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BRIEFING FOR THE MINISTERS ON ILLICIT FINANCIAL FLOWS

This Briefing Paper was produced in collaboration with the African Tax Administration Forum (ATAF)

I. Introduction

Illicit Financial Flows (IFFs)

Illicit Financial Flows (IFFs) has been at the centre of discussions in Africa due to their negative impact on development financing, sustainable development and growth. To determine the tenacity of the IFF phenomenon and come to grips with the subject matter, the High-Level Panel on Illicit Financial Flows from Africa, (HLP) investigated the matter at the request of the 4th Joint African Union Commission/United Nations Economic Commission for Africa (AUC/ECA) Conference of African Ministers of Finance, Planning and Economic Development, which was held in 2011. The HLP Report (2015)[1] defined IFFs as money illegally earned and transferred out of the African continent. The continent has lost approximately US$ 1 trillion to illicit outflows over the last 50 years, with an estimated US$ 50 billion in annual losses. A recent report by the United Nations Conference of Trade and Development (2020)[2] estimated losses at about US $89 billion annually. These outflows are of tremendous concern, given the various socioeconomic challenges still faced by the continent. The amount of Official Development Aid (ODA) of US $48 billion and foreign direct investment of US $54 billion received on average annually between 2013 and 2015 amounts to nearly the same amount lost in illicit financial outflows.

Illicit Financial flows are often associated with the extractive sector as extractive industries are particularly vulnerable to IFFs due to the complex and elaborate global value chains associated with the sector. More so, the lack of financial transparency in the extractive sector all too often allows for sector-wide corruption and prevents governments from collecting the needed revenue. Illicit financial flows related to the export of extractives commodities ($40 billion in 2015) are the largest component of IFFs in Africa, serving to further drain the continent of critical resources necessary to drive its development agenda[3]. The Extractive Industries Transparency Initiative (EITI) and the International Council on Mining and Metals (ICMM) along with international donors have provided a wealth of lessons learned and best practices. However, these initiatives have primarily remained fragmented and have yet to be scaled up and fully integrated into broader sustainable development strategies.

The emergence of the novel coronavirus pandemic is exacerbating the fiscal deficit situation in some African countries. The contraction in budgetary resources is likely to impede and delay the implementation of Agenda 2063 and the United Nation's Sustainable Development Goals (SDGs). Therefore, strengthening domestic resources

[1] AU and ECA (2015), Report of the High Level Panel on Illicit Financial Flows from Africa

[2] UNCTAD (2020), Economic Development in Africa Report: Tackling illicit financial flows for sustainable development in Africa

[3] https://unctad.org/en/PublicationsLibrary/aldcafrica2020_en.pdf

mobilization through intensifying the fight against IFFs and supporting current continental ongoing initiatives is urgent and imperative.

At the continental level, several initiatives are being undertaken to curb the fight against IFFs. The AU dedicated the year 2018 theme to "*Winning the Fight against Corruption: A Sustainable Path for Africa's Transformation*," a concerted effort of the organization's willingness to combat poor financial governance, misallocation of budget resources, obstacles to productive investment, and systemic increase of inequality across the continent. In support of the theme, the Commission, through the Department of Economic Affairs, published a book on domestic resource mobilization: fighting against illicit financial flows and corruption. The book is a collection of best practices from various member states and partners on their efforts to combat IFFs.

Additionally, through the Department of Economic Affairs, the AUC is actively working with various partners on IFFs projects, including the European Union, the Organisation for Economic Cooperation and Development (OECD), African Tax Administration Forum (ATAF), and other African networks. These projects include IFFs in oil commodity trading, considering that commodity trade finance and trade-based money laundering constitute a large component of illicit outflows; capacity building of Member States in the area of strengthening tax administrations and fighting against IFF; and publications on various issues on IFFs and tax.

Moving forward in the fight against IFFs, Member States should take all necessary steps to curtail and eliminate all avenues for illicit outflows. Though sources of IFFs are within the continent, mechanisms for facilitating them often involves non-African private and public actors and entities, empowered through laws and policies adopted by intergovernmental bodies outside the continent. In that respect, African governments must engage non-African actors to ensure that their operations do not knowingly or unknowingly encourage illicit outflows from the continent.

II. Ongoing initiatives at Continental level to curb IFFs

1. High-Level Panel on Illicit Financial Flows

The establishment of the High-Level Panel (HLP) on Illicit Financial Flows led by H.E. Thabo Mbeki, former President of South Africa was a stepping stone in the fight against IFFs. The HLP was established with the determination to ensure Africa's accelerated and sustained development, relying as much as possible on its own resources that includes strengthening the fight against IFFs. In 2012 the HLP produced a report aimed at (i) developing a realistic and accurate assessment of the volumes and sources of these outflows; (ii) gaining a concrete understanding of how these outflows occur in Africa, based on case studies of a sample of African countries; and (iii) providing 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. The report received various contributions from the Member States and partners, including the World Bank, the United Nations and the OECD.

Among the findings of the HLP was that ending IFFs is inherently a political issue. It is in light of this finding, and the recognition that the nature and size of the IFFs are evolving, that this discussion is being re-introduced to this Forum to make a determination of measures to be taken to permanently curb financial outflows from Africa. According to the HLP Report (2015), Africa was losing an estimated US $50 billion in illicit financial outflows annually, based on available data. IFFs undermine the ability of African countries to provide the necessary financing for development and social spending. Poverty and inequality are rife in a continent that is mostly unable to provide essential social services such as healthcare and education. The adoption of the recommendations of the HLP by the African Union Heads of State and Government in January 2015 placed the fight against IFFs at the top of the African development agenda. This meeting provides an opportune moment to intensify the policy stance of the continent and to fully engage the various international partners on curbing IFFs, using the recommendations of the HLP as a foundation.

2. The Consortium to Stem IFFs

The Consortium to Stem IFFs was established under the leadership of H. E. Thabo Mbeki to implement the recommendations of the HLP Report. The main objectives of the Consortium are to ensure a more streamlined collaboration on the anti-IFF agenda and to leverage partnerships and provide overall strategic direction of efforts to reduce IFFs from Africa. Most importantly, the Consortium guides a joint delivery of actions by the various partners on the basis of comparative advantage and pooling of resources for effectively stemming IFFs from Africa. The IFF Working Group (IWG) provides the necessary technical support to the Consortium.

Members of the Consortium include the AU and its organs; the United Nations Economic Commission for Africa (ECA), the African Development Bank (AfDB), the Regional Economic Communities (RECs), the Pan-African Parliament, the African Capacity Building Foundation, ATAF, Global Financial Integrity (GFI), Tax Justice Network-Africa, other African networks, CSOs, and private sector, and some non-African partners.

3. African Union Commission publication on Domestic Resource Mobilization*: Fighting Against Corruption and IFFs*

Following the AU 2018 theme of the year, "*Winning the Fight against Corruption: A Sustainable Path for Africa's Transformation*." The Department of Economic Affairs held its annual Specialized Technical Committee on Finance, Monetary Affairs, Economic

Planning, and Integration under the same theme. During the STC, the member states recommended the publication of the book Domestic Resource Mobilization: *Fighting against Corruption and IFF.* This book includes best practices and experiences of various member states, RECs, and partners in the fight against IFFs.

4. African Union Commission (AUC) and the African Tax Administration Forum (ATAF) partnership

Tax revenue remains a significant source of income for most African countries. However, the continent still lags in the collection of tax revenues owing, among other factors, to the low capacity of tax administrations and weak infrastructure. To address this challenge, the AUC, ATAF and OECD jointly publish an annual Revenue Statistic Report which compiles comparable tax revenue and non-tax revenue statistics for 30 countries in Africa. In addition, the ATAF facilitates the exchange of information for tax purpose for African countries which enables recovering of revenue evaded to other African jurisdictions.

Moreover, the parties are leading the global discussions on the redistribution of taxing rights over the digital activities of multinational enterprises (MNEs) that trade remotely in jurisdictions with no physical presence but create value and make significant profits by their interactions with citizens. Also, discussions on global minimum tax, ensuring that all large MNEs pay at least a minimum taxation level. This issue is critical for the continent to reach a momentum on its position, so it speaks with a single voice when negotiating at the international level.

In August 2020, the AUC and ATAF co-organized a High-Level Policy Dialogue. Some of the recommendations that came out from the meeting were the organization of an annual High-Level Tax Policy Dialogue which facilitates the exchange of views and best practises in strengthening tax systems to enhance revenue collection. The parties are working to ensure this policy dialogue occurs annually as per the recommendation from member states.

5. Global Forum on Transparency and Exchange of Information for Tax Purposes

The African Union Commission in 2019 joined the Global Forum as an associate member/observer. The Forum facilitates the exchange of information for tax purposes, which has achieved great success in fighting offshore tax evasion in several countries, including Africa. Working through the Global Forum, nations have implemented robust standards that have prompted an unprecedented level of transparency in tax matters. In addition, the Global Forum, the OECD, the African Union Commission (AUC), the African Tax Administration Forum (ATAF), the African Development Bank (AfDB), the World Bank Group and the Cercle de Réflexion et d'Échange des Dirigeants des Administrations

Fiscales (CREDAF), have been producing an annual Africa Initiative Progress Report. The report informs decision-makers and citizens by providing comparable statistics on tax transparency as one of the African countries' responses to illicit financial flows. Tax Transparency in Africa 2020 shows significant progress made on the two pillars of the Africa Initiative: (i) raising political awareness and commitment in Africa and (ii) developing capacities in African countries in tax transparency and exchange of information.

6. IFFs and oil commodity trading- AUC and OECD joint project

In addition to the aforementioned priority areas, AUC Department of Economic Affairs in collaboration with the OECD Development Assistance Committee (DAC), launched a multiyear programme of work on IFFs in oil commodity trading which aims to assemble credible evidence on the efficacy of transparency efforts to date; survey the mutually supportive networks of actors, interests, and incentives that shape and facilitate IFFs in oil trading, as well as recommend ways in which IFF related interventions can be reinforced by ODA and other actions by OECD members. Though the project is mainly concentrated on the oil sector, the partners are considering extending the projects to all commodities, including minerals, agriculture products such as cocoa, etc.

Oil commodity trading related to IFFs have a negative impact on domestic resources mobilization and sustainable development. The work that is being undertaken jointly by the AUC and OECD aims to specifically interrogate the relationship between oil traders and national oil companies, particularly, in the following three areas: (i) the selection of buyers and allocation of buyers' rights; (ii) the negotiation of terms of sale; and (iii) the collection and transfer of revenues into national spending systems. These areas of work are interrelated and have a direct impact on the efforts of Member States to mobilize domestic resources.

7. AUC and EU joint Action on IFFs

The Department of Economic Affairs, in partnership with the European Union (EU) through the GIZ, is working on a project on IFFs. The **overall objective** of the Action is "*to contribute to reducing Illicit Financial Flows in Africa."* The project will leverage existing partnerships and develop new approaches to enhance activities to combat Illicit Financial Flows. The specific objectives include (i) the AUC facilitating role in fighting IFFs in Africa is strengthened (ii) Awareness regarding IFFs is raised among public institutions (including the AUC and the AU Member States) and CSOs; (iii) Accountability of public institutions regarding IFFs is improved at national and regional levels, through the implementation, among others, of good governance standards; (iv) Increased effectiveness of pilot government efforts to tackle IFFs. The project will also enable the strengthening of the strategy being developed by the AUC to tackle IFFs on the continent

III. Conclusions and Recommendations

Domestic resource mobilization remains imperative for the continent to achieve its developmental goals, including Agenda 2063. Many efforts are underway in the fight against IFFs at the national, regional, and continental levels. The challenge of IFFS may further be compounded, should the continent neglect to ensure adequate representation at Inclusive Framework discussions. This in is particular reference to Pillar 2 proposals, which aim to address BEPS by ensuring that all profits of a Multinational Enterprise are taxed at a minimum tax rate. While the current proposals currently insufficiently ensure the protection of taxing rights for source countries, they provide a basis for further debate and discussion within the context of pursuing greater taxing rights for the continent.

The corollary of an allocation greater taxing rights within the context of Pillar 2 discussions is a significant dent on IFFs as an effective tax rate, provided that it is fair to source countries, will avert complexities inherent in the current Transfer Pricing rules. In addition to the activities mentioned above, there are several initiatives going-on at various levels. As the continent is faced with the unprecedented coronavirus that exacerbates fiscal issues for the continent, strengthening resource mobilization becomes urgent and crucial. The Member States need to foster innovative ways and support ongoing initiatives in the fight against IFFs. Strong partnerships are essential at the continental and international levels to ensure the continent recovers its resources and channel it toward sustainable development. The role of the African policymakers at the highest level is crucial in forging the way forward with the various regional, continental, and international partners. The recommendations for strengthening the fight against IFFs are as follows:

- ✓ Strengthen the implementation of the recommendations from the High-Level Panel on the IFFs report;

- ✓ Stem IFFs leakages before they leave Africa's shores to avoid complicated process requiring capacities often in short supply in African countries to recover the resources.

- ✓ Forge and enhance robust partnerships in the fight against IFFs;

- ✓ Reach a consensus and strengthening the capacity of member states on the current global debate on taxing the digital economy and Base Erosion and Profit Shifting (BEPS) issues and guidance on how the continent ought to proceed in the said debate;

- ✓ Share various experiences and initiatives at the national level in the fight against IFFs;

- ✓ Member States are encouraged to utilize and be part of the ATAF and Global Forum platform that promotes the exchange of information for tax purposes that has benefited other countries.