental development. We took note of the NPCA/ECA study on mobilizing domestic resources for the implementation of national and regional infrastructure projects in Africa and the subsequent Dakar Financing Summit, which identified practical actions that should be taken for this purpose. These efforts are undoubtedly being greatly undermined by illicit financial outflows. Moreover, infrastructure is not the only area in which African governments can “crowd in” investment. By taking equity stakes in key sectors, partly to pioneer investment in strategic sectors and also as an investment guarantee, governments have been able to attract substantial private investment. It is therefore important that they have access to the full extent of tax revenue that can be raised from the economic activity taking place within their countries.

Deficiencies in African countries’ tax revenue are also partly responsible for the vulnerability of African economies to recurring fiscal deficits. While not necessarily problematic in the short run, continuing fiscal deficits will eventually cause resort to reductions in spending and attendant austerity.

Indeed, IFFs can contribute to austerity in other ways. Balance of payments statistics influence fiscal and monetary policy, yet IFFs mask the real export performance of African countries. The well-known effects of austerity manifest themselves in various ways. These include a squeeze on growth, slowdown of investment, and factories operating at far less than full capacity—all of which are accompanied by retrenchment and job losses. Given their role in managing economic shocks and adjustment in African countries, and their assigned role in generating financial statistics, the IMF, World Bank and Bank for International Settlements should play a more active role in refining data that will assist in tracking IFFs.

Beyond the consequences of fiscal deficits, reduced tax earnings resulting from hiding taxable funds has a direct effect on the provision of public services such as schools, clinics, sanitation, security, water and social protection. Finance Ministers were quite clear in their discussions with our Panel that their governments face continuing pressures for social spending on education, health and poverty eradication programmes. We were made aware of a study (O’Hare and others 2013) that explored the potential impact of IFFs on under-five child and infant mortality. Figure 3.1 shows the ways in which IFFs exacerbate indicators from Millennium Development Goal (MDG) 4 on child mortality.

The study looked at the potential reduction in years required for 34 African countries to reach MDG 4 if IFFs were eliminated, as compared with current rates of progress in meeting those goals. As table 3.1 shows, the impact would be quite dramatic. Without IFFs, the Central African Republic would be able to reach the MDG indicators in 45 years compared with 218 years at current rates of progress. Other striking examples are Mauritania, 19 years rather than 198 years; Swaziland, 27 years rather than 155 years; and the Republic of Congo, 10 years rather than 120 years. Perhaps most striking is the finding that if IFFs had been arrested by the turn of the century, Africa would reach MDG 4 by 2016.

Figure 3.1

Illicit financial flows and their impact on child mortality rates

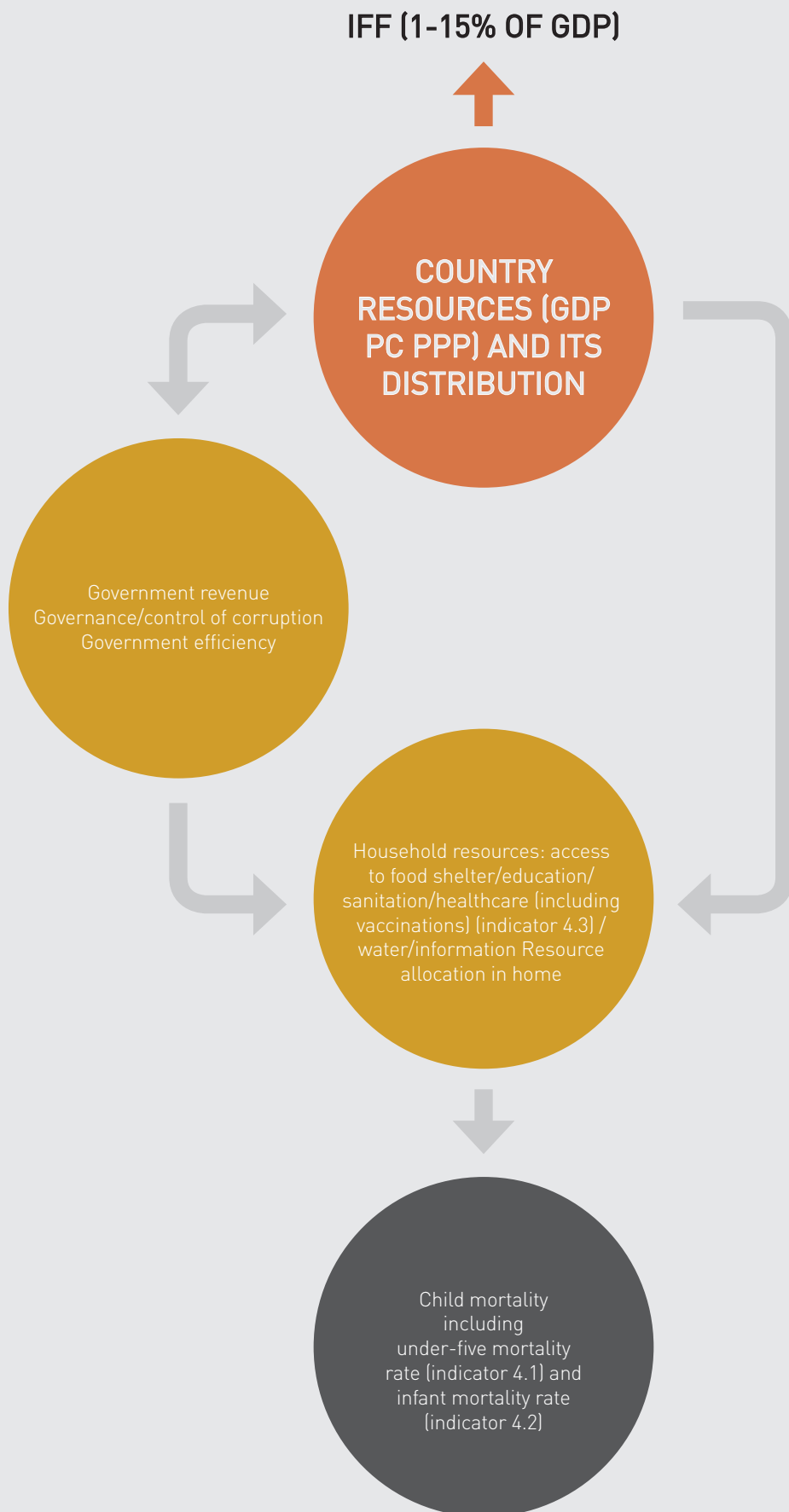




Table 3.1

## Illicit financial flows and their impact on Millennium Development Goal 4

| Country                    | Under-5 mortality rates in 2000 (per 1000) | MDG 4 target (under-5 mortality rates, 2000-2011) | Actual annual Reduction in under-5 mortality rates (2000-2011) | Illicit financial flows (per-cent of GDP) | Potential annual reduction in under-5 mortality absent IFFs | Number of years from 2000 to reach MDG 4 at current rate of decline | Number of years from 2000 to reach MDG 4 if IFFs curtailed |
|----------------------------|--|---|--|---|---|---|--|
| Angola                     | 200  | 87  | 20.0   | 7   | 4.66  | 41  | 17   |
| Botswana                   | 96   | 17  | 10.4   | 10  | 14.20   | 16  | 11   |
| Burkina Faso               | 191  | 67  | 2.0  | 3   | 3.14  | 52  | 33   |
| Burundi                    | 164  | 63  | 1.5  | 6   | 3.78  | 63  | 25   |
| Cameroon                   | 148  | 50  | 0.8  | 6   | 3.08  | 135   | 35   |
| Central African Republic   | 176  | 59  | 0.5  | 5   | 2.40  | 218   | 45   |
| Chad                       | 190  | 67  | 1.0  | 20  | 8.60  | 104   | 12   |
| Congo, Democratic Republic | 181  | 66  | 0.7  | 3   | 1.84  | 144   | 54   |
| Congo, Republic of         | 104  | 35  | 0.9  | 25  | 10.40   | 120   | 10   |
| Côte d'Ivoire              | 148  | 51  | 1.7  | 6   | 3.98  | 62  | 26   |
| Ethiopia                   | 141  | 70  | 5.3  | 6   | 7.58  | 13  | 9  |
| Gabon                      | 88   | 31  | 2.1  | 11  | 6.28  | 49  | 16   |
| Gambia                     | 128  | 55  | 2.6  | 14  | 7.92  | 32  | 10   |
| Ghana                      | 99   | 39  | 2.2  | 2   | 2.96  | 42  | 31   |
| Guinea                     | 175  | 76  | 2.8  | 9   | 6.22  | 29  | 13   |
| Guinea-Bissau              | 177  | 80  | 1.3  | 7   | 3.96  | 61  | 20   |
| Kenya                      | 111  | 35  | 4.0  | 1   | 4.38  | 28  | 26   |
| Lesotho                    | 127  | 34  | 2.8  | 15  | 8.50  | 46  | 15   |
| Madagascar                 | 102  | 56  | 4.8  | 6   | 7.08  | 12  | 8  |
| Malawi                     | 167  | 75  | 6.2  | 10  | 10.00   | 13  | 8  |
| Mali                       | 213  | 83  | 1.8  | 3   | 2.94  | 52  | 32   |
| Mauritania                 | 116  | 43  | 0.5  | 12  | 5.06  | 198   | 19   |
| Mozambique                 | 177  | 83  | 4.7  | 5   | 6.60  | 16  | 11   |
| Niger                      | 218  | 102   | 5.0  | 3   | 6.14  | 15  | 12   |
| Nigeria                    | 186  | 77  | 3.8  | 12  | 8.36  | 23  | 10   |
| Rwanda                     | 177  | 58  | 11.1   | 5   | 13.00   | 9   | 8  |
| Senegal                    | 119  | 50  | 6.4  | 1   | 6.78  | 13  | 12   |
| South Africa               | 78   | 19  | 4.2  | 4   | 5.72  | 33  | 24   |
| Sudan                      | 114  | 41  | 1.7  | 3   | 2.84  | 60  | 35   |
| Swaziland                  | 114  | 28  | 0.9  | 11  | 5.08  | 155   | 27   |
| Tanzania                   | 130  | 52  | 5.7  | 2   | 6.46  | 16  | 14   |
| Togo                       | 124  | 50  | 1.4  | 6   | 3.68  | 64  | 24   |
| Uganda                     | 144  | 62  | 4.1  | 3   | 7.52  | 20  | 16   |
| Zambia                     | 157  | 57  | 5.6  | 9   | 5.60  | 18  | 11   |
| Total                      | 143  | 56  | 3.3  |   | 3.31  | 29  | 16   |

The social consequences of IFFs extend beyond the implementation of the MDGs to the worsening inequality in Africa. Our earlier observation that IFFs contribute to a regressive tax system and impose an unfair tax burden on poorer sections of society is pertinent in this regard. IFFs contribute to worsening inequality in Africa in other ways as well. The provision of social services and social protection schemes are means of reducing inequality. African governments find it increasingly harder to provide these forms of support in increasingly constrained economic circumstances. Hidden wealth moreover increases inequality between recipient countries and African countries. The African Tax Administration Forum estimates that up to one-third of Africa's wealth is being held abroad. This wealth and its associated income are beyond the reach of African tax authorities, thus depriving countries of resources that could be used to mitigate inequality.

Instead, IFFs contribute to shifting resources from productive to less productive activities. Available evidence shows that many large companies, including multinational ones, devote considerable effort to activities that seek to increase their profitability through tax evasion and avoidance rather than through making their operations more efficient. IFFs reduce the efficiency of resource allocation through the focus on activities with the highest pre-tax returns to those with best after-tax returns. This focus tends to reduce value creation, which is very important as Africa seeks to shift its production structures from primary to secondary activities.

### 3.3 Discouraging transformation and transparency

By discouraging value creation, IFFs impact negatively on African aspirations for structural transformation. Indeed, the structure of African economies also makes them vulnerable to IFFs. Africa has on average been doing well in terms of economic growth since the turn of the century, with growth rates of about 5 per cent a year. However, the economic structure of African countries has remained unchanged since the era of early independence, with continued reliance on agriculture, extraction of natural resources and traditional and basic services (ECA and African Union Commission, 2014).

Case studies and other related literature indicated to our Panel that the natural resource sector is especially prone to IFFs. The research showed that countries such as Nigeria and the Democratic Republic of Congo, which have huge oil/gas and mineral sectors, are quite vulnerable to this scourge. In Nigeria, the share of oil in total government revenue is more than 70 per cent, while in the Democratic Republic of Congo the mining sector accounts for up to 30 per cent of gross domestic product and 90 per cent of export revenue.

Reliance on extractive industries for revenue and export earnings in Africa usually means that the sector has a high degree of discretionary power and political influence. This is the source of the secret and unequal contracts that African countries sometimes enter into with multinational mining companies. These contracts in turn undermine efforts to promote transparency and accountability in the extractives industry. (See figure 3.2 illustrating Nigeria's efforts to increase transparency in its extractive sector).

Figure 3.2

The Central Bank of Nigeria now delivers monthly reports on national oil revenue

# CBN REPORT ON OIL REVENUE

## for the month of february 2014

# N847.81 BILLION

estimated federally  
collected gross revenue



According to the economic report for the month of February 2014 provided by the CBN, available data showed that estimated federally collected gross revenue for that month was **N847.81 billion**.

This figure according to the report is **10.3%** below the provisional monthly budget estimated.

### CRUDE OIL & GAS SALES



N224.0 billion

### DOMESTIC CRUDE OIL & GAS



N128.2 billion

### PPT/ROYALTIES

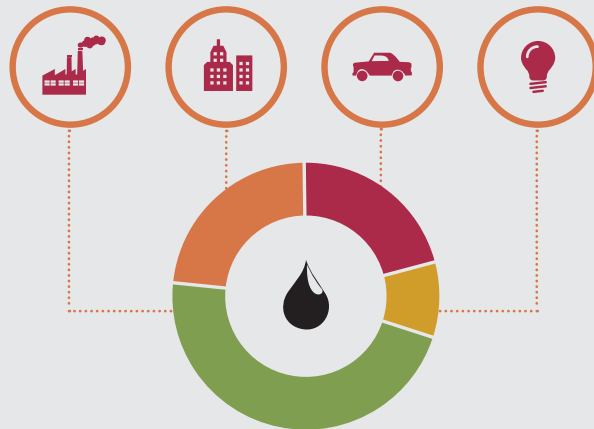


N262.2 billion

### OTHERS



N15.7 billion



# N630.14 BILLION

Oil revenue for the month was N630.14 billion gross which constitutes 74.3% of the total revenue.

The figure is lower than the provisional monthly budget estimate. The month's decrease in oil revenue was caused by the shortfall in receipts from crude oil and gas export due to pipeline vandalism resulting in a drop in production.



By the same token, the inability of African countries to establish the precise quantities of their natural resources that are exported only serves to aggravate poor record keeping and data collection which is a well-known bane of development planning on the continent.

The high correlation between reliance on extractive industries and IFFs also impacts on development and inequality. Indeed, there is an established positive correlation between the level of resources that African countries export and their levels of inequality. Similarly, the 2013 Resource Governance Index, which measures transparency in oil, gas and mining in the 58 countries that collectively produce 85 per cent of the world's petroleum, 50 per cent of its diamonds and 80 per cent of its copper reveals that 80 per cent of these countries "fail to achieve good governance in their extractive sectors".

Of particular concern to our Panel is the lack of transparency in national budgets that are dependent on earnings from the extractive sector. We have taken note of the *Publish What You Pay* initiative, which in addition to requiring companies in the extractive sector to report their payments to governments, also requires governments to disclose how much revenue they receive. This is the backbone of the Extractive Industries Transparency Initiative (EITI). However, we are concerned that schemes like EITI and the related parts of the Dodd-Frank Act will not succeed in eliminating unrecorded transactions, including provisions in secret contracts or undeclared quantities.

The main consequences of undeclared quantities are loss of revenue, but there are also the associated results of undermining the ability to quantify environmental damage and the negative impact on sustainable development. This is also the case for losses arising from secret contracts. The intertemporal loss or reduction in the welfare of future generations due to overextraction permitted by secret contracts is a key concern of our Panel. In many instances, lack of contract transparency is the result of failure to learn from the experience of others in negotiating contracts and the inability of different stakeholders to coordinate their efforts effectively in the management of such contracts.

## 3.4 Straining Africa's capacities

In addition to other governance and development consequences, IFFs strain the capacities of African governments in various ways. While we established that a good deal of IFFs take place because of weak regulatory and law enforcement capacities, the effort to stem such outflows strains these already weak capacities. Drawing on the example of global negotiations in development, trade, and climate change for instance, we noted that the ability of African countries to negotiate and obtain fair outcomes is always a matter of concern. This is also the case with regard to the negotiation of agreements and contracts that sometimes enable IFFs. We are particularly concerned about the risk that African countries face in making unbalanced

concessions with regards to double taxation agreements, concession contracts for the extraction of natural resources and indeed participation in ongoing global processes and negotiations aimed at curbing IFFs.

In addition to digging deep to find the resources to undertake negotiations that would help stem IFFs, African countries also have to reallocate resources to tackle this growing scourge. The point has been made elsewhere that for African countries to have the same ratio of tax officials to their populations as the OECD countries they would need up to 650,000 new tax officials.

Given concerns about ineffective and corruption-prone public tendering processes, some African countries have had to establish special procurement units for this purpose. Anti-corruption agencies, financial intelligence units and transfer pricing units are examples of the creation of additional cost centres to combat IFFs.

We are aware of studies that show that the additional cost of building capacity, especially for revenue authorities, often pays off through increased tax collection. The key thing is that the resources have to be found first in a context of competing priorities, while the results will take time in coming. Closely related to this problem is the expense of coping with emerging global standards for fighting tax evasion, including automatic exchange of information and building the capacity to use mutual assistance programmes. While African countries cannot afford to remain outside emerging global frameworks, there is the reality that given their capacity constraints, many cannot cope with the often onerous requirements of such agreements.

We re-iterate the view that in addition to technical assistance to tackle IFFs, African countries should benefit from the principle established in other global negotiations of “common but differentiated responsibilities” or, in other words, an asymmetry in obligations. After all, the flow of illicit finance is mostly one way, and developed countries are unlikely to demand from African countries taxes deriving from the activities of their multinational companies.

## 3.5 Undermining international development cooperation

IFFs undermine development cooperation in various ways. It is clear that such outflows do not help reach the goals of international agreements like the Monterrey Consensus and its successor the Doha Declaration on Financing for Development, which emphasize the important role of domestic resource mobilization. In a similar vein, IFFs undercut global efforts to promote partnerships for aid effectiveness and development effectiveness.

Policy coherence is another victim of IFFs. It is somewhat contradictory for developed countries to continue to provide technical assistance and development aid (though at lower levels) to Africa while at the same time maintaining tax rules that enable the bleeding of the continent's resources through illicit financial outflows. It might indeed be useful to undertake an analysis of the impact of the tax systems of developed countries on African countries. A closely related concern is the revelation by the Norwegian Commission on Tax Havens that some development agencies actually make investments in financial secrecy jurisdictions. This practice should be stopped and necessary divestments should be made.

There is as yet insufficient international cooperation on IFFs. It is well known that the MDGs had nothing to say about IFFs, yet the trend of such outflows from Africa was increasing at the very time that efforts were being intensified to achieve the MDGs by the target date of 2015. While illicit financial outflows cannot be blamed solely for failure to achieve the MDGs, they certainly contributed to the fiscal constraints that hampered meeting these noble objectives. We take heart from various proposals to include IFFs in a post-2015 development agenda and wish to stress the importance of setting clear, achievable targets in this regard.

IFFs, ranging from profit shifting to lack of transparency, financial secrecy jurisdictions, lack of clarity about beneficial ownership, and inadequate reporting of payments in the extractive sector, have attracted the attention of G8 and G20 countries. Certainly, if such countries are negatively affected by these activities, as they indeed are, there can be no doubt that African countries face an even tougher challenge given the governance gap, which can only be widened by the illicit outflows.



# Chapter

# 4

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Findings and policy  
implications



The previous three chapters of this Report outlined the approach employed by the Panel, the framework it used to analyse illicit financial flows (IFFs) from Africa and some of the development consequences of such outflows. Chapter 4 contains the findings of the Panel and their related policy implications. It is informed by the analyses in the previous chapters and the Panel's extensive work, including case studies of selected countries, and its wide-ranging consultations with relevant actors both within and outside Africa. The findings and policy implications in Box 4.1 inform the recommendations contained in the final chapter.

## Findings of the HLP Report on IFFs

- **Finding 1:**  
Illicit financial flows from Africa are large and increasing
- **Finding 2:**  
Ending illicit financial flows is a political issue
- **Finding 3:**  
Transparency is key across all aspects of illicit financial flows
- **Finding 4:**  
Commercial routes of illicit financial flows need closer monitoring
- **Finding 5:**  
The dependence of African countries on natural resources extraction makes them vulnerable to illicit financial flows
- **Finding 6:**  
New and innovative means of generating illicit financial flows are emerging
- **Finding 7:**  
Tax incentives are not usually guided by cost-benefit analyses
- **Finding 8:**  
Corruption and abuse of entrusted power remains a continuing concern
- **Finding 9:**  
More effort needed in asset recovery and repatriation
- **Finding 10:**  
Money laundering continues to require attention
- **Finding 11:**  
Weak national and regional capacities impede efforts to curb illicit financial flows
- **Finding 12:**  
Incomplete global architecture for tackling illicit financial flows
- **Finding 13:**  
Financial secrecy jurisdictions must come under closer scrutiny
- **Finding 14:**  
Development partners have an important role in curbing illicit financial flows from Africa
- **Finding 15:**  
Illicit financial flow issues should be incorporated and better coordinated across United Nations processes and frameworks

In communicating these findings and recommendations, the Panel wishes to emphasize from the outset that African countries must adopt a systemic approach and take the lead in tackling IFFs from their countries, among other things by mainstreaming transparency requirements and adopting standards through legislation and regulation.

## Finding 1: Illicit financial flows from Africa are large and increasing

It is established that IFFs from Africa are large and increasing. This finding is valid irrespective of the source of data and is evident across the three main categories of IFFs: commercial, criminal, and corrupt activities. Our own empirical research, focusing mainly on the merchandise trade sector, found that illicit financial outflows from Africa had increased from about \$20 billion in 2001 to \$60 billion in 2010. The same conclusions were reached from a review of other related work undertaken by Global Financial Integrity, the African Development Bank, the United Nations Development Programme and several civil society organizations. Using a different methodology, Global Financial Integrity puts the trend growth of IFFs from Africa over 2002–2011 at 20.2 percent a year. Even those who question the methodologies used to estimate the outflows tend to agree that the problem of IFFs is serious and demands urgent action.

*Policy implication:* High and increasing IFFs from Africa impact on development through losses in tax revenue and the opportunity cost of lost savings and investment in various sectors of African economies. These impacts are of particular policy significance now due to the increased importance of domestic resource mobilization at a time when the role of official development assistance is declining. Whether IFFs are three times the amount of official development assistance, as attributed to the Secretary-General of the OECD, or are 10 times the amount of aid received, as claimed by the Tax Justice Network, the implications are clear. These considerations compel urgent and coordinated action to curb these illicit outflows.

## Finding 2: Ending illicit financial flows is a political issue

The range of issues related to IFFs makes this a technically complex subject. However, we are convinced that success in addressing IFFs is ultimately a political issue. Issues involving abusive transfer pricing, trade misinvoicing, tax evasion, aggressive tax avoidance, double taxation, tax incentives, unfair contracts, financial secrecy, money laundering, smuggling, trafficking and abuse of entrusted power and their interrelationships confer a very technical character to the study of IFFs. However, the nature of actors, the cross-border character of the phenomenon and the effect of IFFs on state and society attest to the political importance of the topic. Similarly, the solutions to IFFs that are the subject of ongoing work in various global forums attest to this political significance.

*Policy implication:* The technical aspects of IFFs are responsible for divergences in understanding, measurement and emphasis with regard to IFFs. A global consensus in tackling the problem is required. This means that the required concerted response depends on the necessary decisions being taken at the political level. This requirement is obvious from the work on disparate components of illicit financial outflows undertaken regionally by the African Union and regional economic communities and at the global level by the G20, OECD, the World Bank, the IMF and the United Nations. Such work needs to be coordinated to ensure consistency and success in tackling the illicit outflows.

## Finding 3: Transparency is key across all aspects of illicit financial flows

Transparency is key to achieving success in the fight against IFFs. The admonition of the late Justice Louis D. Brandeis of the United States mentioned earlier that “sunlight is the best disinfectant” is especially pertinent in this regard. The importance of transparency is evident in ongoing approaches to tackle IFFs, whether through the automatic exchange of information, country-by-country reporting, project-by-project reporting, disclosure of beneficial ownership, public information about commercial contracts that African governments enter or implementation of the recommendations of the Financial Action Task Force. While voluntary

approaches to the exchange of information such as the Extractive Industries Transparency Initiative are making steady progress for extractive industries, the push for transparency should encompass all commercial sectors, moving to mandatory requirements such as those contained in Section 1504 of the US Dodd-Frank Act and the European Union Transparency Directive.

*Policy implication:* The policy implication of increased transparency is that it should ensure access to such information and the right to obtain it. While various countries and regions are developing mechanisms for information sharing, there is a need to move to a common global mechanism. African countries in turn need to show commitment to the various voluntary and mandatory initiatives by joining them and mainstreaming their requirements nationally and regionally, including through legislation and adoption of common standards. They also need to develop the capacity to request, process and use the information that they obtain.

## Finding 4: Commercial routes of illicit financial flows need closer monitoring

The commercial sector is the major source of in Africa, but it is the least understood. This is due to the range of methods by which IFFs take place in the commercial sector as well as the technicality of issues such as transfer pricing, tax evasion, aggressive tax avoidance, trade misinvoicing, tax incentives, double-taxation agreements and the like. Although the OECD is working to address issues of base erosion and profit shifting, this work is not principally geared to developing country concerns. African governments are concerned about the negative impact of these illicit financial outflows on their tax revenues and investment capital, but most of them lack legislation and guidelines on transfer pricing or effective units to address the problem. When countries prosecute corporate tax evasion and aggressive tax avoidance they find themselves in a long and costly process that often results in a mutually agreed settlement that is not necessarily beneficial to the countries concerned.

*Policy implication:* African countries need to pay closer attention to illicit flows from the commercial sector. This means developing the required capacities, establishing or strengthening necessary institutions including transfer pricing units, and providing resources for the effective functioning of these institutions. It would also mean holding multinationals accountable for fraudulent practices by setting up requirements for their transfer of funds and business practices. Furthermore, it is essential that the private sector, especially large corporations, such as the headquarters of international banks and other multinational corporations play a stronger role in ensuring that they are not accomplices to IFF practices. This will also mean tracking and participating where possible in global processes to improve commercial transparency and the international tax regime. Similarly, global actors have to take Africa's interests and concerns into account in their ongoing processes.

## Finding 5: The dependence of African countries on natural resources extraction makes them vulnerable to illicit financial flows

African countries depend to a large extent on the extraction of natural resources for their exports and tax revenues. However, this sector is very prone to the generation of illicit financial outflows by such means as transfer mispricing, secret and poorly negotiated contracts, overly generous tax incentives and underinvoicing. The lack of transparency in the extractive sector informs various initiatives to redress the situation, such as the Extractive Industries Transparency Initiative, relevant sections of the US Dodd-Frank Act and the *Publish What You Pay* initiative driven by civil society organizations.

We established from the case studies and our consultations that indeed there is a clear relationship between countries that are highly dependent on extractive industries and the incidence of IFFs. We found there is extensive underreporting of the quantity and sometimes quality of natural resources extracted for export be it crude oil, diamonds, coltan, gold, shrimp or timber, yet none of the countries we studied and visited had its own independent means of verifying the precise amount of natural resources extracted and exported. Instead, they depend on reports filed by the operators, who have an incentive to underreport, especially since requirements in legislation such as the Dodd-Frank Act cannot cover undeclared quantities. In the case of timber, Liberia's government now tags logs for export to respond to the problem. Accordingly, the Panel put the Democratic Republic of Congo, which faces a similar challenge, in contact with the Liberian authorities.

*Policy implication:* It is vitally important to pay attention to activities in the extractive sector in efforts to curb IFFs from Africa. African countries need the capacities and technology to monitor extraction of their natural resources better and to negotiate contracts more effectively. They also need to make greater use of the information and support provided by voluntary existing mechanisms promoting transparency in the natural resource sector while calling for the adoption of mandatory global reporting requirements. Ultimately, African countries need to diversify their economies away from dependence on natural resources into higher value activities.

## Finding 6: New and innovative means of generating illicit financial flows are emerging

In addition to the difficulties that exist in measuring the contribution to IFFs of traditional services, the digital economy and intangibles, these now contribute to the problem in novel and abstruse ways. This finding reflects the increased share of the service sector in global economic activity as well as the technological changes underpinning service transactions. The digital revolution has enabled speedier transfers of money, often at the click of a button, while e-commerce and online gambling make it harder to “follow the money”. While consultancy fees, payment of royalties and charges for the use of intellectual property are not in themselves new, there is increased resort to such activities because of the opportunity they afford for increased opacity.

*Policy implication:* There is need for a better appreciation of the increasing contribution of services to IFFs. This requires further research and the improved generation of data on service-related transactions, particularly by the international organizations charged with maintaining statistics on international trade and financial flows. As the Democratic Republic of Congo has done for telecommunications, it is important for countries to share with others their experience of discrepancies in services trade with others.

## Finding 7: Tax incentives are not usually guided by cost-benefit analyses

African countries grant a host of tax incentives such as tax holidays, investment allowances, tax rate reductions and use administrative discretion in order to attract foreign direct investment. However, in many instances these policy decisions are not guided by proper cost-benefit analyses but rather by the intention of outdoing competitors for foreign direct investment, leading to harmful tax competition and a “race to the bottom”. At the same time, there is general consensus that investment decisions of foreign investors are informed by a broader set of considerations beyond tax incentives. In many countries, the picture is further complicated by the lack of coordination among agencies responsible for granting tax incentives and those concerned with raising revenue, compounded by the additional

burden of managing such incentives. We were informed about the abuse of tax holidays through the sale of assets and transfer of ownership just before the expiration of the exemption period in order to perpetuate the tax holidays.

*Policy implication:* There is a clear need to undertake cost-benefit analysis in granting tax incentives, especially tax holidays intended to attract foreign direct investment. Moreover, there should be coordination of such incentives among regional economic communities to develop common standards and prevent a “race to the bottom”. For tax holidays, rules should be drawn up to prevent the same entity/beneficial owner from continuing to benefit after there is an apparently substantial change in ownership.

## Finding 8: Corruption and abuse of entrusted power remains a continuing concern

Corruption remains a matter a major concern despite the global and regional attention that resulted in adoption of the United Nations Convention against Corruption (UNCAC) and the African Union Convention on Preventing and Combating Corruption (AUCPCC). Corruption is a cross-cutting and integral part of IFFs because of its facilitating role. Indeed, the general perception expressed during our consultations and also emanating from the questionnaires used in the case studies was that corruption is one of the main drivers of IFFs. This is not surprising, since corruption is a main area of policy attention and intervention by civil society, while also being a driver of IFFs that the general public can relate to without having specialist knowledge. Corruption in the form of abuse of entrusted power for private benefit in both the public and private sectors thus remains an issue of continuing concern.

*Policy implication:* African countries need to domesticate the provisions of the UNCAC and AUCPCC at the national level. Such existing instruments and frameworks, particularly the AUCPCC, in turn need to be updated to reflect the importance of tackling IFFs. The global effort to fight corruption needs to continue unabated in terms of establishing national anti-corruption agencies, bringing them together for regional cooperation and providing them with autonomy, resources and capacities to prevent and prosecute corruption cases.

## Finding 9: Stimulating and expediting the process of asset recovery and repatriation

There are initiatives and increased efforts to trace, recover and return IFFs, especially where corruption is involved. The UNCAC is notable as a global instrument that seeks to provide a legal framework for asset recovery. The AUCPCC contains similar provisions. There are also bilateral efforts between originating and destination countries. Another significant development is the Stolen Assets Recovery Initiative, which is a partnership of the World Bank and the United Nations Office on Drugs and Crime (UNODC). These sorts of initiatives—some of which exist at the sub-regional level in Africa, such as the Arab Forum on Asset Recovery and the Asset Recovery Inter-Agency Network of Southern Africa—are important to show that determined efforts to find and repatriate illicitly acquired monies can be and are being undertaken.

One of the initiatives to be encouraged and strengthened is the African Legal Support Facility, hosted by the African Development Bank, which has been supporting African governments in the negotiation of complex commercial transactions since 2010. The Facility was established to address the asymmetric negotiating capacity of African governments when dealing with deep-pocketed international investors. The Facility was established in response to a call by African Ministers of Finance for assistance in three key areas: commercial creditor litigation, negotiation of complex commercial transactions, and capacity building.

Action should be taken to overcome obstacles to the proper functioning of asset recovery initiatives in Africa, including providing legal and financial expertise and aligning domestic policy and institutional frameworks with global instruments. It was observed that the frameworks for asset recovery are mostly limited to the return of proceeds of corruption and illicit enrichment while efforts to repatriate proceeds of tax evasion usually depend on the efforts and abilities of individual countries. An exemption that came to our attention was illegal fishing in South African waters, which led US authorities to apprehend and prosecute the offender and return to South Africa the illicitly derived gains, which had been deposited in US banks.

One matter of concern in the context of asset recovery efforts is the treatment of frozen funds. Our view is that not only should accepting tainted funds be rendered highly unattractive to banks but also that banks that are determined to have been complicit in the receipt of illicit funds should not be allowed to keep these funds while they are frozen. A clear framework for the handling of frozen assets is needed. Creating an institutional escrow system in which regional development banks are designated as escrow agents seems to be one rational path to follow in this regard.

*Policy implication:* Regulations and mechanisms are needed to ensure that financial establishments and banks identify and refuse to accept IFFs rather than relying on self-regulation by banks. Global frameworks on asset recovery should be reconfigured to require that frozen assets be placed in escrow accounts in regional development banks rather than allowing banks that are culpable in accepting such deposits to continue to benefit from them.



## Finding 10: Money laundering continues to require attention

There has been notable success in tackling money laundering, especially due to the desire to choke off financial resources going to terrorist organizations. Many countries have put an emphasis on implementing the recommendations of the Financial Action Task Force. This has included establishing financial intelligence units, adopting anti-money laundering and counter-terrorist financing legislation, improving banking supervision and raising awareness about such activities among banks and non-financial institutions. Indeed, banks try to work in accordance with anti-money laundering/counter-terrorist financing requirements because of the reputational risks of non-compliance.

However, new and more obscure ways of money laundering have emerged, including cash smuggling and triangulated transactions routed through Africa. There are sometimes lags or delays in the implementation of anti-money laundering/counter-terrorist financing in some African countries due to political instability and institutional and resource constraints. The fight against money laundering may also be constrained by laws restricting the use of tax information solely for tax purposes. This is an example of the dichotomy of interests among government bodies, with the revenue body being solely interested in raising revenue without regard to the interests of the law enforcement agencies.

*Policy implication:* The international community needs to continue to pay close attention to money laundering, with increased focus on the new and obscure ways of laundering money. It is also important to address the dichotomy between revenue and law enforcement agencies on the sharing of information about money laundering discovered in the process of tax audits.

## Finding 11: Weak national and regional capacities impede efforts to curb illicit financial flows

The ability of African countries to combat IFFs is seriously impeded by deficiencies in their capacities to track, stop and repatriate illicit financial outflows. This lack of capacity is reflected at various levels, such as the lack of accurate data and up-to-date information, inadequate understanding of the various mechanisms used, and absent or ineffective legislative, regulatory and institutional frameworks. For example, very few African countries have transfer pricing units in their government structures, and

the few that do have them suffer from staff shortages. In some countries, an extensive institutional framework had been established to combat various dimensions of IFFs, but the outcome has not been encouraging either due to political interference, poor coordination among agencies and lack of resources.

Most African countries do not have enough highly trained lawyers, accountants and tax experts to carry out the oversight functions to prevent or punish perpetrators of illicit financial outflows. The few that exist are often overworked and unable to prepare sufficiently to take on top-class professionals representing large corporations. We were told of several instances of attempts by such perpetrators to suborn or recruit state officials working on their cases. A similar trend observed in several countries was that state prosecutors tend to lose key cases against powerful interests engaged in IFFs to the extent that they sometimes feel that the judiciary is not supporting their efforts.

*Policy implication:* Illicit financial outflows from Africa can be reduced and stemmed only by enhancing and improving relevant capacities across the board. This requires a dedicated and up-scaled effort to provide resources. It means providing money to create relevant agencies, such as revenue authorities, transfer pricing units, customs services, anti-corruption agencies, financial intelligence units and the like where these do not exist. It also means strengthening existing institutions by giving them the necessary autonomy and tools with which to carry out their duties. It further means recruiting and training top-flight personnel and making efforts to retain them in the public sector. Regional efforts are also needed, including through forums such as the African Tax Administration Forum and related mutual assistance programmes. The support of the global community is also essential to make up for current capacity deficiencies. The idea of Tax Inspectors Without Borders is a good example of how such support could be rendered (box 4.1).

#### Box 4.1 Tax Inspectors Without Borders

The OECD's Tax Inspectors Without Borders is a very good example of how developed countries can help African countries overcome capacity constraints. The way it operates is that tax audit experts are made available to work directly with officials in developing countries to undertake tax audits or learn general audit practices. An anonymized case study of one country provided by the OECD shows a 76 per cent increase in tax revenues in one year (from \$3.3 million to \$5.8 million) following transfer pricing audit assistance provided at a programme cost of \$15,000.

## Finding 12: Incomplete global architecture for tackling illicit financial flows

There is as yet no global architecture for tackling IFFs. There are a number of commendable initiatives and instruments to deal with the commercial, criminal and corrupt activities of IFFs, but they are often disparate and handled in separate processes and forums. There are also different levels of commitment to combating IFFs among countries, regions and groupings, and the use of the existing architecture is challenging even for developed countries. Some notable initiatives and instruments are emerging under the auspices of the United Nations, African Union, G20, OECD, G8, World Bank, IMF and individual countries. However, even taken together these initiatives and instruments do not amount to a coherent and overarching institutional framework to tackle IFFs. These initiatives include:

- The Global Forum for Transparency and Exchange of Information for Tax Purposes (OECD)
- The Multilateral Convention on Mutual Cooperation in Tax Matters (OECD)
- The Extractive Industries Transparency Initiative (EITI)
- Base Erosion and Profit Shifting Project (OECD + G20)
- Sections 1502 and 1504 of the Dodd Frank Act (US)
- The Foreign Account Tax Compliance Act (US)
- Automatic Exchange of Information (OECD, G20, G8)
- Anti-Bribery Convention (OECD)
- Public Registry (UK)
- United Nations Convention Against Corruption (UNCAC)
- The Recommendations of the Financial Action Task Force
- Open Government Partnership
- United Nations Tax Committee

There are fledging attempts in Africa to introduce similar initiatives and instruments. Notable among them is the African Tax Administration Forum, which is working on an Agreement on Mutual Assistance in Tax Matters and a Model Double Taxation Agreement. Also noteworthy is the AUCPCC.

*Policy implication:* The above referenced processes are not universal and at times are undertaken by various countries and groups in their own interest with no obvious interface between them, links between these processes need to be made to optimize their effectiveness in helping stem IFFs from Africa. In some cases, the complexity and cost of complying could pose a problem for African countries. It might also be important to consider how best all these elements could fit into an overarching global framework, perhaps under the auspices of the United Nations.

## Finding 13: Financial secrecy jurisdictions must come under closer scrutiny

Although financial secrecy jurisdictions and tax havens are not strictly the same thing, there are commonalities between them with regard to their allowing harmful tax practices and high levels of opacity in financial transactions, as well as laws enabling banking secrecy and the registration of shell companies. While we found increased political disapproval of these destinations for IFFs across the board, the involvement of overseas territories and subnational jurisdictions of some major economies has watered down the criteria used for including well-known destinations in these categories. The number of countries and jurisdictions in such categories, as determined by the OECD, has fallen over time, but, as pointed out earlier, the volume of IFFs from Africa continues to increase. A related finding is that some developing countries (including some in Africa) continue to be attracted by the perceived benefits of allowing financial secrecy.

*Policy implication:* The main policy implication is that efforts must continue to be made to put political pressure on jurisdictions that enable a high level of financial opacity or that have laws enabling banking secrecy and the registration of shell companies. Countries that desire to be financial services centres would need assistance to ensure that they do not use the tools of tax havens and financial secrecy jurisdictions to facilitate the receipt of IFFs.

## Finding 14: Development partners have an important role in curbing illicit financial flows from Africa

We acknowledge that actions taken by some countries to stem some aspects of IFFs have proved to be very effective. Their political support will continue to be invaluable in curbing such illicit outflows from Africa. This has been demonstrated in several instances. With the passage of the Patriot Act in the United States, shell banks disappeared from the financial landscape. Similarly, the Foreign Account Taxpayer Compliance Act has elicited cooperation with US authorities by tax havens and financial secrecy jurisdictions. The recent case in which the United States was able to freeze assets linked to the late Sani Abacha, former military ruler of Nigeria, across several jurisdictions also speaks to the importance of the role of key players in addressing their responsibilities to stem IFFs. The essential contribution of development partners is also evident from the ongoing work in this area at the global level, particularly under the auspices of the G8, G20 and the OECD (box 4.2).

#### Box 4.2 The important contribution of development partners

One illustration of the impact of political action can be found in the implementation of the US Patriot Act of 2001 which, among others, seeks to improve surveillance of terrorist activities, ease information sharing and combat money laundering. As part of the effects of its implementation, for the first time, United States banks and securities firms were barred from opening accounts for non-US shell banks that had no physical presence anywhere and no affiliation with another bank. The Patriot Act has been instrumental in considerably reducing, if not totally eliminating the activity of shell banks— one important conduit for tax evasion.

*Policy implication:* Development partners need to ensure that Africa's interests are taken into account in ongoing regional and global processes for commercial transparency, including exchange of information and transfer pricing regimes. They should also continue to provide financial and technical assistance for national and regional efforts to tackle criminal activities, especially money laundering and trafficking of people, drugs and arms. Similar support is needed with IFF-related asset recovery.

## Finding 15: Illicit financial flow issues should be incorporated and better coordinated across United Nations processes and frameworks

The Panel is concerned that the issue of IFFs in its entirety is not firmly on the policy agenda of the United Nations system. There are United Nations agencies and bodies working on various dimensions of IFFs, such as the UNODC on corruption, drugs and crime, the United Nations Development Programme on IFFs and fragile states, the United Nations Department of Economic and Social Affairs through its practical guide on transfer pricing, and the United Nations Committee of Experts on International Cooperation on Tax Matters. The United Nations Conference on Trade and Development continues to maintain a scaled-down programme on transnational corporations, while intergovernmental organizations like the World Customs Organization also work on related issues. Various instruments, including the United Nations Convention against Corruption, set the pace for global action in the key area of IFFs.

The Panel is encouraged that ongoing work to frame the Post-2015 Development Agenda is poised to take account of IFFs, which were not mentioned in the Millennium Development Goals. We feel that this positive development should be complemented by a more rigorous effort in support of a unified global architecture on the issue of IFFs. The starting point of this effort should be a clear United Nations Declaration on the issue of IFFs.

*Policy implication:* Africa needs to act in concert with its partners to ensure that the United Nations plays a more coherent and visible role in tackling IFFs. This involves ensuring that efforts to combat IFFs are included in the Post-2015 Development Agenda. Similarly, Africa needs to initiate steps for the United Nations to adopt a unified policy instrument on IFFs in order to place the matter squarely on the agenda of the world organization.



# Chapter

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Recommendations





The recommendations set out here serve as our humble contribution to addressing the complex issue of the illicit outflows of capital from Africa. As we noted in the Foreword, despite the challenges of gathering information about illicit activities, available information shows that our continent is losing in excess of \$50 billion to \$60 billion a year through illicit financial outflows.

Commercial activities are by far the largest contributor to illicit financial flows (IFFs), followed by organized crime, then public sector activities. Corrupt practices play a key role in facilitating these outflows.

The sources of IFFs are from within our continent, and the fundamental responsibility for eliminating the sources rests with the governments of African States. Therefore, the Panel calls for the African Union to take leadership in ensuring that Africa takes the necessary measures to curtail and indeed eliminate all avenues for IFFs.

Although the sources of IFFs are within our Continent, the mechanisms for moving IFFs often involve non-African private and public actors and are sometimes the result of policies and laws adopted by intergovernmental bodies and governments outside our Continent. It is therefore necessary for African governments to engage with these non-African actors to ensure that their practices do not facilitate the illicit outflow of funds from Africa.

The ultimate goal of these recommendations is to eliminate IFFs from Africa. Given that the international community will shortly launch the Post-2015 Development Agenda, the timing of this Report is fortunate. The Post-2015 Development Agenda should reflect the recommendations contained in this Report. Indeed, the Common African Position on the Post-2015 Development Agenda already calls for action against IFFs.

The biggest cross-cutting challenge found through our country case studies is the lack of appropriate capacity to ensure that illicit outflows are curtailed. In many cases, this does not entail acquiring additional resources but better using existing capacities. Take Nigeria, where capacity exists within the Customs Agency, but the authority to monitor some exports has been transferred to another agency.

Given that most measurable IFFs are trade based, actions set forth in the recommendations below for improving capacity and accountability to curtail trade-related IFFs should be given primacy. African States should take primary responsibility for mobilizing resources for tackling trade-related IFFs (and, indeed, other types of IFFs) from Africa.

# A. The commercial component of illicit flows

## 1. Trade mispricing

African countries should ensure that they have clear and concise laws and regulations that make it illegal to intentionally incorrectly or inaccurately state the price, quantity, quality or other aspect of trade in goods and services in order to move capital or profits to another jurisdiction or to manipulate, evade or avoid any form of taxation, including customs and excise duties.

The first step in revenue collection is to ensure that all corporations, big and small, are registered for tax purposes. In addition to existing registration requirements, countries may consider a provision in the respective acts regulating the registration of companies or small businesses to the effect that no registration shall take place without proof of tax registration. In some countries, one cannot open a business bank account without proof of registration for tax. To avoid unnecessary delays in the registration of companies, the relevant agencies must have adequate capacity to process such registrations. We recommend further that the databases of the companies' registration office and the tax authority be linked.

African States' customs authorities should use available databases of information about comparable pricing of world trade in goods to analyse imports and exports and identify transactions that require additional scrutiny. States should also begin collecting trade transaction data and creating databases from that information, which can then be searched and shared with other States so that a more robust dataset of local and regional comparables is available.

## 2. Transfer pricing

The "arm's-length principle" is currently accepted as the international standard to combat transfer pricing, but its effective implementation depends on the availability of comparable pricing data on goods and services. The Panel calls on national and multilateral agencies to make fully and freely available, and in a timely manner, data on pricing of goods and services in international transactions, according to accepted coding categories.

African countries should establish transfer pricing units as a matter of extreme urgency. These units should be appropriately situated in revenue authorities and should be well equipped in accordance with global best practices. Establishing transfer pricing units may entail the training of a selection of existing revenue officers in this specialized area. We have been informed that those African countries that have established transfer pricing units have been and are willing to continue training other countries' officials. In this case, a small investment in training can have a major positive impact on revenue collection.

African States should require multinational corporations operating in their countries to provide the transfer pricing units with a comprehensive report showing their disaggregated financial reporting on a country-by-country or subsidiary-by-subsidiary basis. African governments could also consider developing a format for this reporting that would be acceptable to multiple African revenue authorities.

### 3. Base erosion and profit shifting

The practice by which multinational corporations shift profits to subsidiaries in low-tax or secrecy jurisdictions is one of the biggest single sources of illicit outflows. In many cases, those subsidiaries exist on paper only, mostly with one or two employees, while the bulk of the activities of the company occur in another country. While we recommend that African countries support the OECD-led response to this problem, which focuses on improving access to the information of these multinational corporations, we know that the challenge is a bit more complex for African countries.

We also recommend that there should be an automatic exchange of tax information among African countries. Africa must strongly call for an automatic exchange of tax information globally, subject to national capacity and to maintaining the confidentiality of price-sensitive business information.

### 4. Related recommendations

Transparency of ownership and control of companies, partnerships, trusts and other legal entities that can hold assets and open bank accounts is critical to the ability to determine where illicit funds are moving and who is moving them. African countries should require that beneficial ownership information is provided when companies are incorporated or trusts registered; such information is updated regularly; and such information is placed on the public record. Beneficial ownership declarations should also be required of all parties entering into government contracts. False declarations should result in robust penalties.

Double taxation agreements can contain provisions that are harmful to domestic resource mobilization and can be used to facilitate illicit financial outflows. We recommend that African countries review their current and prospective double taxation conventions, particularly those in place with jurisdictions that are significant destinations of IFFs, to ensure that they do not provide opportunities for abuse. The use of the Model Double Taxation Agreement developed by the African Tax Administration Forum is recommended for consideration.

Regional integration arrangements should be used to introduce accepted standards for tax incentives to prevent harmful competition in the effort to attract foreign direct investment.

African countries are encouraged to join the African Tax Administration Forum and to provide it with the necessary support, including giving it political

standing in African regional processes such as the AU/ECA Conference of Ministers of Finance.

The extractive sector is a primary source of IFFs in Africa, but it is not the only source of IFFs. African countries and companies operating in extractive industries in Africa should join voluntary initiatives like the Extractive Industries Transparency Initiative. Africa should also push for mandatory country-by-country and project-by-project reporting requirements immediately in the extractive sectors and in the near term across all sectors.

## 5. Institutional support for these measures

African States should establish or strengthen the independent institutions and agencies of government responsible for preventing IFFs. These include (but are not limited to) financial intelligence units, anti-fraud agencies, customs and border agencies, revenue agencies, anti-corruption agencies and financial crime agencies. All such agencies should render regular reports on their activities and findings to national legislatures.

African States should create methods and mechanisms for information sharing and coordination among the various institutions and agencies of government responsible for preventing IFFs, with such coordination being led by the country's financial intelligence unit.

Banks and financial institutions have a major role in preventing and eliminating IFFs. Robust regimes should be put in place for the supervision of banks and nonbank financial institutions by central banks and financial supervision agencies. Such regimes must require mandatory reporting of transactions that may be tainted with illicit activity.

## B. The criminal component of illicit flows

Poaching; drugs, arms and human trafficking; oil and mineral theft; and other forms of crime that generate money contribute to IFFs, sometimes employing the same commercial mechanisms used to evade taxes and customs duties to move the proceeds of these crimes out of African countries. African governments should ensure that those investigators responsible for identifying the criminals engaged in these activities are also required, trained and empowered to investigate the financial aspects of these cases, prosecuting those who facilitate the movement and laundering of the proceeds of these crimes as well.

Each African country's financial intelligence unit should share information with other African financial intelligence units about cases of people and companies being prosecuted for facilitating the movement and laundering of the proceeds of these crimes so that cross-border illicit activities and patterns can be identified.

We recognize the excellent reports that the United Nations Office on Drugs and Crime (UNODC) has produced on transnational organized crime in Eastern and Western Africa. We request that the UNODC extend this work to cover the whole of Africa. The work should include estimates of the financial magnitude of various types of criminal activity affecting the continent.

## C. The corrupt component of illicit flows

IFFs should be integrated as a specific component in the African Union Convention on Preventing and Combating Corruption. This will immediately bring IFFs into the Strategy of the Advisory Board of the Convention. The association of civil society and media, as required of governments under Article 12 of the Convention, will become accepted standard practice.

To eliminate the opportunity for IFFs from national and local government treasuries, African States should ensure that the public can access national and subnational budget information, and that processes and procedures for budget development and auditing are open and transparent to the public.

Non-transparent government procurement and supply chains can provide opportunities for corruption-related IFFs. African governments should adopt best practices in open contracting to reduce IFFs through government procurement processes.

Global standards in anti-corruption and anti-money laundering require financial institutions to subject accounts held by certain persons to greater scrutiny and monitoring, including senior government officials, leaders of political parties, executives at state-owned enterprises and others with access to large amounts of state assets and the power to direct them (often called politically exposed persons, or PEPs). African governments can greatly help financial institutions in this task by publishing lists of 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.

African governments can require foreign financial institutions to provide details of accounts held by their listed PEPs, preferably as part of the new system of automatic exchange of financial information being created under the auspices of the OECD.

## D. Additional strategic measures by African States

African countries should adopt a normative instrument in the form of a declaration to commit to combatting IFFs and urging similar actions at the global level.

Given the vital and positive role of civil society organizations (media, non-governmental organizations, academia and think tanks) in efforts to curb IFFs, it is essential that they should be given the operating space and legal freedoms required for advocacy, activism and research in this area. The Panel also recognizes the importance of African governments continuing to engage such global campaigns against IFFs.

Article 22 of the African Union Convention on Preventing and Combating Corruption regarding the functions of the AU Advisory Board on corruption should be extended along the following lines: "Develop methodologies for analysing the nature and extent of illicit financial flows from Africa, and disseminate information and sensitize the public on the negative effects of illicit financial flows from Africa."

The African Peer Review Mechanism, which is a unique governance instrument, should incorporate issues of IFFs in its questionnaires for the country review process.

A 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, bearing in mind current international standards and pragmatic opportunities for the improvement of these standards.

The ECA should be mandated to undertake research on the cost-benefit analysis of tax incentives to help guide African countries in drawing up such frameworks intended to attract foreign direct investment.

The ECA should also 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. This document would also serve as an educational tool in addition to serving other measures.

African countries must become involved with the work of the OECD on base erosion and profit shifting to ensure that global rules being discussed and agreed on do not result in increased IFFs from Africa. African countries should consider coordinating efforts and presenting regional or larger unified positions in response to OECD consultations and meetings. Where measures are adopted by the OECD that African countries determine will hurt their countries or the continent as a whole, African governments should recommend and publish measures that all African countries can take to counter profit-shifting practices detrimental to African countries.

Initiatives to improve financial transparency, while welcome, may involve complicated requirements or have the potential for adverse economic consequences. The ECA should accordingly be mandated to assess the impact of such initiatives on African economies. In this regard, it should assess the impact of the relevant provisions in the Dodd-Frank Act and comparable legislation elsewhere on Africa and make appropriate recommendations.

## E. Further responsibilities of Africa's partners

The Panel recommends that the Bank for International Settlements publish the data it holds on international banking assets by country of origin and destination in a matrix format, along the lines of the data published by the IMF for bilateral trade; foreign direct investment and portfolio investment, so that it can inform the analysis of IFFs from Africa.

The Panel asks that the global community in all of its institutions, including parliaments, take all necessary steps to eliminate secrecy jurisdictions, introduce transparency in financial transfers and crack down on money laundering. The AU, G20, IMF and OECD should provide required leadership in these efforts.

The Panel calls for 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, with banks being required to ascertain the identity, source of wealth and country of origin of their depositors and their deposits.

The Panel calls for partner countries to require publicly available disaggregated, country-by-country reporting of financial information for multinational companies incorporated, organized or regulated in their jurisdictions.

Transparency of ownership and control of companies, partnerships, trusts and other legal entities that can hold assets and open bank accounts is critical to determining where illicit funds are moving and who is moving them. All countries should require beneficial ownership information to be provided when they incorporate companies, for that information to be updated regularly, and for that information to be available on the public record. Beneficial ownership declarations should also be required for all government contracts with third parties. False declarations should result in robust financial penalties.

The African Union should engage with partner institutions to elaborate a global governance framework that will determine the conditions under which assets are frozen, managed and repatriated. The framework should include the creation of escrow accounts managed by regional development banks that will serve as custodians of the assets determined to be of illicit origin.

Existing laws which have proven successful in combatting IFFs should be replicated as global best practices and standards. The use of The Lacey Act in the United States which was used to repatriate illegal fishing proceeds to the Republic of South Africa (RSA) is one such example. Similarly, the South African tax laws that enabled the country to reclaim \$2 billion of unpaid taxes is another case in point.

The IMF, United Nations and World Bank should play a more coherent and visible role in tackling IFFs. African countries should accordingly initiate steps for adopting a unified policy instrument to curb IFFs in order to place the matter squarely on the global agenda and bring coherence to all ongoing efforts in this regard.

If Africa is to effectively curtail IFFs, the measures outlined above must be put into effect on the ground. National, regional and global actors need to actively engage with the process of stemming IFFs.

We are absolutely certain that with the necessary institutions, many of which are in place; and which are staffed by officials with the requisite skills (which some African countries are prepared to help transfer); and with transparent systems across the board, Africa can reverse illicit financial outflows. At the very least, as a result of our collective action, approximately \$50 billion a year will become available to finance Africa's identified developmental needs.

We recommend this report to you, our African leaders, the people of Africa, and to the peoples of the rest of the world.



# Annex I:

## Resolution establishing the High Level Panel on Illicit Financial Flows

### Resolution 896 (XLIV)

#### Illicit Financial Flows from Africa

#### The Conference of Ministers,

Recalling resolution 886 (XLIV) on illicit financial flows adopted at the Fourth Joint Annual Meetings of the African Union Conference of Ministers of Economy and Finance and the Economic Commission for Africa Conference of Ministers of Finance, Planning and Economic Development, providing for action to be taken to address the problem of such flows,

1. Commends the establishment and inauguration of a High-Level Panel on Illicit Financial Flows from Africa headed by Mr Thabo Mbeki, former President of South Africa, assisted by nine other members;
2. Reiterates that illicit financial flows constitute a major development challenge for Africa, draining the continent of needed financial resources, causing economic distortions and perpetuating poverty;
3. Calls on the Economic Commission for Africa to provide the necessary technical backstopping for the Panel;
4. Invites the Panel to work actively in addressing the problem and report to the next Conference of Ministers; and
5. Urges the different stakeholders including governments, civil society organizations, the private sector and regional and international organizations to fully support the work of the Panel.

# Annex II:

## Typology of commercially driven illicit financial flows and their immediate impacts

| Flow                     | Manipulation  | Illicit Motivation   | IFF Type   |
|--------------------------|---------------|--|--|
| <b>Exports</b>           | Overpricing   | <ul style="list-style-type: none"> <li>Exploit subsidy regime</li> <li>(Re)patriate undeclared capital</li> </ul>  | <ul style="list-style-type: none"> <li>Tax abuse</li> <li>Market/regulatory abuse</li> </ul>                                       |
|                          | Under-pricing | <ul style="list-style-type: none"> <li>Shift undeclared (licit) income/profit</li> <li>Shift criminal proceeds out</li> <li>Evade capital controls (including on profit repatriation)</li> </ul> | <ul style="list-style-type: none"> <li>Tax abuse</li> <li>Laundering proceeds of crime</li> <li>Market/regulatory abuse</li> </ul> |
| <b>Imports</b>           | Overpricing   | <ul style="list-style-type: none"> <li>Shift undeclared (licit) income/profit</li> <li>Shift criminal proceeds out</li> <li>Evade capital controls (including on profit repatriation)</li> </ul> | <ul style="list-style-type: none"> <li>Tax abuse</li> <li>Laundering proceeds of crime</li> <li>Market/regulatory abuse</li> </ul> |
|                          | Under-pricing | <ul style="list-style-type: none"> <li>Evade tariffs</li> <li>(Re)patriate undeclared capital</li> </ul>   | <ul style="list-style-type: none"> <li>Tax abuse</li> <li>Market/regulatory abuse</li> </ul>                                       |
| <b>Inward Investment</b> | Overpricing   | <ul style="list-style-type: none"> <li>(Re)patriate undeclared capital</li> </ul>  | <ul style="list-style-type: none"> <li>Market/regulatory abuse</li> </ul>  |
|                          | Under-pricing | <ul style="list-style-type: none"> <li>Shift undeclared (licit) income/profit</li> <li>Shift criminal proceeds out</li> <li>Evade capital controls (including on profit repatriation)</li> </ul> | <ul style="list-style-type: none"> <li>Tax abuse</li> <li>Laundering proceeds of crime</li> <li>Market/regulatory abuse</li> </ul> |
|                          | Anonymity     | <ul style="list-style-type: none"> <li>Hide market dominance</li> <li>Hide political involvement</li> </ul>  | <ul style="list-style-type: none"> <li>Market/regulatory abuse</li> <li>Abuse of power</li> </ul>                                  |

| Flow                               | Manipulation   | Illicit Motivation  | IFF Type  |
|------------------------------------|--|---|---|
| <b>Outward Investment</b>          | Overpricing  | <ul style="list-style-type: none"> <li>• Shift undeclared (licit) income/profit</li> <li>• Shift criminal proceeds out</li> </ul> | <ul style="list-style-type: none"> <li>• Tax abuse</li> <li>• Laundering proceeds of crime</li> </ul> |
|                                    | Under-pricing  | <ul style="list-style-type: none"> <li>• Evade capital controls (including on profit repatriation)</li> </ul>                     | <ul style="list-style-type: none"> <li>• Market/regulatory abuse</li> </ul>                           |
|                                    | Anonymity  | <ul style="list-style-type: none"> <li>• Hide political involvement</li> </ul>  | <ul style="list-style-type: none"> <li>• Abuse of power</li> </ul>                                    |
| <b>Public Lending</b>              | (If no expectation of repayment, or if under-priced) | <ul style="list-style-type: none"> <li>• Public asset theft (illegitimate allocation of state funds)</li> </ul>                   | <ul style="list-style-type: none"> <li>• Abuse of power</li> </ul>                                    |
| <b>Public Borrowing</b>            | (If state illegitimate, or if overpriced)            | <ul style="list-style-type: none"> <li>• Public asset theft (illegitimate creation of state liabilities)</li> </ul>               | <ul style="list-style-type: none"> <li>• Abuse of power</li> </ul>                                    |
| <b>Related Party Lending</b>       | Under-priced   | <ul style="list-style-type: none"> <li>• Shift undeclared (licit) income/profit</li> </ul>  | <ul style="list-style-type: none"> <li>• Tax abuse</li> </ul>   |
| <b>Related Party Borrowing</b>     | Overpriced   | <ul style="list-style-type: none"> <li>• Shift undeclared (licit) income/profit</li> </ul>  | <ul style="list-style-type: none"> <li>• Tax abuse</li> </ul>   |
|                                    | Under-pricing  | <ul style="list-style-type: none"> <li>• Public asset theft</li> </ul>  | <ul style="list-style-type: none"> <li>• Abuse of power</li> </ul>                                    |
| <b>Public Asset Sales</b>          | Anonymity  | <ul style="list-style-type: none"> <li>• Hide market dominance</li> </ul>   | <ul style="list-style-type: none"> <li>• Market/regulatory abuse</li> </ul>                           |
|                                    | Anonymity  | <ul style="list-style-type: none"> <li>• Hide political involvement</li> </ul>  | <ul style="list-style-type: none"> <li>• Abuse of power</li> </ul>                                    |
| <b>Public Contracts</b>            | Overpricing  | <ul style="list-style-type: none"> <li>• Public asset theft</li> </ul>  | <ul style="list-style-type: none"> <li>• Abuse of power</li> </ul>                                    |
|                                    | Under-pricing  | <ul style="list-style-type: none"> <li>• Hide market dominance</li> </ul>   | <ul style="list-style-type: none"> <li>• Market/regulatory abuse</li> </ul>                           |
|                                    | Anonymity  | <ul style="list-style-type: none"> <li>• Hide political involvement</li> </ul>  | <ul style="list-style-type: none"> <li>• Abuse of power</li> </ul>                                    |
| <b>Offshore Ownership Transfer</b> | Anonymity  | <ul style="list-style-type: none"> <li>• Corrupt payments</li> </ul>  | <ul style="list-style-type: none"> <li>• Abuse of power</li> </ul>                                    |

Source: Developed by Alex Cobham and Alice Lépissier, Center for Global Development.

# Annex III:

## ECA analysis on quantifying illicit financial flows: Methodology and data

Several attempts have been made to quantify the illicit financial flows (IFFs) that leave African countries and others. These include Kar and Cartwright-Smith (2008, 2010); Kar and Freitas (2011) and Ndikumana and Boyce (2011). However, no analysis has been conducted that disaggregates IFFs from Africa by subsector and by destination country. UNECA has therefore conducted such an analysis, and the results are reviewed in the discussion below.

### Overview of the main methods of estimating illicit financial flows

In terms of the methodologies used to estimate IFFs, several empirical models have been used to estimate both the magnitude of IFFs and their economic implications for developing countries, including those in Africa. These models and the analytic methods underlying them deserve further scrutiny. In particular, four methods have dominated the empirical literature: the Hot Money Method, the Dooley Method, the World Bank Residual Method and the International Monetary Fund (IMF) Direction of Trade Statistics (DOTS)-based Trade Mispricing Method. The latter two remain the most widely used.

The Hot Money Method records IFFs through net errors and omissions in payment balances. The Dooley Method relies on the privately held foreign assets reported in the balance of payments that do not generate investment income. The World Bank Residual Method estimates IFFs as the difference between the source of funds (external debt and foreign direct investment) and the use of funds (current account deficit and reserves). The Trade Mispricing Model assesses IFFs by looking for disparities arising from overinvoicing of imports and underinvoicing of exports after adjusting for ordinary price differences. In this model, imports are generally recorded after adjusting for the cost of insurance and freight, while exports are usually valued free-on-board (Kar and Cartwright-Smith, 2008).

To provide the most thorough estimates of IFFs, Global Financial Integrity has combined the World Bank Residual Method and the Trade Mispricing Model in its computations (Kar and Cartwright-Smith, 2008, 2010; Kar and Freitas, 2011). Ndikumana and Boyce (2008, 2011) have adopted a similar methodology.

In terms of the final estimates of IFF globally, the latest estimates indicate an average annual loss of more than \$1 trillion for 2007–2009, with Africa's share being nearly 6 per cent (Kar and Freitas, 2011). Note, however, that these estimates are conservative given the inadequacy of the data and the diverse channels through which illicit capital flows.

Estimates of IFFs can differ considerably because of the use of different methods, assumptions and data, even when using the same basic methodology. For example, the latest report by Global Financial Integrity on IFFs from developing countries estimates that IFFs at the regional and national levels could differ from those published in its 2010 report due to revisions of the underlying data supplied by member countries (Kar and Freitas, 2011). In 2006, annual losses from developing countries were estimated to be between \$443.4 billion (World Bank Residual Method) and \$1.1 trillion (Dooley Method; Kar and Cartwright-Smith, 2008).

Despite these significant variations, noteworthy convergences exist for Africa:

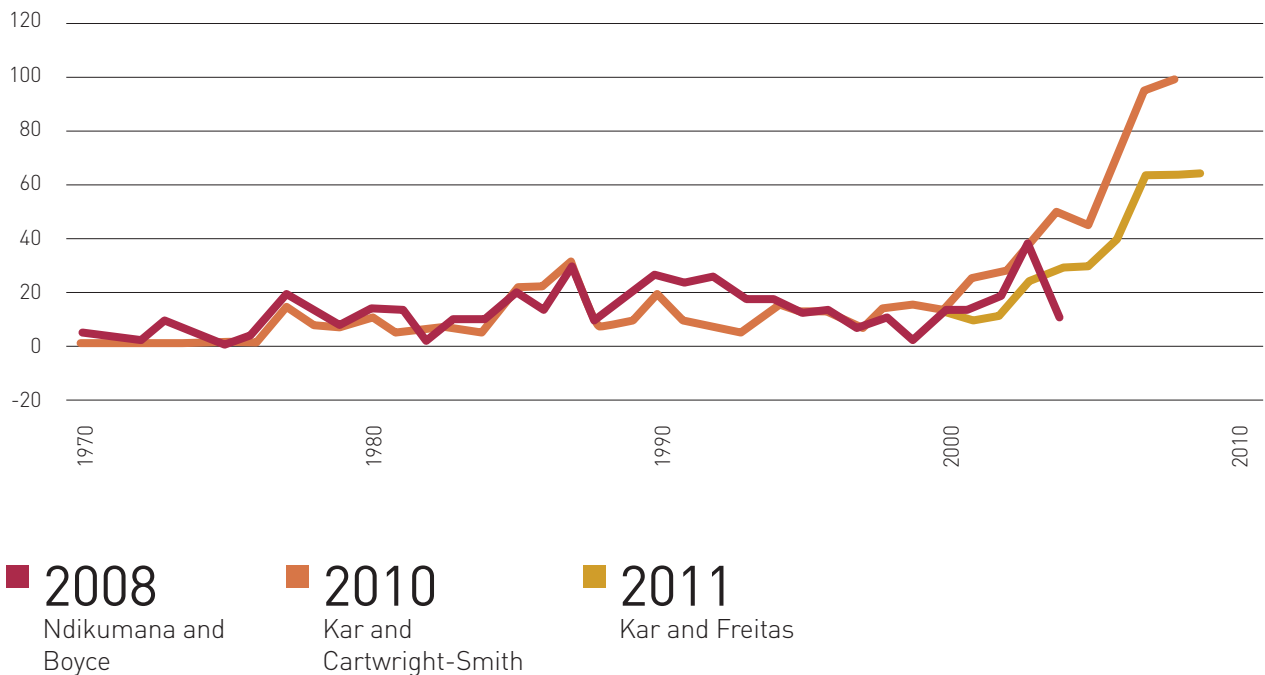
- IFFs are high;
- IFFs from the continent have been increasing over time; And
- Oil-exporting countries tend to top the list of African net creditors to the world.

Ndikumana and Boyce (2008, 2011), Kar and Cartwright-Smith (2010) and Kar and Freitas (2011) confirm these findings. Although these studies adopt similar approaches for combining residual (accounting for balance of payments and external debt) and trade mispricing methods, they differ in their data sources and assumptions.

According to Kar and Cartwright-Smith (2010), Africa lost about \$854 billion in IFFs over 1970–2008, a yearly average of about \$22 billion (figure AIII.1). This cumulative amount is considerable compared with both the external debt of the continent and the official development assistance received over the same period. Indeed, it is equivalent to nearly all the official development assistance received by Africa during that time frame (OECD, 2012). From a different perspective, a sum equal to only a third of the loss associated with IFFs would have been enough to fully cover the continent's external debt, which reached \$279 billion in 2008 (UNECA, 2009).

Figure AIII.1

Illicit financial flows from Africa, 1970–2009 (billions of dollars)



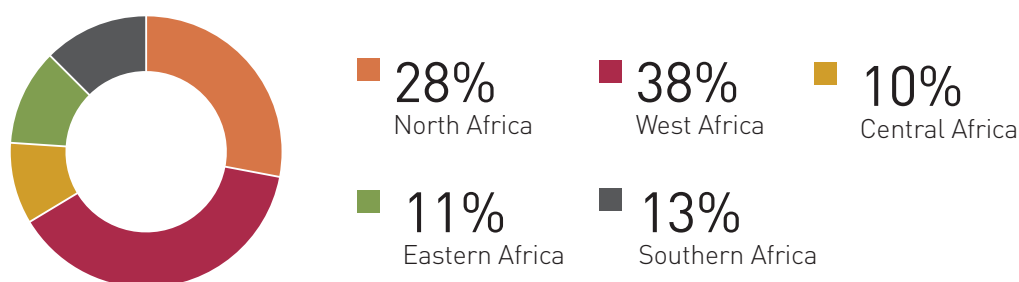
Source: Based on Ndikumana and Boyce (2008), Kar and Cartwright-Smith (2010) and Kar and Freitas (2011).

The trend has been increasing over time and especially in the last decade, with average annual IFFs of \$50 billion over 2000–2008 compared with only \$9 billion for 1970–1999 (Kar and Cartwright-Smith, 2010). The decline in 2009 is a likely result of the recent economic and financial crises, which have depressed overall global trade (Kar and Freitas, 2011).

Cumulative IFFs in Africa for 1970–2008 were unequally distributed. Two-thirds of IFFs were attributed to only two regions: West Africa (38 per cent) and North Africa (28 per cent; figure AIII.2). Each of the other three regions (Southern, Eastern and Central Africa) registered about 10 per cent of Africa’s total IFFs. But the particularly low shares of IFFs from the latter three regions could also be attributed to the lack of data or their poor quality.

Figure AIII.2

Cumulative illicit financial flows from Africa by region, 1970–2008



Source: Authors' calculations based on Kar and Cartwright-Smith (2010).

In addition, the data show the great significance of IFFs from oil-exporting countries dominated by the North African and West African regions. Nigeria accounts for the largest share of IFFs for West Africa (79 per cent of the West African total), whereas Egypt and Algeria account for 66 per cent of the IFFs from North Africa. Non-oil-exporting countries such as South Africa, Morocco, Côte d'Ivoire and Ethiopia also register significant levels of IFFs for 1970–2008. Interestingly, IFFs are extremely concentrated in a few countries: the top 10 for 1970–2008 accounted for 79 per cent of total IFFs from Africa (table AIII.1).

Table A3.1

Top 10 African countries by cumulative illicit financial flows, 1970–2008

| Country            | Cumulative IFFs (1970–2008) US\$ Billion | Share in Africa's Total IFFs |
|--------------------|--|------------------------------|
| Nigeria            | 217.7                                    | 30.5%                        |
| Egypt              | 105.2                                    | 14.7%                        |
| South Africa       | 81.8                                     | 11.4%                        |
| Morocco            | 33.9                                     | 4.7%                         |
| Angola             | 29.5                                     | 4.1%                         |
| Algeria            | 26.1                                     | 3.7%                         |
| Côte d'Ivoire      | 21.6                                     | 3.0%                         |
| Sudan              | 16.6                                     | 2.3%                         |
| Ethiopia           | 16.5                                     | 2.3%                         |
| Congo, Republic of | 16.2                                     | 2.3%                         |

Source: Based on Kar and Cartwright-Smith (2010).

The literature emphasizes that IFFs considerably limit the resources available for development of the African economies, impeding poverty reduction. But even if the observations at the country level tend to indicate higher IFFs for oil-exporting countries, a thorough analysis at the sector level that incorporates the destination of IFFs from Africa is critical to help identify specific niches. No such disaggregated analysis has been conducted, so UNECA has developed a methodology based on trade mispricing. This approach is critical to inform policymakers about the urgent need to tackle IFFs.

## ECA Methodology

This section briefly overviews the ECA methodology for assessing IFFs at the country and sector levels through trade mispricing using misinvoicing.

Assessing IFFs at the sector level by considering their bilateral dimension requires a significant amount of data. For this reason, the analysis focuses only on the trade mispricing aspect of commercial transactions by multinational corporations. According to Raymond Baker, “trade mispricing accounts for up to 55% of total illicit capital outflows from developing countries.” In other words, the bulk of illicit flows from developing countries are due to trade mispricing by multinational corporations (see figure AIII.2).

The methodology here is similar to that in the Trade Mispricing Model in that estimates are made using data for misinvoicing. Similar to the Trade Mispricing Model, the ECA methodology uses bilateral data for the same trade flow, comparing country I’s exports of product a to country J, with country J’s imports of product a from country I. This two-way information is usually mismatched for several reasons:

- Exports are generally expressed free-on-board (FOB), while imports are normally reported as including the cost of insurance and freight (CIF);
- Each country does not necessarily use the same nomenclature for a given product;
- Mistakes in reporting the value of the flows are possible;
- Delays often occur in the export/import process; and
- IFFs can be a source of discrepancies.

The ECA analysis takes the discrepancy between the data reported on the imports and on the exports of the same flow and subtracts the differences between CIF and FOB values and the ad valorem equivalent of the delays in the export/import process. The remainder is used as the estimate of the IFFs associated with that trade flow. This remainder could also, in part, be due to mistakes in reporting or discrepancies in nomenclature used by importing and exporting countries. However, assuming that these errors are evenly distributed on either side (that is, they artificially reduce discrepancies just as often and just as much as artificially adding to them), the errors on either side should roughly cancel each other out in the overall estimates of IFF and the overall estimates should be accurate.



In addition, the ECA approach “nets off” the IFF estimates—that is, its IFF estimates are the difference between the trade mispricing IFF flows in the two directions for a given pair of countries for a given product. The net method is not universally favoured because it may improperly capture reversals in countries subject to political and economic instabilities. But there are reasons for supporting its use. We do not observe any significant illicit financial inflows for African countries based on the ECA model’s computations. Moreover, at the global or national level, differences between estimates using either a net or a gross approach are generally limited. In addition, when it comes to finer-grained analysis of IFFs, the gross method is likely to create inconsistencies with analysis at the global level. If a gross approach is used, then “negative IFFs” for a particular country will be set to zero, which will create inconsistencies with global totals when IFFs are aggregated up.

Further details of the methodology are as follows. To calculate the cost of insurance and freight, the ECA model uses the BACI database, which provides reconciled bilateral trade flows using Comtrade data at the HS6 level of product disaggregation. An econometric model estimating transport costs is used to assess CIF values and mirror flows at FOB prices. The econometric analysis allows for offsetting other discrepancies, such as potential data mistakes and nomenclature differences. See Gaulier and Zignago (2010) for more details. This contrasts with the Trade Mispricing Model, which uses a fixed CIF/FOB ratio of 1.1 for assessing the value of CIF.

To estimate the ad valorem equivalent of time lags in the export/import process, the present paper accounts for ad valorem equivalents of the time to trade across borders. This contrasts with the Trade Mispricing Model, which does not correct for such factors for identifying misinvoicing.

The ECA uses data from UN Comtrade. This allows for analysis at the product level, with data available for several nomenclatures, including the Harmonized System at the six-digit level (HS6), which provides bilateral trade data for more than 5,000 products (the Trade Mispricing Model instead uses data from IMF Trade Statistics, which does not allow this).

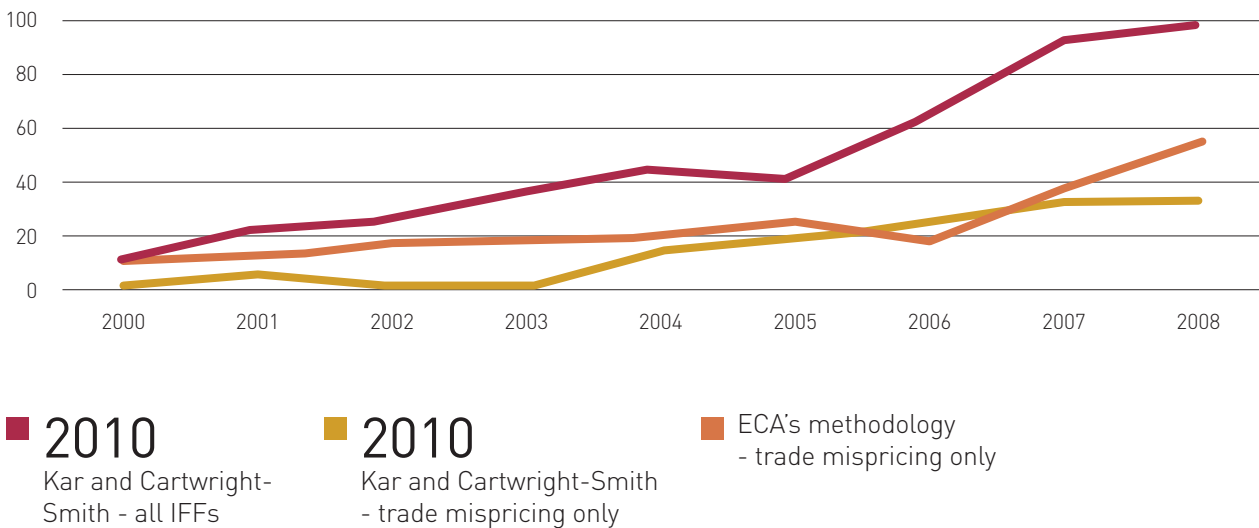
It is worth noting that this methodology has limitations in addition to those associated with the assumptions listed above. Although some argue for assessing IFFs through trade mispricing as determined by misinvoicing because they see international trade as a predictable channel for IFFs, others argue that misinvoicing is mainly a response to high trade taxes. In addition, many trade transactions are not recorded, especially in Africa, and so they cannot be captured through misinvoicing. Also note that the methodology only captures IFFs in goods, not in services, because such detailed data are not available for African countries. At the country level, Kar and Cartwright-Smith (2010) attempt to include services in their estimates of IFFs by using a proxy for services-related IFFs derived from the ratio of world trade in services to world trade in goods, but this is a highly questionable approach. Furthermore, and despite meaningful outcomes from very detailed levels of aggregation for countries and products, a downside is that data inconsistencies negatively affect country results more than global results. This drawback is relatively controlled in our estimates due to use of the BACI database. Even if trade mispricing accounts for more than half of IFFs, it cannot explain all the IFF pathways. Other pathways are hard to quantify, and as a consequence it is difficult to precisely determine the magnitude of IFFs.

## Results

The ECA estimates are in the same range as the Trade Mispricing Model's for the ratio of trade mispricing to total IFFs, which represent up to 55 per cent of total IFFs from developing countries (Baker, 2005). Figure AIII.3 also shows estimates from Kar and Cartwright-Smith (2010) for total IFFs over 2000–2008. It is possible to use the analysis in Kar and Cartwright-Smith (2010) as a comparator for the ECA results, since they isolate trade mispricing from the rest of IFFs in their estimates. Even if not strictly comparable, the trends are relatively similar. For 2000–2008, Kar and Cartwright-Smith (2010) estimate cumulative IFFs from Africa due to trade mispricing at \$162 billion, whereas comparable estimates from ECA are higher, at \$242 billion. Kar and Cartwright-Smith assess total cumulative IFFs in Africa at \$448.4 billion. The ECA estimates for cumulative IFFs through trade mispricing represent 54.1 per cent of this total, while Kar and Cartwright-Smith's computations for trade mispricing would correspond to 36.2 per cent. Finally, even though Baker's approximation of the share of IFFs through trade mispricing in total IFFs is for developing countries in general and not specifically Africa, Global Financial Integrity states that "illicit outflows through trade mispricing from Africa grew faster, with a real growth rate of 32.5% between 2000 and 2009, clearly outpacing such outflows from developing Europe (9.7%), Asia (7.7%), and other regions" (Kar and Freitas, 2011: 10).

Table AIII.1

Evolution of illicit financial flows from Africa, 2000–2008 (billions of dollars)

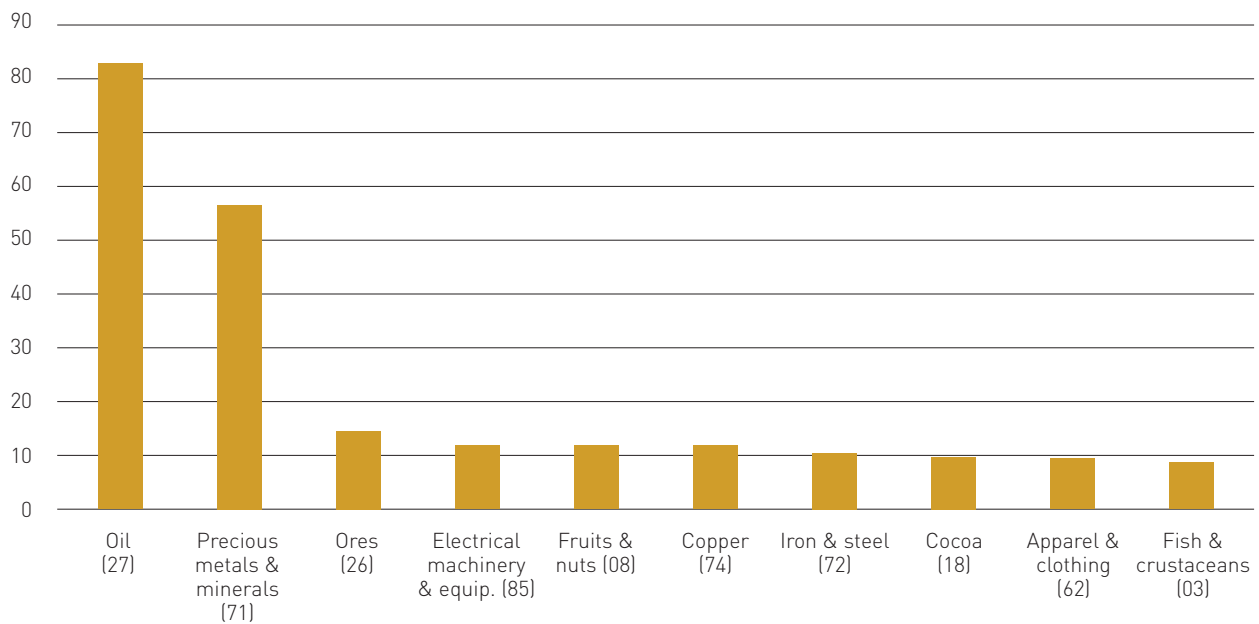


Source: Based on Ndikumana and Boyce (2008), Kar and Cartwright-Smith (2010), Kar and Freitas (2011) and the ECA methodology.

Figure AIII.4 provides the 10 sectors used in the sector-level analysis, defined for the Harmonized System at the two-digit level (HS2), for which cumulative IFFs from Africa have been the highest for 2000–2010. IFFs from the continent are highest in the extractive industries, including mining. More than half (56.2 per cent) of the IFFs from the African continent over the period come from oil, precious metals and minerals, ores, iron and steel, and copper. Moreover, these are highly concentrated in very few countries. Nearly three-fourths of the total IFFs in oil from Africa during 2000–2010 are from Nigeria (34.5 per cent), Algeria (20.1 per cent) and Sudan (12.0 per cent; ECA 2012). In precious metals and minerals, iron and steel, and ores, the greatest shares in total IFFs from Africa are from the Southern African Customs Union (SACU), with 97.6 per cent, 59.7 per cent and 51.8 per cent, respectively. Zambia accounts for 65 per cent of the continent's IFFs in copper.

**Table AIII.4**

Top 10 sectors by cumulative illicit financial flows for Africa, 2000–2010 (billions of dollars, trade mispricing only)



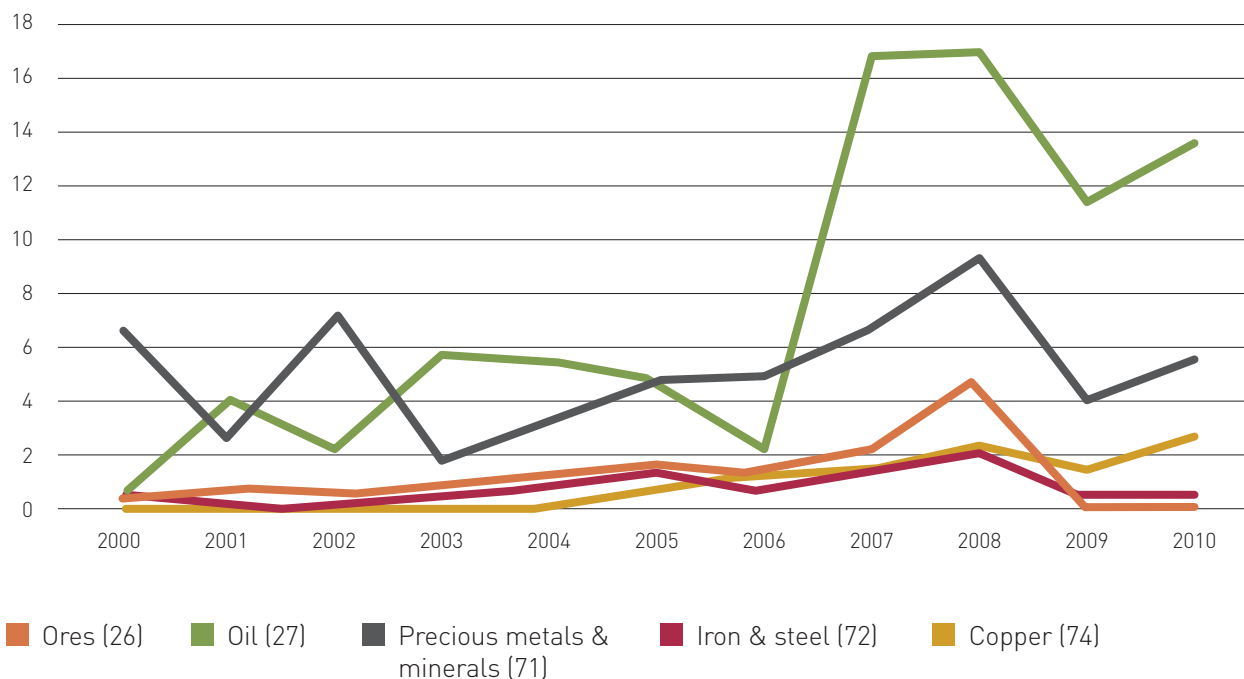
Note: Top 10 sectors are by HS2 classification. See annex IV for full details about HS2 codes and definitions.

Source: ECA calculations.

The trend of IFFs in the extractive industries, including mining, has been growing exponentially, peaking in 2008, especially for oil, when world prices were highest (figure AIII.5). But 2009 was marked by a reduction in illicit flows compared with 2008, mainly due to the financial and economic crisis. Demand for these products declined, as did world prices. IFFs gradually picked up again in 2010, with notable increases in the oil, precious metals and minerals, copper and cocoa sectors.

Table All.5

Evolution of illicit financial flows from Africa in some extractive sectors, 2000–2010 (billions of dollars, trade mispricing only)



Note: Sectors are listed by HS2 classification.

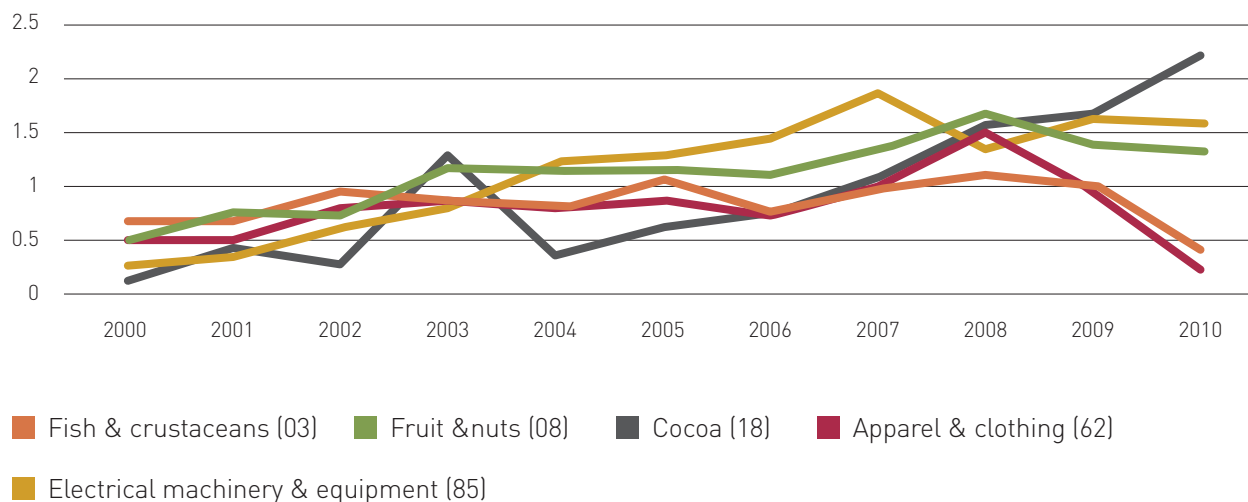
Source: ECA calculations.

Sectors such as edible fruit and nuts, electrical machinery and equipment, fish and crustaceans, apparel and cocoa have also been targets for IFFs over 2000–2010, each accounting for 3–4 per cent of the African total. IFFs between 2000 and 2010 are also concentrated in a few countries. In the cocoa sector, 86.8 per cent of total IFFs are from Côte d'Ivoire (38.1 per cent), Ghana (26.4 per cent) and Nigeria (22.3 per cent). In the electrical machinery and equipment sector, 82.7 per cent of total IFFs are from Morocco (51.8 per cent), Tunisia (19.1 per cent) and the SACU countries (11.8 per cent). The same is true of the edible fruit and nuts sector, with IFFs coming mainly from the SACU countries (46.4 per cent), Cameroon (14.3 per cent) and Côte d'Ivoire (13.9 per cent). In the apparel sector, Tunisia (33.4 per cent) and Morocco (31.4 per cent) register the largest shares of IFFs. IFFs in the fish and crustaceans sector are distributed more evenly across African countries.

As in the extractive and mining sectors, IFFs in edible fruit and nuts, electrical machinery and equipment, fish and crustaceans, apparel and cocoa have greatly increased in the past few years (figure All.6).

**Table AIII.6**

Evolution of cumulative illicit financial flows from Africa in selected non-extractive sectors, 2000–2010 (billions of dollars, trade mispricing only)



Note: Sectors are by HS2 classification.  
Source: ECA calculations.

Further, IFFs tend to be confined to a few sectors within each country, reflecting the volumes of the internationally tradable goods exported by these countries. Of African countries where cumulative IFFs are the highest over 2000–2010, 93.2 per cent of total IFFs occur in the oil sector in Sudan, 92.9 per cent in Nigeria, 74.1 per cent in Algeria and 40.6 per cent in Egypt; 80 per cent of Zambian IFFs are from copper. IFFs in the SACU countries are mainly from precious metals and minerals (51 per cent); cocoa generates most of Côte d'Ivoire IFFs (49.7 per cent).

In Morocco, the concentration is less pronounced, with 29.9 per cent of total IFFs in electrical machinery and equipment, 14.2 per cent in apparel and 10.7 per cent in edible vegetables. However, Moroccan exports are among the most diversified in Africa. Therefore, if African countries' exports were more varied, IFFs would be more distributed across sectors and perhaps of lesser magnitude for the continent as a whole.

Concentration is also high in the destination countries. In 2008, 76.4 per cent of the IFFs in oil from Nigeria benefited only the United States, Spain, France, Japan and Germany (table AIII.2). More generally, the main recipients of IFFs from African countries are developed countries (especially the United States, various European countries, Canada, Japan and the Republic of Korea) and emerging economies (such as China and India), which are also Africa's major trading partners.

**Table AIII.2**

Top five destinations by share of total illicit financial flows for selected African countries and sectors where these flows are particularly large, 2008 (per cent, trade mispricing only)

| Nigeria - Oil<br>(HS2 code 27) |       | Algeria - Oil<br>(HS2 code 27) |       | SACU - Precious<br>metals and minerals<br>(HS2 code 71) |       | Cote d'Ivoire -<br>Cocoa (HS2 code 18) |       | Zambia - Copper<br>(HS2 code 74) |       |
|--------------------------------|-------|--------------------------------|-------|---|-------|--|-------|----------------------------------|-------|
| United States                  | 29.0% | Germany                        | 16.1% | India   | 23.2% | Germany                                | 23.6% | Saudi Arabia                     | 23.4% |
| Spain                          | 22.5% | Turkey                         | 14.6% | United Arab Emirates                                    | 22.7% | Canada                                 | 9.4%  | Korea, Rep                       | 15.7% |
| France                         | 8.7%  | Canada                         | 11.7% | Italy   | 14.2% | United States                          | 9.2%  | China                            | 10.4% |
| Japan                          | 8.5%  | Tunisia                        | 10.2% | United States   | 10.8% | Mexico                                 | 8.5%  | Thailand                         | 5.7%  |
| Germany                        | 7.7%  | United States                  | 6.8%  | Turkey  | 7.2%  | France                                 | 7.4%  | Pakistan                         | 2.6%  |
| Top 5 Total                    | 76.4% | Top 5 Total                    | 59.4% | Top 5 Total   | 78.2% | Top 5 Total                            | 58.1% | Top 5 Total                      | 57.9% |

Note: Sectors are by HS2 classification.

Source: ECA calculations.

## Conclusion

IFFs from Africa measured through trade mispricing show high concentrations in a few countries and a few sectors. African economies specializing in exporting extractive industry products (such as Algeria, Egypt, Nigeria, the SACU, Sudan and Zambia) generally register the highest IFFs. But IFFs from Africa also occur in sectors such as edible fruit and nuts, electrical machinery and equipment, iron and steel, fish and crustaceans, apparel, and cocoa. Within each country, IFFs are derived mainly from one sector. Moreover, IFFs from Africa are high, and the total of IFFs over 1970–2008 is also about three times larger than the continent's current external debt, according to some estimates.

Table AIII.3

Ad valorem equivalents of the time to trade across borders (per cent)

|                          | Exports | Imports |
|--------------------------|---------|---------|
| Algeria                  | 0,9     | 8,6     |
| Angola                   | 0,5     | 20,8    |
| Benin                    | 11,1    | 20,8    |
| Burkina Faso             | 20      | 27,7    |
| Burundi                  | 32,8    | 20,8    |
| Cameroon                 | 4,9     | 12      |
| Cape Verde               | 6,2     | 20,8    |
| Central African Republic | 3,9     | 29,7    |
| Chad                     | 9,3     | 53,3    |
| Comoros                  | 6,2     | 20,8    |
| Congo Dem. Rep.          | 11,1    | 20,8    |
| Congo Rep.               | 1,9     | 16,6    |
| Côte d'Ivoire            | 3,6     | 10,3    |
| Djibouti                 | 31,9    | 20,8    |
| Egypt, Arab Rep.         | 13      | 4,5     |
| Equatorial Guinea        | 0,6     | 28,6    |
| Eritrea                  | 20,6    | 15,6    |
| Ethiopia                 | 21,3    | 27,1    |
| Gabon                    | 0,4     | 13,9    |
| Gambia, The              | 6,4     | 20,8    |
| Ghana                    | 27,2    | 23,9    |
| Guinea                   | 19,3    | 20,8    |
| Guinea-Bissau            | 0,5     | 11,4    |
| Kenya                    | 10,6    | 19,2    |
| Liberia                  | 11,1    | 20,8    |
| Libya                    | 11,1    | 20,8    |
| Madagascar               | 10      | 7,1     |
| Malawi                   | 3,7     | 30,5    |
| Mali                     | 14,1    | 32      |
| Mauritania               | 2,6     | 12,3    |

|                       | Exports | Imports |
|-----------------------|---------|---------|
| Mauritius             | 3,5     | 3,8     |
| Morocco               | 6,8     | 15,3    |
| Mozambique            | 0,9     | 7       |
| Niger                 | 11,1    | 39,4    |
| Nigeria               | 0,2     | 22,8    |
| Rwanda                | 6,1     | 52      |
| Sao Tome and Principe | 1,4     | 20,8    |
| Senegal               | 6,7     | 11,3    |
| Seychelles            | 6,8     | 10      |
| Sierra Leone          | 14,1    | 20,8    |
| Somalia               | 11,1    | 20,8    |
| SACU                  | 17,6    | 13,4    |
| Sudan                 | 32,2    | 36,9    |
| Tanzania              | 24      | 11      |
| Togo                  | 4,4     | 12      |
| Tunisia               | 4,8     | 8,2     |
| Uganda                | 33,6    | 50,5    |
| Zambia                | 14,1    | 26,2    |
| Zimbabwe              | 26,4    | 23,4    |

Source: Based on Hummels and others (2007).



Table AIII.4

Illicit financial flows from Africa by sector, 2000–2010 (billions of dollars, trade mispricing only)

| Year HS2 code | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | Cumulative total | Yearly average |
|---------------|------|------|------|------|------|------|------|------|------|------|------|------------------|----------------|
| 01            | 0    | 0    | 0    | 0    | -0,1 | -0,1 | -0,1 | -0,1 | -0,1 | 0    | -0,1 | -0,6             | -0,1           |
| 02            | 0    | 0    | 0    | 0    | 0    | 0    | -0,1 | -0,1 | -0,1 | 0    | -0,2 | -0,4             | 0              |
| 03            | 0,7  | 0,7  | 0,9  | 0,8  | 0,8  | 1,1  | 0,8  | 0,9  | 1,1  | 1    | 0,4  | 9,3              | 0,8            |
| 04            | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0,1  | 0    | 0    | 0,2              | 0              |
| 05            | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0,1              | 0              |
| 06            | 0,1  | 0,1  | 0,1  | 0,1  | 0,1  | 0,1  | -0,3 | 0,1  | 0    | 0,1  | 0,2  | 0,7              | 0,1            |
| 07            | 0,1  | 0,1  | 0,2  | 0,2  | 0,3  | 0,4  | 0,2  | 0,7  | 0,7  | 0,5  | 0,5  | 3,8              | 0,3            |
| 08            | 0,5  | 0,8  | 0,8  | 1,2  | 1,1  | 1,1  | 1,1  | 1,4  | 1,6  | 1,4  | 1,3  | 12,2             | 1,1            |
| 09            | 0,2  | 0,2  | 0,2  | 0,2  | 0,3  | 0,4  | 0,3  | 0,2  | 0,3  | 0,2  | 0,3  | 2,7              | 0,2            |
| 10            | 0    | 0    | 0    | 0    | 0    | -0,1 | 0,1  | 0,1  | -0,1 | 0,1  | 0    | 0,4              | 0              |
| 11            | 0    | 0    | 0    | 0    | 0    | -0,1 | 0    | 0    | 0    | 0    | 0,1  | 0,1              | 0              |
| 12            | 0    | 0,1  | 0,1  | 0,1  | 0,1  | 0,1  | 0,2  | 0    | 0,2  | 0,1  | -0,2 | 0,9              | 0,1            |
| 13            | 0    | 0    | 0    | 0    | 0    | 0    | -0,1 | 0    | 0    | 0    | -0,2 | -0,2             | 0              |
| 14            | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0                | 0              |
| 15            | 0    | 0    | 0,1  | 0,1  | 0,1  | 0    | 0,2  | 0,1  | 0,2  | 0,1  | 0,1  | 1                | 0,1            |
| 16            | 0    | 0,1  | 0,1  | 0,1  | 0,2  | 0,1  | 0,2  | 0,2  | 0,4  | 0,3  | 0,2  | 1,9              | 0,2            |
| 17            | 0    | 0,1  | 0,1  | -0,1 | 0    | 0    | 0    | 0,1  | 0,4  | 0,3  | 0,3  | 1,2              | 0,1            |
| 18            | 0,1  | 0,5  | 0,3  | 1,3  | 0,4  | 0,6  | 0,8  | 1,1  | 1,5  | 1,7  | 2,2  | 10,4             | 0,9            |
| 19            | 0    | 0    | -0,1 | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0                | 0              |
| 20            | 0    | 0    | 0    | 0    | 0    | 0    | 0,1  | 0,1  | 0,1  | 0,1  | 0    | 0,6              | 0,1            |
| 21            | 0    | 0    | 0,1  | 0,1  | 0,1  | 0,1  | 0    | 0,1  | 0,2  | 0,2  | 0,1  | 0,8              | 0,1            |
| 22            | 0    | 0    | 0,1  | 0    | 0    | 0    | 0    | 0    | 0    | 0,1  | -0,1 | 0,2              | 0              |
| 23            | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0,1  | 0,1  | 0    | 0,1  | 0,6              | 0,1            |
| 24            | 0,2  | 0,2  | 0,5  | 0,2  | 0,2  | 0,5  | 0,2  | 0,5  | 0,2  | 0,3  | 0,5  | 3,4              | 0,3            |
| 25            | 0,2  | 0,3  | 0,3  | 0,4  | 0,2  | 0,6  | 0,6  | 0,7  | 1,1  | 0,4  | 0,7  | 5,4              | 0,5            |
| 26            | 0,7  | 0,8  | 0,7  | 0,9  | 1,2  | 1,8  | 1,4  | 2,2  | 4,6  | 0,5  | 0,4  | 15,2             | 1,4            |
| 27            | -0,8 | 4,2  | 2,5  | 5,8  | 5,6  | 4,9  | 2,5  | 16,6 | 17   | 11,5 | 13,7 | 83,4             | 7,6            |
| 28            | 0,3  | 0,3  | 0,3  | 0,3  | 0,4  | 0,6  | 0,6  | 0,5  | 0,5  | 0,7  | 1    | 5,5              | 0,5            |
| 29            | 0,1  | 0,1  | 0,1  | 0,1  | 0,1  | 0,1  | 0,2  | 0,2  | 0,5  | 0,2  | 0,3  | 2,1              | 0,2            |
| 30            | 0    | 0    | 0,1  | 0    | 0    | 0,1  | 0    | 0,1  | 0,1  | 0,1  | 0,1  | 0,8              | 0,1            |
| 31            | 0,1  | 0,1  | 0,1  | 0,1  | 0,1  | 0,1  | 0,1  | 0,1  | 1,2  | 0,2  | 0,4  | 2,6              | 0,2            |
| 32            | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0,1  | 0,1  | 0,1  | 0,4              | 0              |
| 33            | 0    | 0    | 0    | 0    | -0,4 | -0,3 | -0,3 | -0,2 | 0,1  | 0,1  | 0,1  | -0,9             | -0,1           |

| Year HS2<br>code | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | Cumulative<br>total | Yearly<br>average |
|------------------|------|------|------|------|------|------|------|------|------|------|------|---------------------|-------------------|
| 34               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | -0,1                | 0                 |
| 35               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0                   | 0                 |
| 36               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0                   | 0                 |
| 37               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0                   | 0                 |
| 38               | 0,1  | 0,1  | 0,1  | 0,1  | 0    | 0    | -0,1 | -0,2 | 0,1  | 0,1  | 0,1  | 0,3                 | 0                 |
| 39               | 0    | 0    | 0,1  | 0,1  | 0    | 0    | 0,1  | 0    | -0,4 | -0,1 | -0,4 | -0,6                | -0,1              |
| 40               | 0    | 0,1  | 0,1  | 0,1  | 0,1  | 0,2  | 0,3  | 0,2  | 0,2  | 0,2  | 0,1  | 1,6                 | 0,1               |
| 41               | 0,2  | 0,3  | 0,3  | 0,3  | 0,1  | 0,1  | 0,2  | 0,2  | -0,1 | 0    | -1,3 | 0,4                 | 0                 |
| 42               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0,2                 | 0                 |
| 43               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0                   | 0                 |
| 44               | 0,5  | 0,6  | 0,5  | 0,8  | 0,7  | 0,8  | 0,5  | 1,1  | 1,2  | 0,6  | 0,8  | 8,2                 | 0,7               |
| 45               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0,1                 | 0                 |
| 46               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0                   | 0                 |
| 47               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0,1  | 0,1  | 0,1  | 0    | 0,3                 | 0                 |
| 48               | 0    | 0    | 0,1  | 0,1  | 0    | 0,1  | 0,1  | 0    | 0,2  | 0    | 0,2  | 0,8                 | 0,1               |
| 49               | -0,1 | -0,1 | -0,1 | -0,2 | -0,1 | -0,2 | -0,2 | -0,6 | -0,8 | 0,1  | 0    | -2,3                | -0,2              |
| 50               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0                   | 0                 |
| 51               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0,1  | 0    | 0    | 0,3                 | 0                 |
| 52               | 0,4  | 0,3  | 0,2  | 0,3  | 0,4  | 0,5  | 0,3  | 0,3  | 1    | 0,1  | 0,5  | 4,2                 | 0,4               |
| 53               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0,2                 | 0                 |
| 54               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0,1  | 0,1  | 0,1  | 0,3                 | 0                 |
| 55               | 0    | 0    | 0,1  | 0    | 0    | 0    | 0    | 0    | -0,1 | 0    | 0    | 0,3                 | 0                 |
| 56               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0,1                 | 0                 |
| 57               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0,2  | 0,1  | 0,1  | 0,4                 | 0                 |
| 58               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | -0,1 | 0    | 0                   | 0                 |
| 59               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0,3  | -0,1 | 0    | 0    | 0,2                 | 0                 |
| 60               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0,1                 | 0                 |
| 61               | 0,3  | 0,4  | 0,6  | 0,6  | 0,9  | 0,9  | 0,9  | 0,9  | 1,3  | 0,8  | 1,1  | 8,9                 | 0,8               |
| 62               | 0,5  | 0,5  | 0,8  | 0,8  | 0,8  | 0,9  | 0,7  | 1    | 1,5  | 1    | 1,2  | 9,7                 | 0,9               |
| 63               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0,2                 | 0                 |
| 64               | 0    | 0    | 0,1  | 0,1  | 0,1  | 0,1  | 0,1  | 0    | 0,1  | 0,1  | 0,2  | 0,8                 | 0,1               |
| 65               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0                   | 0                 |
| 66               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0                   | 0                 |

| Year HS2<br>code | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | Cumulative<br>total | Yearly<br>average |
|------------------|------|------|------|------|------|------|------|------|------|------|------|---------------------|-------------------|
| 67               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0                   | 0                 |
| 68               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0,1  | 0,1  | 0    | 0,1                 | 0                 |
| 69               | 0    | 0    | 0    | 0    | 0    | 0    | 0,1  | 0    | 0,1  | 0,1  | 0,2  | 0,5                 | 0                 |
| 70               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0,2  | 0,2  | 0,2  | 0,6                 | 0,1               |
| 71               | 6,6  | 2,7  | 7,2  | 2    | 3,3  | 4,8  | 5,1  | 6,7  | 9,3  | 4    | 5,4  | 57,2                | 5,2               |
| 72               | 0,6  | 0,5  | 0,4  | 0,5  | 0,9  | 1,3  | 1    | 1,5  | 2,4  | 0,9  | 0,9  | 10,9                | 1                 |
| 73               | 0    | 0    | 0    | 0    | 0,1  | 0,1  | 0,1  | 0,1  | 0,1  | 0,1  | 0    | 0,7                 | 0,1               |
| 74               | 0    | 0,3  | 0,2  | 0,3  | 0,4  | 1    | 1,3  | 1,7  | 2,5  | 1,7  | 2,9  | 12,2                | 1,1               |
| 75               | 0,2  | 0,1  | 0,1  | 0,2  | 0,3  | 0,4  | 0,7  | 0,3  | 0,4  | 0,2  | 0,8  | 3,6                 | 0,3               |
| 76               | 0,1  | 0,5  | 0,5  | 0,1  | 1,1  | 0,3  | 0,5  | 0,4  | 1,5  | 1    | 1,7  | 7,8                 | 0,7               |
| 78               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0,1  | 0,1  | 0    | 0    | 0,3                 | 0                 |
| 79               | 0    | 0    | 0    | 0    | 0,1  | 0    | 0,1  | -0,1 | 0,1  | 0,2  | 0    | 0,5                 | 0                 |
| 80               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0                   | 0                 |
| 81               | 0,1  | 0,1  | 0,1  | 0    | 0,2  | 0,3  | 0,1  | 0,2  | 0,4  | 0,1  | 0,2  | 1,6                 | 0,1               |
| 82               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0                   | 0                 |
| 83               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0,1  | 0    | 0,1  | 0,3                 | 0                 |
| 84               | 0,2  | 0,3  | 0,4  | 0,4  | 0,5  | 0,5  | 0,6  | 0,5  | 0,9  | 1,3  | 0,5  | 6                   | 0,5               |
| 85               | 0,3  | 0,4  | 0,6  | 0,8  | 1,2  | 1,3  | 1,4  | 1,9  | 1,3  | 1,6  | 1,6  | 12,3                | 1,1               |
| 86               | 0    | 0    | 0    | 0    | 0    | 0    | -0,1 | -0,1 | -0,1 | 0    | 0    | -0,4                | 0                 |
| 87               | -0,1 | 0,1  | 0,3  | 0    | 0    | -0,1 | 0,2  | -0,1 | 0,6  | 0,9  | 0,9  | 2,7                 | 0,2               |
| 88               | 0    | 0    | 0    | 0,1  | 0,1  | 0,2  | 0    | 0,1  | 0,5  | -0,1 | 0,1  | 1,1                 | 0,1               |
| 89               | 0,1  | 0    | 0    | 0    | 0    | 0,4  | 0,2  | -0,5 | -0,9 | 0,1  | -1   | -1,6                | -0,1              |
| 90               | 0,1  | 0,1  | 0    | 0    | 0,1  | 0,1  | 0,1  | 0,1  | 0,1  | 0,1  | 0,1  | 1                   | 0,1               |
| 91               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0,2                 | 0                 |
| 92               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0                   | 0                 |
| 93               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0,1  | 0,1  | 0    | 0    | 0,4                 | 0                 |
| 94               | 0    | 0    | 0    | 0,1  | 0,1  | 0,1  | 0    | 0,1  | 0,2  | 0,1  | 0    | 0,8                 | 0,1               |
| 95               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0,1  | 0    | 0    | 0,3                 | 0                 |
| 96               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0,1                 | 0                 |
| 97               | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0    | 0,1  | 0,2                 | 0                 |
| TOTAL            | 13   | 16,3 | 20,6 | 20,6 | 23   | 26,6 | 23,2 | 42,2 | 56,8 | 35,7 | 40,2 | 318,4               | 28,9              |

Note: For details of the HS classifications, please see [/www.wcoomd.org/en/topics/nomenclature/instrument-and-tools/hs-online.aspx](http://www.wcoomd.org/en/topics/nomenclature/instrument-and-tools/hs-online.aspx).

Source: Authors' calculations.

# Annex IV:

## Vulnerabilities and exposure to financial secrecy

The phenomenon of illicit financial flows (IFFs) with which this Panel is concerned is one of *hidden flows, deliberately obscuring either the illicit origin of capital and/or the illicit nature of transactions undertaken*. By design, hidden flows do not lend themselves to measurement. However, it is possible to analyse more precisely the risks that any given flow of funds contains a hidden component.

Using bilateral data on economic and financial flows, it is possible to assess the risk that a given country faces, according to the extent of financial secrecy of the partner jurisdiction. For example, the IFF risks inherent in a commodity trade with Switzerland will be substantially higher than in the equivalent transaction with Sweden; and similarly, intragroup transactions of a multinational corporation with its subsidiary in Bermuda contain greater risk than those with its subsidiary in Brazil.

This does not of course imply that all trade with Switzerland is illicit, nor that all multinationals with Bermudan subsidiaries are committing tax evasion. However, the greater the transparency of the partner jurisdiction in a given bilateral transaction, the lower will be the risk of something being hidden, all other things being equal. Not all transactions of a less transparent nature will be illicit, but the likelihood of illicit transactions within a less transparent flow will be higher. **The greater the degree of secrecy, in other words, the higher the risk of IFFs.**

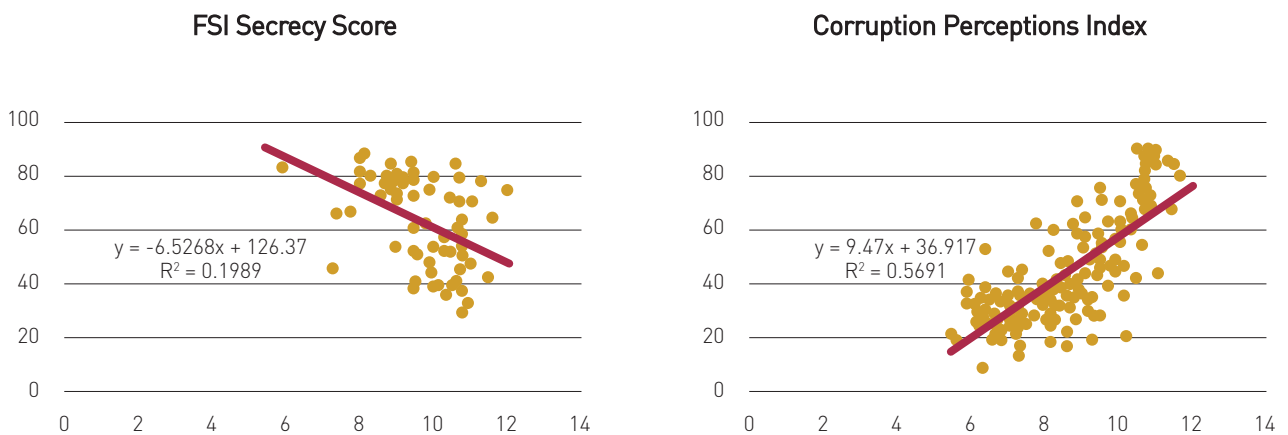
The most common measure of financial secrecy is the Financial Secrecy Index, published every two years by the Tax Justice Network, and now used widely—for example, as a component of the Basle Anti-Money Laundering Index, and as a risk assessment tool recommended in the OECD *Bribery and Corruption Awareness Handbook for Tax Examiners and Tax Auditors*. The Index is based on a “secrecy score”, which is constructed from 48 indicators of transparency in areas from corporate reporting to banking and beneficial ownership, largely based on the assessment of relevant international and multilateral organizations. The full set of indicators can be seen in table AIV.1. This secrecy score provides the basis for assessing countries’ trading and financial partner jurisdictions.

This approach also does not imply a narrow focus on “tax havens”. A central result of the Financial Secrecy Index approach is that it does not make sense to divide jurisdictions into “good” and “bad”. Rather, there is a spectrum of secrecy on which all jurisdictions sit (and where all jurisdictions can make progress). Little progress could be made by “shutting down” some of the smaller jurisdictions most commonly thought of as tax havens, when the great majority of potentially risky flows go through some of the biggest economies.

The secrecy score ranges in theory from zero (perfect financial transparency) to 100 per cent (perfect financial secrecy); in practice no jurisdiction has scored less than 30 per cent. It is informative to compare the relationship across countries between secrecy scores and per capita incomes, and that of a commonly used corruption measure (the Transparency International Corruption Perceptions Index). As figure AIV.1 shows, the secrecy score exhibits a much weaker relationship with (log) per capita income than does the Corruption Perceptions Index—more than half of which can be “explained” by income, implying that it is primarily telling a story of corruption as a problem of poverty. The secrecy score, in contrast—and the Financial Secrecy Index as a whole—reflects the reality that corruption necessarily involves multiple actors, and that the financial secrecy provided by some of the highest income jurisdictions is often central.

Table AIV.1

Financial Secrecy Index secrecy score and the Corruption Perceptions Index, relationship with log GDP per capita



The relationship between financial transparency and IFF risk allows the analysis of individual flows, making possible a detailed identification of IFF vulnerabilities facing each country or region. Recognizing that the current state of knowledge does not allow specific claims to be made about the relative importance of particular types of IFF for particular countries, we explore instead what is known: the extent to which any given country is exposed to financial “secrecy jurisdictions” (a term preferred for its focus and verifiable criteria to “tax havens”, as set out in Cobham (2012) in each of its economic and financial relationships.

To illustrate the approach, consider a particular flow: exports from Zambia. For each trading partner, we allocate to its share of Zambia's exports the partner's secrecy score (which ranges from zero to 100). The results can be summed to give an overall level of secrecy for all of Zambia's exports, and this score reflects Zambia's vulnerability to IFFs in its exports. If we multiply this vulnerability score by the share of exports in Zambia's GDP, we obtain a measure of Zambia's vulnerability to IFFs, which can then be compared across other stocks or flows. A vulnerability of 50, for exports equal to 10 per cent of GDP, would give an exposure of 5 per cent. This is equivalent to Zambia carrying out 5 per cent of its exports with a pure secrecy jurisdiction (that is, one scoring 100 out of 100), and all other exports with completely transparent trading partners. The exposure can then be thought of as Zambia's pure secrecy-equivalent economic activity, as a ratio to its GDP. (Note: Where no secrecy score is available we apply the lowest observed score of 33. This will bias scores downward, though much less so than assuming a zero score.)

In this exercise, we have used data on trade and on direct and portfolio investment. Should the necessary data be made available, equivalent analysis can and should be carried out for other types of financial flows—for example, banking flows and the distribution of corporate profits. We use data for the three most recent years available, 2009–2011, for three types of economic activity: commodity trade (from UN Comtrade), direct investment (IMF Coordinated Direct Investment Survey) and portfolio investment (IMF Coordinated Portfolio Investment Survey). Note that because we are constrained to use stock data on investment (flow data from United Nations Conference on Trade and Development being unavailable), exposure should not be compared directly with that in trade flows, to assess relative importance. Nonetheless, the pattern when African countries are compared with one another, or with their peers elsewhere, will still indicate relative importance.

Figure AIV.2 shows the vulnerability for African countries, stacked for visibility: so the individual score for each type of economic activity for each country reflects the weighted average secrecy score for all partners in that activity. One important issue is revealed: the absence of self-reported trade data for several African countries, confirming the importance of statistics in this area. This will bias the aggregate results downward, and render comparison with this group less revealing.

Figures AIV.3 and AIV.4 show the intensity of each activity—that is, the share of each flow or stock in GDP—again by country for African countries. Figure AIV.4 excludes the three conduit jurisdictions, Mauritius, Seychelles and Liberia, to show the remaining results more clearly. Note that investment dominates for the conduits, while trade is the main component for all other jurisdictions.

Table AIV.2

Stacked vulnerability by country and activity

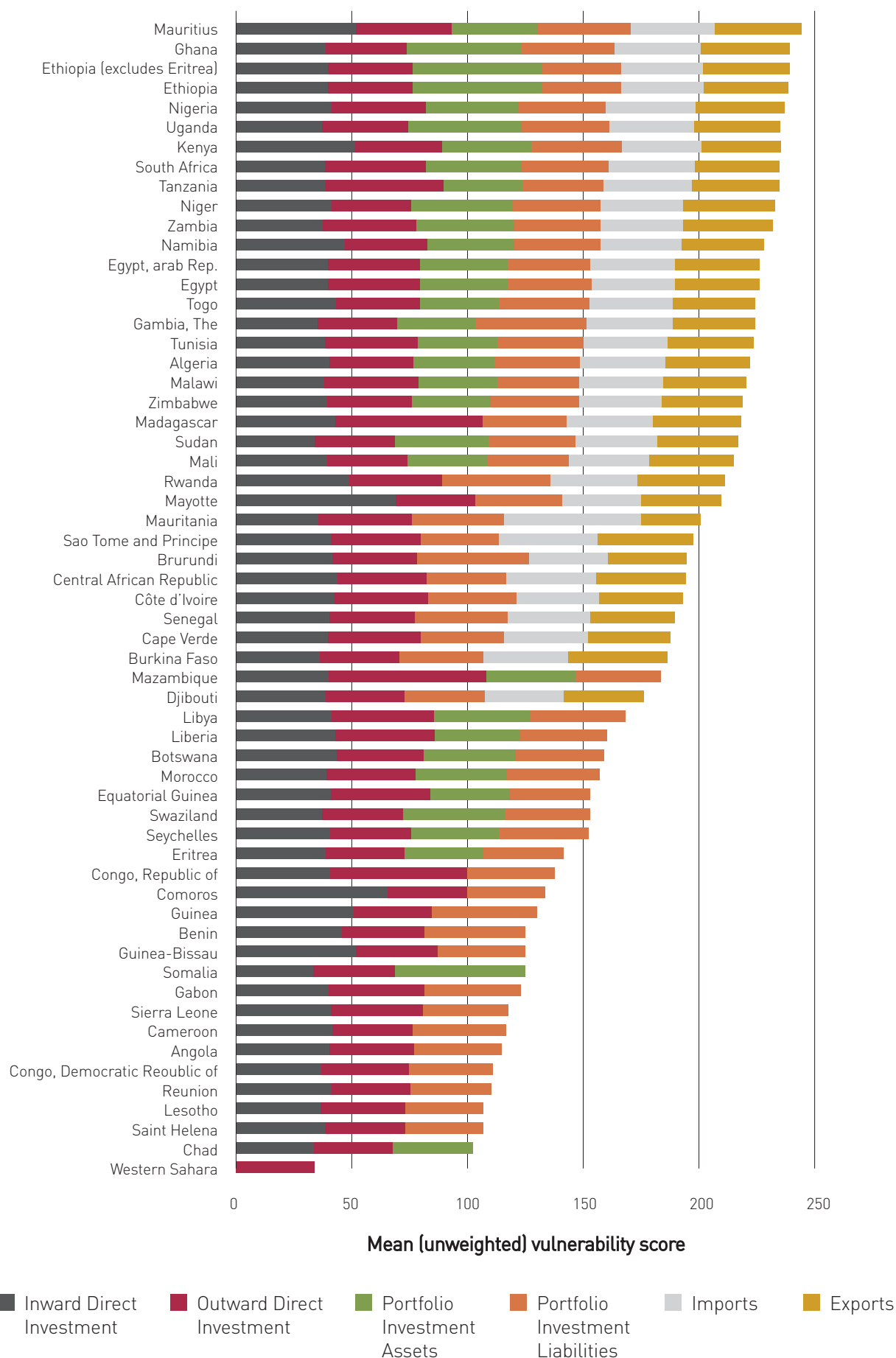


Table AIV.3

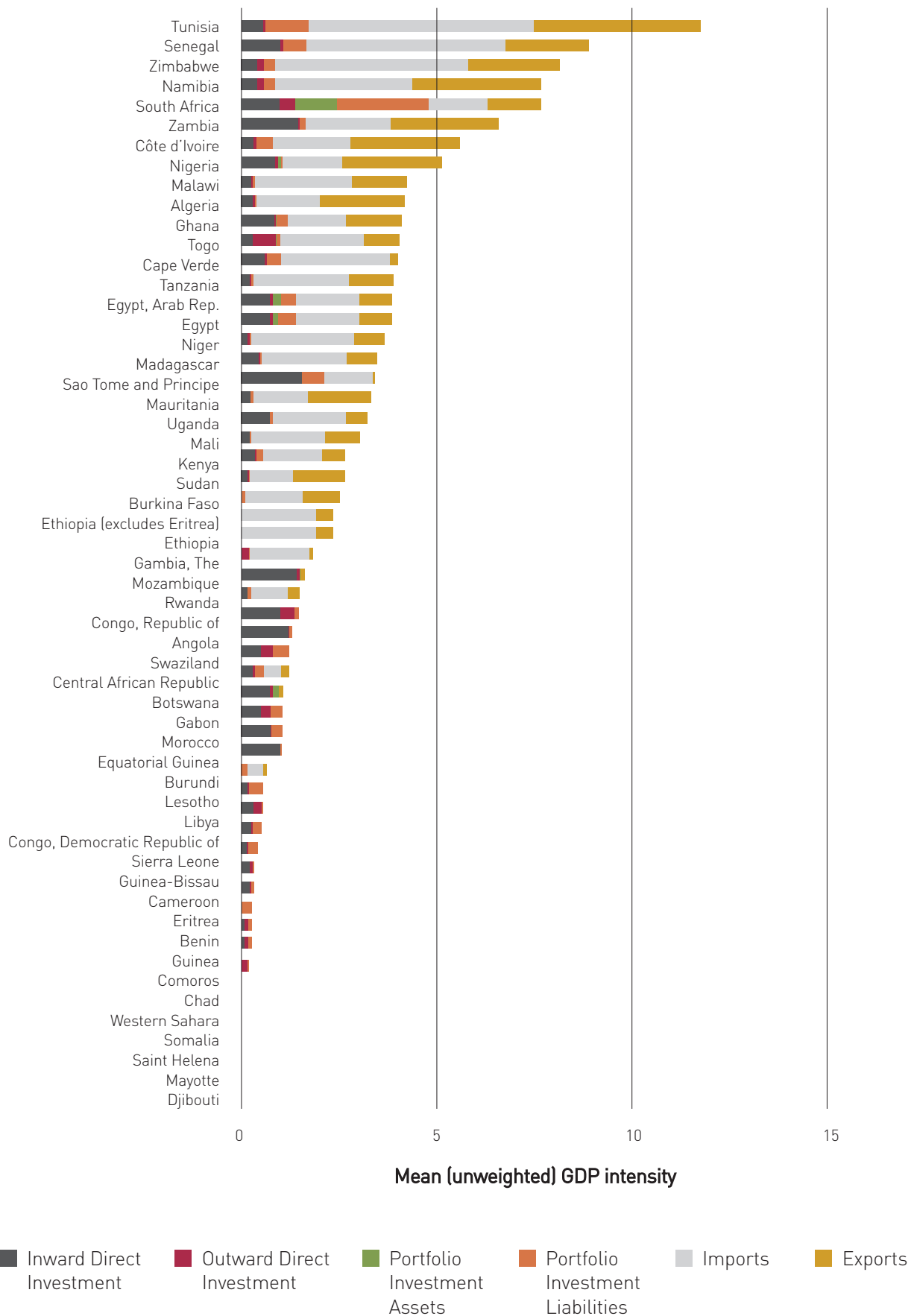
Intensity by activity and country





Table AIV.4

Intensity by activity and country, excluding conduits



We can also draw some broader conclusions about the potential to extend this exercise, and what it can tell individual countries—as well as the implications for regional policy. It is informative to consider the extent of data available to extend this exercise, in order to cover all important areas of economic activity and to generate a full picture of vulnerability to financial secrecy and therefore to IFFs. While we have not been able to access it here, equivalent data on bilateral cross-border banking liabilities is collected by the Bank for International Settlements and if made available could also be used. Some service trade data, similar to Comtrade, could also be considered. In addition, the United Nations Conference on Trade and Development collects foreign direct investment data with broader coverage, and including flow data, though we have been unable to access it for this particular study.

Finally, the major absence in relation to the IFF typology set out in the report relates to data on the profit location of multinational groups of companies. Research under the auspices of the International Centre for Tax and Development aims to assess the scale of distortion of the international corporate tax base, compared with counterfactuals in which profit is allocated in proportion to economic activity—though existing sources of data suffer various limitations.

Without a full set of bilateral data, it is impossible to draw final conclusions about the relative importance of different elements of the IFF typology set out in chapter 2. Overall, it would clearly be of value for African countries to become more consistent in their reporting (as well as their use of data) on bilateral economic relationships.

In terms of the data that we have been able to use, and the IFF estimates discussed above, it is possible to relate back the findings to the typology presented in table AIV.1. One driver of overall exposure in relation to IFFs is the high exposure of individual African countries, most notably Mauritius. Its operation as a relatively financially secretive conduit results both in high exposure for itself, but also for other countries across the region. In terms of actors, the role of investment professionals and companies that promote the use of relatively secretive jurisdictions for investment into Africa may be worthy of greater attention. Similarly, although less extreme, are the positions of the Seychelles and Liberia.

At the level of individual countries, however, we see trade as more exposed in most cases. In some cases, especially at lower income levels, this exposure is related to imports; for others, especially commodity producers, the exposure lies in exports. There are clear implications here for countries that wish to reduce their exposure to IFFs, relating to the secrecy of their trading partners and the extent of transparency and vigilance in regard to their trade pricing. The importance of the commodity supercycle of the 2000s in driving IFFs from Africa is also confirmed.

In terms of the actors involved, emphasis has tended to fall on IFFs relating to criminal proceeds and the abuse of power. The major single channel of IFFs, however, appears to be trade mispricing—whether within Raymond Baker's original (2005) comparative analysis, or if we combine the ECA analysis of more detailed trade data with the Global Financial Integrity estimates of hidden flows through the capital account. Since trade mispricing is incompatible with IFFs driven by abuse of power, this points strongly to the role of corporate abuses (of either tax or market regulation). Rather than direct attention primarily towards movements of illegal capital, it may be that the most relevant actors are those in the private sector whose activities give rise to IFFs of legitimate capital through abusive transactions. This would also imply that the tax component of Africa's IFFs may be a particular concern.

Table AIV.1

Key financial secrecy indicators: Qualitative index components of the Financial Secrecy Index

| KSFI                                     | Description  | Result   | Component Weighting   |
|--|--|--|---|
| <b>KNOWLEDGE OF BENEFICIAL OWNERSHIP</b> |  |  |   |
| <b>Bank Secrecy</b>                      | Does it have a statutory basis?  | YN   | 20%   |
|  | To what extent are banks subject to stringent customer due diligence regulations (FATFrecommendation 5)?   | 1: compliant; 2: largely compliant; 3: partially compliant; 4: non-compliant   | 20%   |
|  | To what extent are banks required to maintain data records of customers and transactions sufficient for law enforcement (FATFrecommendation 10)?   | 1: compliant; 2: largely compliant; 3: partially compliant; 4: non-compliant   | 20%   |
|  | Are banks and/or other covered entities required to report large transactions in currency or other monetary instruments to designated authorities? | YN   | 10%   |
|  | Are banks required to keep records, especially of large or unusual transactions, for a specified period of time, e.g. five years?                  | YN   | 10%   |
|  | Sufficient powers to obtain and provide banking information on request?  | 1: Yes without qualifications; 2: Yes, but some problems; 3: Yes, but major problems; 4=No, access is not possible, or only exceptionally  | 10% (only if answer is 1)   |
|  | No undue notification and appeal rights against bank information exchange on request?  | 1: Yes without qualifications; 2: Yes, but some problems; 3: Yes, but major problems; 4=No, access and exchange hindered   | 10% (only if answer is 1)   |
| <b>Trust and Foundations Register</b>    | Trusts available?  | 0: Foreign law trusts cannot be administered and no domestic trust law; 1: Foreign law trusts can be administered, but no domestic trust law; 2: Domestic trust law and administration of foreign law trusts | Complex Assessment; see KFSI 2 for details; trusts maximum of 50% in KFSI 2 |

| KSFI | Description  | Result  | Component Weighting  |
|------|--|---|--|
|      | Convention of 1 July 1985 on the Law Applicable to Trusts and on Their Recognition                             | YN  |  |
|      | Trusts: Is any formal registration required at all?  | 0: Foreign law trusts (and domestic law trusts if applicable) must be registered; 1: No registration requirement of foreign law trusts, but registration of domestic law trusts mandatory; 2: No registration requirement of domestic law trusts, but of foreign law trusts; 3: Neither foreign law trusts nor domestic law trusts (if applicable) require registration |  |
|      | Trusts: Is registration data publicly available ("on public record")?  | 0: No, neither for foreign law trusts nor domestic law trusts (if applicable); 1: Only for domestic law trusts, but not for foreign law trusts (if applicable); Yes, for both domestic and foreign law trusts (if applicable)   |  |
|      | Foundations available (private)?   | YN  | Complex Assessment; see KFSI 2 for details; foundations maximum of 50% in KFSI 2 |
|      | Foundations: Is any formal registration required at all?   | YN  |  |
|      | Is the settlor named?  | YN  |  |
|      | Are the members of the foundation council named?   | YN  |  |
|      | Are the beneficiaries named?   | YN  |  |
|      | Must the constitution/ foundation documents be submitted, including changes and all bylaws/ letters of wishes? | YN  |  |
|      | Foundations: Is registration data publicly available ("on public record")?                                     | YN  |  |

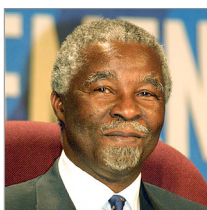
| KSFI  | Description   | Result   | Component Weighting                                |
|---|---|--|--|
|   | Foundations: Is registration data publicly available ("on public record")?  | 0: No online disclosure for all private foundations; 1: Partial online disclosure for all private foundations; 2: Yes, full online disclosure of all private foundations |  |
| <b>Recorded Company Ownership</b>                       | Companies: Registration comprises owner's identity information?   | 0: no; 1: only legal; 2: BO always recorded  | BO=100%; condition that update is not "no"         |
|   | Is update of information on the identity of owners mandatory?   | YN   |  |
| <b>KEY ASPECTS OF CORPORATE TRANSPARENCY REGULATION</b> |   |  |  |
| <b>Public Company Ownership</b>                         | Companies: Registration comprises owner's identity information?   | 0: no; 1: only legal; 2: BO always recorded  | LO=20%; BO=100%; condition that update is not "no" |
|   | Is the update of information on the identity of owners mandatory?   | YN   |  |
|   | Companies Online Availability of Information: On public record (up to 10 €/US\$): Owners' identities?   | 0: no; 1: only legal; 2: BO always recorded  |  |
| <b>Public Company Accounts</b>                          | Accounting data required?   | YN   | Only if all answered<br>Yes = 100%                 |
|   | Accounts submitted to public authority?   | YN   |  |
|   | Online Availability of Information: On public record (up to 10 €/US\$): Accounts?   | YN   |  |
| <b>EFFICIENCY OF TAX AND FINANCIAL REGULATION</b>       |   |  |  |
| <b>Fit for Information Exchange</b>                     | Are all payers required to automatically report to the tax administration information on payments to all non-residents?   | 0: No, none; 1: Yes, dividends, no interest; 2: No dividends, yes interest; 3: yes, both   | 100% (dividends and interest each 50%)             |
| <b>Efficiency Tax Administration</b>                    | Does the tax authority make use of taxpayer identifiers for information reporting and matching for information reported by financial institutions on interest payments and by companies on dividend payments? | 0: No, none; 1: Yes interest, no dividends; 2: No interest, yes dividends; 3: Yes, both  | 80% (dividends and interest each 40%)              |
|   | Does the tax authority have a dedicated unit for large taxpayers?   | YN   | 20%  |

| KSFI   | Description  | Result  | Component Weighting           |
|--|--|---|-------------------------------|
| <b>Avoids Promoting Tax Evasion</b>            | Absent a bilateral treaty, does the jurisdiction apply a tax credit system for receiving interest income payments?                                       | 3: Yes, all three types of resident recipients [i] legal person – independent party; ii) legal person – related party; iii) natural person]; 2: for 2; 1: for 1; 0 for none | 0: 0%; 1: 10%; 2: 20%; 3: 50% |
|  | Absent a bilateral treaty, does the jurisdiction apply a tax credit system for receiving dividend income payments?                                       | 3: Yes, all three types of recipients; 2: for 2; 1: for 1; 0 for none   | 0: 0%; 1: 10%; 2: 20%; 3: 50% |
| <b>Harmful Legal Vehicles</b>                  | Companies – Available Types: Cell Companies?   | YN  | 50%                           |
|  | Trusts – Are trusts with flee clauses prohibited?  | YN  | 50%                           |
| <b>INTERNATIONAL STANDARDS AND COOPERATION</b> |  |   |                               |
| <b>Anti-Money Laundering</b>                   | Money Laundering: Overall compliance score of FATF standards in percent (100% = all indicators rated compliant, 0% = all indicators rated non-compliant) | 49 criteria (each given an equal weight); each criterion: 1: compliant; 2: largely compliant; 3: partially compliant; 4: non-compliant                                      | Scaled up to 100%             |
| <b>Automatic Information Exchange</b>          | EUSTD participant (or equivalent)?   | YN  | 100%                          |
| <b>Bilateral Treaties</b>                      | Number of double tax agreements  | Number  | Sum % of 46; or               |
|  | Number of tax information exchange agreements (TIEA)   | Number  |                               |
|  | 1988 CoE/OECD Convention / Amending Protocol   | YN  | Yes, then 100%                |
| <b>International Transparency Commitments</b>  | 1988 CoE/OECD Convention / Amending Protocol   | YN  | 20%                           |
|  | UN Convention against Corruption   | YN  | 20%                           |
|  | UN Drug Convention 1988  | YN  | 20%                           |
|  | UN International Convention for the Suppression of the Financing of Terrorism  | YN  | 20%                           |
|  | UN Convention against Transnational Organized Crime  | YN  | 20%                           |

| KSFI  | Description  | Result   | Component Weighting |
|---|--|--|---------------------|
| <b>International<br/>Judicial<br/>Cooperation</b> | Will mutual legal assistance be given for investigations, prosecutions and proceedings (FATF recommendation 36)?   | 1: compliant; 2: largely compliant; 3: partially compliant; 4: non-compliant | 20%                 |
|   | Is mutual legal assistance given without the requirement of dual criminality (FATF recommendation 37)?   | 1: compliant; 2: largely compliant; 3: partially compliant; 4: non-compliant | 20%                 |
|   | Is mutual legal assistance given concerning identification, freezing, seizure and confiscation of property (FATF recommendation 38)?   | 1: compliant; 2: largely compliant; 3: partially compliant; 4: non-compliant | 20%                 |
|   | Is money laundering considered to be an extraditable offense (FATF recommendation 39)?   | 1: compliant; 2: largely compliant; 3: partially compliant; 4: non-compliant | 20%                 |
|   | Is the widest possible range of international cooperation granted to foreign counterparts beyond formal legal assistance on anti-money laundering and predicate crimes (FATF recommendation 40)? | 1: compliant; 2: largely compliant; 3: partially compliant; 4: non-compliant | 20%                 |

# Annex V:

## Panel members and secretariat



**H. E. Mr. Thabo Mbeki**

Mr. Mbeki served two terms as the second post-apartheid President of South Africa from 14 June 1999 to 24 September 2008. He was the President of the African National Congress from 1997–2007. Mr. Mbeki held the position of Chairperson of the African Union (2002–2003). Mr. Mbeki holds a Master's Degree in Economics from Sussex University.



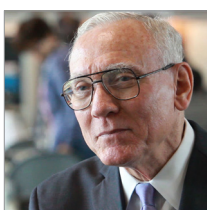
**Mr. Carlos Lopes**

Mr. Carlos Lopes currently serves as the United Nations Under-Secretary-General and Executive Secretary of the Economic Commission for Africa. He assumed this position in September 2012. Mr. Lopes previously served as Executive Director of the United Nations Institute for Training and Research in Geneva and Director of the UN System Staff College in Turin at the level of Assistant Secretary-General from March 2007 to August 2012.



**Ambassador Olusegun Apata**

H. E. Mr. Olusegun Apata is the Chairman of the Coca-Cola Bottler in Nigeria, Nigerian Bottling Company Plc, and has sat on the company's Board of Directors since 2006. Ambassador Apata served for three decades in the Nigerian Diplomatic Service. He attended the University of Lagos for his undergraduate studies, while he earned his graduate degrees from the University College Dublin and Oxford University.



**Mr. Raymond Baker**

Mr. Baker is the director of Global Financial Integrity, a think tank and advocacy organization in Washington, DC, and was formerly a guest scholar at the Brookings Institution and Senior Fellow at the Center for International Policy. In January 2009, Mr. Baker brought together a coalition of research and advocacy organizations and more than 50 governments to form the Task Force on Financial Integrity and Economic Development, an organization that advocates for transparency in the global financial system. He is a graduate of Harvard Business School and Georgia Institute of Technology.



**Dr. Zeinab Bashir el Bakri**

Ms. ElBakri is a member of the World Bank Inspection Panel. She is the former Vice President Sector Operations of the African Development Bank (AfDB) Group in Tunisia. After leaving AfDB she was appointed Director of the Delivery Unit in the Office of His Highness the Prime Minister of Kuwait responsible for delivering key reform initiatives in improving the business environment, education and procurement. She was also member of the HLP to Review the Global Fund for Aids, TB and Malaria, and served as Peer Reviewer of the UN Joint Inspection Unit.





### **Mr. Abdoulaye Bio Tchané**

Abdoulaye Bio Tchané has built a 30-year career in banking, finance and development across Africa. He has held high positions at the WAEMU Central Bank and is a former Director of the Africa Department at the International Monetary Fund as well as the former President of the West African Development Bank. Mr. Bio Tchané is also widely acknowledged as the finance minister of Benin who spearheaded clear and transparent reforms in budgeting, procurement and taxation, and he has actively fought corruption.



### **Mr. Henrik Harboe**

Henrik Harboe, Director of Development Policy at the Norwegian Ministry of Foreign Affairs since July 2013, was previously Norway's Chief Negotiator in the international climate negotiations. Before that he was head of the Multilateral Bank and Finance Section of the Norwegian Ministry of Foreign Affairs, responsible for Norway's relationship with the World Bank and regional development banks for global finance questions and debt relief. He has a Master's Degree in Development Economics from the London School of Economics (1987) and a BSc in Economics from the University of Oslo.



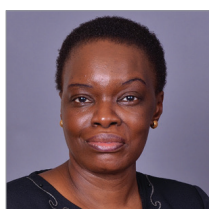
### **Prof. El Hadi Makboul**

Prof. Makboul is Secretary General, Ministry of Industrial Development and Investment Promotion, in Algeria. He is the former director of the National Centre for the Study and Analysis of Population and Development, which undertakes studies and analysis in the field of economy, demography and social and cultural development. Mr. Makboul was recently elected as a member of ECA's Committee on Governance and Popular Participation.



### **Barrister Akere Muna**

Barrister Muna is founder and former president of Transparency International Cameroon. A lawyer by training, he is President of the Pan African Lawyers Union and former president of the Cameroon Bar Association. Akere Muna is President of the African Union's Economic, Social and Cultural Council and a member of several national commissions on legal reform and curbing corruption. Mr. Muna was actively involved in the Transparency International working group that helped draft the African Union Convention on Preventing and Combating Corruption and has written a guide to the convention published by Transparency International.



### **Ms. Irene Ovonji-Odida**

The Chairperson of Action Aid Uganda, Ms. Ovonji-Odida is a human rights lawyer and activist with 21 years of experience in development work. She has worked in the public sector in law reform and on public sector ethics for eight years. She has been involved with ActionAid in Uganda since 2003, becoming National Board Chair in 2005. She is the convener of the International Governance & Board Development Committee and was elected as International Board Chair in June 2009.

## Members of the Technical Committee of the HLP

### Chairperson:

**Mr. Abdalla Hamdok**, Deputy Executive Secretary, ECA

### Members:

**Mr. Said Adejumo**, Director, Sub-Regional Office in Southern Africa

**Mr. Adeyemi Dipeolu**, Director, Capacity Development Division, ECA

**Mr. Adam Elhiraika**, Director, Macroeconomics Policy Division, ECA

**Advocate Mojanku Gumbi**, member and advisor

**Mr. Stephen Karingi**, Director, Regional Integration and Trade Division, ECA

**Mr. René Kouassi**, Director, Economic Affairs, African Union Commission

**Mr Harald Tolan**, Senior Advisor, Ministry of Foreign Affairs, Norway

## Secretariat of the HLP

### Head of the Secretariat

**Mr. Adeyemi Dipeolu**, Director, Capacity Development Division, ECA

### Members

**Mr. Gamal Ibrahim**, Chief, Finance and Private Sector Section, Macroeconomic Policy Division, ECA

**Ms. Souad Aden-Osman**, Senior Programme Officer, Office of the Deputy Executive Secretary, ECA

**Mr. Allan Mukungu**, Economic Affairs Officer, Macroeconomic Policy Division, ECA

**Mr. Simon Mevel**, Economic Affairs Officer, African Trade Policy Centre, ECA

**Mr. William Davis**, Associate Economic Affairs Officer, African Trade Policy Centre, ECA

**Mr. John Kaninda**, Communication Specialist, Public Information and Knowledge Management Division, ECA

**Mr. Oladipo Johnson**, Communications Specialist, Capacity Development Division, ECA

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