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# Domestic Resource Mobilization: Fighting Against Corruption and Illicit Financial Flows

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# 2019

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African Union Commission  
PO Box 3243  
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# 2019

African Union Commission

# Table of Contents

<b>List of Figures</b> .....	4
<b>List of Tables</b> .....	5
<b>Abbreviations</b> .....	6
<b>Foreword</b> .....	11
<b>Tribute to Dr. René N’Guettia Kouassi</b> .....	12
<b>Acknowledgments</b> .....	13
<b>Executive Summary</b> .....	14
Finding Solutions to Illicit Financial Flows in Africa and Ways to Mobilize Domestic Resources .....	14
IFFs: The What, the How and the Where in Africa .....	14
IFFs: Their Effects .....	15
Where Do the Remedies Lie? .....	15
Way Forward.....	17
<b>CHAPTER I. Illicit Financial Flows in Africa: An Overview</b> .....	18
1.1. Introduction .....	18
1.2. Resource Mobilization in Africa and Impacts of Financial Flows .....	19
1.3. Illicit Financial Flows in Africa.....	20
1.4. Corruption and Governance in Africa .....	26
1.5. Conclusion and Recommendations .....	31
<b>CHAPTER II. Taxation and Domestic Resource Mobilization</b> .....	34
2.1. Introduction .....	34
2.2. Structural Factors Affecting Tax Effort and Potential .....	47
2.3. Lessons from Successful Revenue Mobilization Episodes.....	50
2.4. Conclusion and Policy Implications .....	56
<b>CHAPTER III. Policies for Fighting Illicit Financial Flows in Africa: The Centrality of Capacity Development</b> .....	62
3.1. Introduction .....	62
3.2. Illicit Financial Flows: Understanding the Facts and Figures for Effective Policy-making .....	63
3.3. Policy Options to Combat IFFs in Africa.....	68
3.4. Selected Country Initiatives to Curb IFFs.....	70
3.5. Proposed Actionable Recommendations .....	73
<b>CHAPTER IV. Illicit Financial Flows in Africa: How can Governments Respond?</b> .....	76
4.1. IFFs in Africa are Diverse and Require Tailored Responses.....	77
4.2. Policy implications for African Governments, Regional Institutions and Development Partners .....	92
<b>CHAPTER V. Stemming Illicit Financial Flows in Africa: Lessons Learned from Asia</b> .....	99
5.1. Introduction .....	99
5.2. Case Studies from the Region .....	103
5.3. Role of Financial Institutions .....	111
5.4. Efforts by International Organizations and Donors.....	112
5.5. Conclusion and Recommendations.....	113
<b>CHAPTER VI. The Role of South-South Cooperation in Combating Illicit Financial Flows</b> .....	119
6.1. Key Dimensions of Illicit Financial Flows .....	119
6.2. South-South Cooperation .....	120
6.3. Reforming the Global Tax System .....	121
6.4. Stemming IFFs through SSC.....	124
6.5. Conclusion and Recommendations.....	126

<b>CHAPTER VII. Experience of Selected African Peer Review Mechanism: Reviewed Countries in Fighting Corruption and Illicit Financial Flows</b> .....	128
7.1. Introduction .....	128
7.2. Link between the APRM Questionnaire, Corruption and IFFs .....	129
7.3. Overview of APRM Country Review Report Findings .....	131
7.4. Selected APRM Reviewed Country Experiences in Fighting Corruption and IFFs .....	132
7.5. Conclusion and Recommendations .....	137

## Experiences from Member States in Mobilizing Domestic Resources: Fighting Corruption and Illicit Financial Flows

<b>CHAPTER VIII. The Case of Mauritius</b> .....	140
8.1. Background .....	140
8.2. Measures Adopted by Mauritius to Combat Corruption, Money Laundering and the Financing of Terrorism .....	140
8.3. Measures to Ensure Transparency .....	143
8.4. International Cooperation .....	145
8.5. Conclusion and Recommendations .....	151
<b>CHAPTER IX. The Case of Uganda</b> .....	153
9.1. Why Combating IFFs from Africa is Key .....	154
9.2. Conclusion and Recommendations .....	155
<b>CHAPTER X. The Case of Algeria</b> .....	157
10.1. At the Legislative and Regulatory Level .....	157
10.2. At Institutional Level .....	158
10.3. Through Capacity Building .....	158
10.4. Through Monitoring and Control .....	159
10.5. In the Area of International Cooperation .....	159
<b>CHAPTER XI. The Case of Cameroon</b> .....	160
11.1. Introduction .....	160
11.2. Corruption and Illicit Financial Flows as Social Facts .....	160
11.3. Cameroon Experience in Combating Corruption and IFFs .....	162
11.4. Some Lines of Action to Contain Corruption and IFFs .....	166
11.5. Conclusion and Recommendations .....	168
<b>CHAPTER XII. The Case of Burkina Faso</b> .....	171
12.1. The Institutional and Procedural Dynamism of the Anti-Corruption Fight in Burkina Faso .....	171
12.2. Anti-Fraud and Tax Evasion Mechanisms .....	173
12.3. Experience of the General Inspectorate of Finance in Combating Corruption .....	175
12.4. CENTIF Contribution to Combating Corruption and IFFs .....	177
12.5. Contribution of the DGCCOOP in Combating Corruption and IFFs .....	178
12.6. Contribution of the DGD .....	178
12.7. DGI: Mobilization of Internal Resources and Fight against Fraud .....	181
<b>CHAPTER XIII. The Case of Morocco</b> .....	188
13.1. Concretization of Initiatives through the Implementation of Constitutional Arrangements .....	188
13.2. Measures Taken in the Area of Governance .....	189
13.3. Implementation of International Conventions .....	189
<b>CHAPTER XIV. The Case of Benin</b> .....	190
14.1. Policies Implemented in the Fight against Corruption in Benin .....	190
14.2. Implementation Approach .....	193
14.3. Results from the Fight against Corruption in Benin .....	196
14.4. Difficulties Encountered .....	197

## List of Figures

1.1: Evolution of IFFs and GDP .....	21
1.2: IFFs around the World by Region.....	22
1.3: Evolution of IFFs in Africa by Geographical Region.....	23
1.4: Distribution of IFFs in the World and in sub-Saharan Africa.....	23
1.5: IFFs per Country and Heterogeneity Per Zone.....	24
1.6: IFFs, % in Trade, Averaged over the 2005–2014 Period.....	25
1.7: IFFs, % of Trade, 2014.....	25
1.8: Composition of IFFs .....	26
1.9: Corruption and Public Management in Countries and Regions.....	28
1.10: Corruption, Public Management and Economic Performance .....	29
A1.1: Corruption and Governance of the Road Transport in West Africa .....	33
2.1: Change in Revenue Excluding Grants, Percent of GDP, Median, 1995–2016 .....	36
2.2: Total Revenue Excluding Grants to GDP, Median, 2016.....	36
2.3: Tax Revenue to GDP, Median, 2016.....	36
2.4: Total Revenue ( <i>Percent of GDP</i> ) .....	37
2.5: Total Revenue ( <i>Percent of GDP</i> ) .....	37
2.6: Non-resource Revenue ( <i>Percent of Non-resource GDP</i> ).....	37
2.7: Africa: Tax Revenue to GDP Ratio .....	38
2.8: Africa: Tax-to-GDP Ratio.....	38
2.9: Africa: Sources of Revenue, Percent of GDP.....	39
2.10: Africa: Decomposition of Revenue to GDP, 2016, Percent .....	39
2.11: Africa: Revenue to GDP, Oil Exporting Economies, Median.....	40
2.12: Africa: Non-resource Revenue to GDP, Fragile and Non-fragile States, Median.....	40
2.13: Africa: Personal Income Tax Rate, Average Top Rate, 2000–2016.....	41
2.14: Africa: Corporate Income Tax Rate, Average Top Rate, 2000–2016.....	41
2.15: Africa: PIT Threshold Relative to Per Capita GDP, 2016 or Latest Available.....	42
2.16: Africa: CIT Productivity and CIT to GDP, 2016 or Latest.....	42
2.17: CIT Productivity, Percent, Average .....	43
2.18: VAT C-Efficiency, Percent, Average .....	43
2.19: Africa: VAT C-Efficiency, 2016 or Latest Available .....	43
2.20: Africa: VAT Thresholds Relative to Per Capita GDP, 2016 or Latest Available.....	44
2.21: Excise Taxes as a Share of GDP, 2015, Average .....	45
2.22: Africa: Excise Taxes as Share of GDP, 2015 or Latest Available .....	46
2.23: Custom Taxes as a Share of GDP and Total Taxes, 2015 .....	47
2.24: Tax effort, in percent of GDP .....	48
2.25: Africa: Tax Frontier and Gap, Percent of GDP.....	49
2.26: Non-African Countries: Tax Frontier and Gap, Percent of GDP .....	49
2.27: Africa: Tax Ratio and Tax Frontiers, Percent of GDP, 2015.....	49
2.28: Tax Potential for Low Tax Revenue Countries, Percent of GDP .....	50
2.29: Africa: Revenue Mobilization Episodes, Non-resource Revenue to Non-resource GDP .....	51
2.30: Africa: Revenue Mobilization Episodes, Non-resource Revenue to Non-resource GDP Ratio.....	51
3.1: IFFs from Africa, Cumulative 2004–2013 (in Millions of USD, Nominal).....	64
3.2: Key Actors Involved in Fighting IFFs .....	69
4.1: Corruption Risks of Cross-cutting Relevance across the Extractive Value Chain.....	81
4.2: Dynamism of Crime .....	87
4.3: OECD Oslo Dialogue.....	87
4.4: Cumulative Increases in Tax Collection across the World .....	90

4.5: Change in Tax-to-GDP Ratios between 2015 and 2016 (Percentage Points of GDP).....	91
4.6: Tax Structure, Africa (21) Average as Percentage of Total Tax Revenue and Percentage of GDP, 2000 and 2016.....	92
A3.1: Breakdown of Shares of Regional Financial Flows to Africa, 2014–2016 .....	98
5.1: Channels of Illicit Financial Flows.....	102

## List of Tables

2.1: African Revenue Mobilization Episodes .....	52
2.2: African Revenue Mobilization Episodes: Timeline of Tax Policy and Administrative Reforms .....	53
A2.1: Estimates of African Countries' Tax Frontier, Percent of GDP .....	59
3.1: IFFs from Developing Countries, 2004–2013 (in Millions of USD, Nominal).....	63
3.2: Drivers of IFFs .....	65
3.3: Centers of Powers in Revenue Governance: Country Cases Examples .....	69
4.1: Summary of Selected International Instruments Governing Illicit Trade.....	79
4.2: FATF Categories, Sub-categories and Recommendations.....	84
4.3: Trade-offs and Synergies in Relation to IFFs.....	93
A4.1: Foreign and Domestic Financial Flows and Tax Revenues to Africa (Current USD, billion), 2010–2016.....	98
A4.2: Financial Flows and Tax Revenues to African Regions, 2014–2016 .....	98
5.1: Malaysia – Total Illicit IFFs, 2005–2014 .....	111
5.2: Annual Illicit Financial Flows, 2005–2013.....	111
5.3: Summary of Issues and Remedies from Case Studies.....	114
A8.1: Number of Complaints against Allegations of Corruption, as a Result of Increasing Awareness of Corruption by the Population .....	151
A8.2: Details of Properties on which the Commission has Requested and Obtained Restraining Orders by the ARID .....	152
A8.3: Assets Forfeited on Court Order Following Convictions of Accused Parties Involved in Money Laundering Offences .....	152
12.1: DGI Collections from 2006 to 2017 for the State Budget.....	184
12.2: Collection of Taxes between 2015 and 2017.....	184
12.3: Revenue Collected by the DGI in CFAF Millions and in % of GDP .....	185

## List of Boxes

3.1: Initiatives to Curb IFFs in Uganda .....	67
3.2: Lack of Coordination in Combating IFFs in Nigeria .....	68
3.3: Anti-Corruption Commission Integrity Committee Initiative (Zambia) and Implementation of Anti-Smuggling Measures by the Uganda Revenue Authority (URA) .....	70
3.4: The Accelerated IFF Agenda in Africa .....	71
3.5: Capacities required to address IFFs .....	72
4.1: Cooperation Agreement in Uganda.....	88
5.1: ASYCUDA .....	104
5.2: Basel III on Banking Supervision.....	108
5.3: Tax Amnesty Program of Indonesia, 2016.....	110

## Abbreviations

<b>AAAA</b>	Addis Ababa Action Agenda	<b>ASCE</b>	Supreme State Control Authority
<b>AAACA</b>	Association of Anti-Corruption Agencies of Commonwealth Africa	<b>ASCE-LC</b>	Supreme State Control and Anti-Corruption Authority
<b>ACBF</b>	African Capacity Building Foundation	<b>ASSIST</b>	ASEAN Solutions for Investments, Services and Trade
<b>ACC</b>	Anti-Corruption Commission	<b>ASYCUDA</b>	Automated System for Customs Data
<b>ACCU</b>	Anti-Corruption Coalition of Uganda	<b>ASW</b>	ASEAN Single Window
<b>ADB</b>	Asian Development Bank	<b>ATAF</b>	African Tax Administration Forum
<b>AEOI</b>	Automatic exchange of information	<b>AMATM</b>	ATAF Mutual Assistance in Tax Matters
<b>AfDB</b>	African Development Bank	<b>AMLA</b>	Anti-Money Laundering Act
<b>AFI</b>	African-Indian Ocean	<b>AU</b>	African Union
<b>AFRIPOL</b>	African Union Mechanism for Police Cooperation	<b>AUC</b>	African Union Commission
<b>AFROPAC</b>	African Organization of Public Accounts Committees	<b>AUCPCC</b>	African Union Convention on Preventing and Combating Corruption
<b>AFROSAI</b>	African Organization of Supreme Audit Institutions	<b>BAI</b>	Bureau of Analysis of Investigations
<b>ALCRER</b>	Association against Racism, Ethnocentrism and Regionalism	<b>BAPA</b>	Buenos Aires Plan of Action
<b>AML</b>	Anti-money laundering	<b>BEPS</b>	Base Erosion and Profit Shifting
<b>AML/CFT</b>	Anti-money Laundering/Combating Financing of Terrorism	<b>BIANCO</b>	Bureau Independent Anti-Corruption
<b>ANIF</b>	National Agency for Financial Investigation	<b>CABRI</b>	Collaborative African Budget Reform Initiative
<b>ANLC</b>	National Anti-Corruption Authority	<b>CACs</b>	Anti-corruption committees
<b>ANLF</b>	National Authority Against Fraud	<b>CbCR</b>	Country-by-Country Reporting
<b>APRM</b>	African Peer Review Mechanism	<b>CBK</b>	Central Bank of Kenya
<b>AQIM</b>	Al-Qaeda in the Islamic Maghreb	<b>CCG</b>	Centre for Corporate Governance
<b>ARCOOP</b>	Public Procurement Regulatory Authority	<b>CDD</b>	Customer due diligence
<b>ARID</b>	Asset Recovery Investigation Division	<b>CEMAC</b>	Economic and Monetary Community of Central African States
<b>ARIN-AP</b>	Asset Recovery Interagency Network-Asia Pacific	<b>CENTIF</b>	National Anti-Corruption Authority
<b>ASEAN</b>	Association of Southeast Asian Nations	<b>CFT</b>	Combating the financing of terrorism
		<b>CISLAC</b>	Civil Society Advocacy and Legislative Centre



<b>CIT</b>	Corporate income tax	<b>DGE</b>	Large Enterprises Directorate
<b>CITES</b>	Convention on International Trade in Endangered Species of Wild Fauna and Flora	<b>DGEP</b>	Directorate General of Economy and Planning
<b>CLARION</b>	Centre for Law and Research International	<b>DGI</b>	Directorate General of Taxes
<b>CML/TF</b>	Combating money laundering and terror financing	<b>DGSN</b>	General Delegation for National Security
<b>CMLV</b>	Cambodia, Myanmar, Laos, Vietnam	<b>DGTCP</b>	Directorate General of Treasury and Public Accounting
<b>CONAC</b>	National Anti-Corruption Commission	<b>DGTTM</b>	Direction Générale du Transport Terrestre et Maritime
<b>CNSS</b>	National Social Security Fund	<b>DME</b>	Directorate of Medium Enterprises
<b>CP</b>	Commissioner of Police	<b>DMP</b>	Directorate of Public Procurement
<b>CPI</b>	Consumer Price Index	<b>DOS</b>	Reporting of suspicious transactions
<b>CPRs</b>	Corruption Prevention Reviews	<b>DPI</b>	Provincial Tax Directorates/ Direction Provinciale des Impôts
<b>CRRs</b>	Country review reports	<b>DRM</b>	Domestic resource mobilization
<b>CSAR</b>	Country Self-Assessment Report	<b>DTAA</b>	Double Taxation Avoidance Agreement
<b>CSOs</b>	Civil society organizations	<b>ECA</b>	United Nations Economic Commission for Africa
<b>CTRF</b>	Financial Intelligence Processing Unit	<b>ECCAS</b>	Economic Community of Central African States
<b>DAAF</b>	Directorate of Administration and Finance	<b>ECOWAS</b>	Economic Community of Western African States
<b>DAC</b>	Development Co-operation Actors	<b>EFDs</b>	Electronic fiscal devices
<b>DCI</b>	Directorates of the Tax Centers/ Direction des Centres des Impôts	<b>EITI</b>	Extractive Industries Transparency Initiative
<b>DERF</b>	Directorate of Investigations and Tax Research	<b>EOI</b>	Exchange of information
<b>DFID</b>	Department for International Development	<b>EPDRF</b>	Ethiopian People's Revolutionary Democratic Front
<b>DGAIE</b>	Directorate General of State Real Estate Affairs	<b>EMU</b>	Efficiency Monitoring Unit
<b>DG-CMEF</b>	Directorate General for Control of Public Procurement and Financial Commitments; La Direction générale du contrôle des marchés publics et des engagements financiers	<b>ESCAP</b>	United Nations Economic and Social Commission for Asia and the Pacific
<b>DGCOOP</b>	Directorate General of Cooperation	<b>EU</b>	European Union
<b>DGD</b>	Directorate General of Customs	<b>ESAAMLG</b>	East and Southern African Anti-Money Laundering Group

<b>FAARF</b>	Support Fund for Women's Remunerative Activities	<b>ICT</b>	Information and communications technology
<b>FATCA</b>	Foreign Account Tax Compliance Act	<b>IFFs</b>	Illicit financial flows
<b>FATF</b>	Financial Action Task Force	<b>IFU</b>	Taxpayer identification system
<b>FCTC</b>	Framework Convention on Tobacco Control	<b>IFU</b>	Investment Fund for Developing Countries
<b>FDI</b>	Foreign Direct Investment	<b>IG</b>	Inspectorate of Government
<b>FBDES</b>	Burkina Faso Fund for Economic and Social Development	<b>IGG</b>	Inspector-General of Government
<b>FEER</b>	Fund for Water and Rural Equipment	<b>IGF</b>	Inspector-General of Finances
<b>FIA</b>	Financial Intelligence Authority	<b>IGSEP</b>	Inspector-General for Public Service and Employment
<b>FIAMLA</b>	Financial Intelligence and Anti-Money Laundering Act 2002	<b>ILO</b>	International Labour Organization
<b>FIU</b>	Financial Intelligence Unit	<b>IMF</b>	International Monetary Fund
<b>FONAC</b>	Front of National Anti-Corruption Organizations	<b>INSD</b>	National Institute of Statistics and Demography
<b>FSA</b>	Financial Services Act 2007	<b>INSW</b>	Indonesia National Single Window
<b>FSAP</b>	Financial Sector Assessment Programme	<b>INTERPOL</b>	International Criminal Police Organization
<b>FSC</b>	Financial Services Commission	<b>IODMz</b>	Institute of Board of Directors of Mozambique
<b>FSP</b>	Financial service providers	<b>IOM</b>	International Organization for Migration
<b>GABAC</b>	Task Force on Money Laundering in Central Africa	<b>IOSCO</b>	International Organization of Securities Commissions
<b>GCCC</b>	Central Office for Combating Corruption	<b>IT</b>	Information technology
<b>GDP</b>	Gross Domestic Product	<b>KACAB</b>	Kenya Anti-Corruption Advisory Board
<b>GFI</b>	Global Financial Integrity	<b>KACC</b>	Kenya Anti-Corruption Commission
<b>GIABA</b>	Inter-Governmental Action Group against Money Laundering in West Africa	<b>KPK</b>	Anti-Corruption Commission, Indonesia
<b>GJLOS</b>	Governance, Justice, Law and Order Sector	<b>KYC</b>	Know Your Customer
<b>GSPWG</b>	Global Standards and Proportionality Working Group	<b>MCs</b>	Management companies
<b>GTC</b>	General Tax Code	<b>MENA</b>	Middle East and North Africa
<b>IAACA</b>	International Association of Anti-Corruption Authorities	<b>MENAFATF</b>	Middle East and North Africa Financial Action Task Force
<b>ICAC</b>	Independent Commission Against Corruption	<b>MER</b>	Mutual Evaluation Report
		<b>MINEFID</b>	Le ministère de l'Économie, des Finances et du Développement

<b>ML/TF</b>	Money laundering/terrorist financing	<b>IODMz</b>	Institute of Board of Directors of Mozambique
<b>MLA</b>	Mutual legal assistance	<b>PAC</b>	Public Accounts Committee
<b>MLI</b>	Multilateral Instrument	<b>PEPs</b>	Politically exposed persons
<b>MMoU</b>	Multilateral MoU	<b>PFM</b>	Public Finance Management
<b>MNCs</b>	Multinational corporations	<b>PIC</b>	Public Investments Committee
<b>MNEs</b>	Multinational enterprises	<b>PIT</b>	Personal income tax
<b>MoFPED</b>	Ministry of Finance, Planning and Economic Development	<b>PNACCSC</b>	Permanent National Anti-Corruption Campaign Steering Committee
<b>MoUs</b>	Memorandums of Understanding	<b>PNDES</b>	National Plan for Economic and Social Development
<b>MRA</b>	Mauritius Revenue Authority	<b>PoCA</b>	Prevention of Corruption Act 2002
<b>NACC</b>	National Anti-Corruption Commission	<b>PoTA</b>	Prevention of Terrorism Act 2002
<b>NACP</b>	National Anti-Corruption Policy	<b>RADEX</b>	Revenue Authority Digital Data Exchange
<b>NAFDAC</b>	National Agency for Food and Drug Administration and Control	<b>RBI</b>	Reserve Bank of India
<b>NARC</b>	North African Regional Capability	<b>RCBC</b>	Rizal Commercial Banking Corporation
<b>NBR</b>	National Board of Revenue	<b>RECs</b>	Regional Economic Communities
<b>NEPAD</b>	New Partnership for Africa's Development	<b>RENLAC</b>	National Anti-Corruption Network
<b>NGO</b>	Non government organizations	<b>RESINA</b>	Inter-Administration Network/ Réseau Inter-Administration
<b>NORAD</b>	Norwegian Agency for Development Cooperation	<b>RTR</b>	Rests-to-recover
<b>NRA</b>	National Risk Assessment	<b>RWAs</b>	Risk weighted assets
<b>NSI</b>	National System of Integrity	<b>SAARC</b>	South Asian Association for Regional Cooperation
<b>NSWs</b>	National Single Windows	<b>SACRP</b>	SIDS Anti-Corruption Research Platform
<b>OCERTID</b>	Central Office to Combat Illicit Traffic in Drugs and Precursors	<b>SADC</b>	Southern African Development Community
<b>OCLEI</b>	Office de Lutte Contre L'Enrichissement Illicite	<b>SCC</b>	Special Criminal Court
<b>ODA</b>	Official development assistance	<b>SCR 2</b>	Second-generation Growth Strategy for Poverty Reduction
<b>OECD</b>	Organisation of Economic Co-operation and Development	<b>SDGs</b>	Sustainable Development Goals
<b>OHADA</b>	Treaty on the Harmonization of Business Law in Africa	<b>SEZs</b>	Special economic zones
<b>OJK</b>	Financial Services Authority	<b>SGS</b>	Société Générale de Surveillance
<b>OLC</b>	Observatory for the Fight against Corruption	<b>SHaSA</b>	Harmonization of Statistics in Africa
<b>IOSCO</b>	International Organization of Securities Commissions		

<b>SIDS</b>	Small Island Developing States	<b>UHRC</b>	Uganda Human Rights Commission
<b>SIGFIP</b>	Integrated Public Finance Management System	<b>UK</b>	United Kingdom
<b>SIGTAS</b>	Integrated Tax and Assimilated Taxes Management System	<b>UN</b>	United Nations
<b>SIGU</b>	One-stop-shop system	<b>UNCAC</b>	United Nations Convention against Corruption
<b>SNLCC</b>	National Anti-Corruption Strategy	<b>UNECA</b>	United Nations Economic Commission for Africa
<b>SONABEL</b>	Société Nationale d'électricité du Burkina Faso	<b>UEMOA</b>	West African Economic and Monetary Union
<b>SOEs</b>	State-owned enterprises	<b>UNCDF</b>	United Nations Capital Development Fund
<b>SSC</b>	South-South Cooperation	<b>UNCTAD</b>	United Nations Conference on Trade and Development
<b>StAR</b>	Stolen Asset Recovery Initiative	<b>UNDP</b>	United Nations Development Programme
<b>STC</b>	Specialized Technical Committee	<b>UNHCR</b>	United Nations High Commissioner for Refugees
<b>STI</b>	Service Technical Inspections	<b>UNTOC</b>	UN Convention on Transnational Organized Crime
<b>SYGICOD</b>	Computerised Customs Litigation Management System	<b>UNODC</b>	United Nations Office on Drugs and Crime
<b>SYLVIE</b>	Virtual Link System for Import and Export Operations	<b>URA</b>	Uganda Revenue Authority
<b>TF-CIT ISP</b>	OECD Task Force on Charting Illicit Trade Information Sharing Platform	<b>USA</b>	United States of America
<b>TFPs</b>	Technical and financial partners	<b>VAT</b>	Value-added tax
<b>TI</b>	Transparency International	<b>WB</b>	World Bank
<b>TIEA</b>	Tax Information Exchange Agreement	<b>WBG</b>	World Bank Group
<b>TIWB</b>	Tax Inspectors Without Borders	<b>WCO</b>	World Customs Organization
<b>TIWB-CI</b>	Tax Inspectors Without Borders for Criminal Investigations	<b>WEO</b>	World Economic Outlook
<b>TRA</b>	Tanzania Revenue Authority	<b>WAEMU</b>	West African Economic and Monetary Union
<b>TRIPS</b>	Trade-related Aspects of Intellectual Property	<b>WDI</b>	World Development Indicators
<b>UAC</b>	Unidade Anti-Corrupção. [Anticorruption Unit]	<b>WGI</b>	World Governance Indicators

## Foreword


The ability of the African continent to mobilize financial resource is a strong predictor of its capability to achieve the goals spelt out in the African Union (AU) Agenda 2063 and in the Agenda 2030. As the global economic landscape is rapidly changing, the new AU Commission's Report, is most timely, as it gives an in-depth analysis of issues related to domestic resource mobilization and illicit financial flows (IFFs) in Africa. This report is the result of partnership between AU Member States, the AU Commission and many continental and international organizations and provides support to decision-makers by proposing efficient and long-lasting solutions to the challenges facing Africa.

The AU's initiative to dedicate the year 2018 to combating corruption under the theme, 'Winning the Fight against Corruption: A Sustainable Path for Africa's Transformation', marks our continuing commitment to find predictable and substantial resources to win the fight against corruption through concrete action and therefore make progress towards the continent's inclusive socio-economic development. Indeed, without financial autonomy, Agenda 2063 will not deliver.

The aim of this report is to share experience on the initiatives set up by Members States and international organizations to mobilize domestic resource and optimize tax collection, win the fight against corruption and strengthen tax cooperation to stem IFFs. The Specialized Technical Committee (STC) on Finance, Monetary Affairs, Economic Planning and Integration, which was held in 2018 in Addis Ababa, Ethiopia, called upon the Commission to lead in the tax transparency and information exchange agenda for Africa, set up an experience-sharing platform and foster stronger collaboration among countries and regions in order to tackle the root causes of IFFs. To this end, the Commission through this book reiterates the AU's commitment to contribute to improving domestic resource mobilization, fighting corruption and curbing IFFs.

Africa has experienced strong economic growth with an average of around 5% since 2000. However, this growth has not substantially reduced poverty and inequality nor led to job creation. In view of the current limited budgetary resources, the scarcity and volatility of development aid, African countries should explore more options for mobilizing domestic resources to finance productive activities, generate inclusive growth and mitigate the increasing social demands. A High Level Panel on Illicit Financial Flows was established to improve knowledge of the nature, scale and impacts of illicit financial flows and curb them. The recommendations of the Panel, which were adopted by the AU Heads of State provide a basis to fight IFFs and helped build strong political momentum across the continent.

The report is divided into two parts and fourteen chapters. The first part comprises analytical contributions while the second part presents specific actions that are being taken by AU Member States, to mobilize domestic resource and fight against corruption and IFFs. This type of partnership is to be continued.



**Moussa Faki Mahamat**  
Chairperson  
African Union Commission

## Tribute to Dr. René N'Guettia Kouassi

Driven by the ardour of youth, the desire to serve and to succeed, Dr. René N'Guettia Kouassi, commonly known as Dr. Kouassi, joined the African Union Commission and devoted the last third of his life to the institution.

He was one of the fervent architects of continental integration and was a key player in the advent of the Abuja Treaty, which Africa is working to implement to meet its huge economic challenges.

Dr. Kouassi was sometimes understood with a lot of delay. This led him to write the book entitled: "**Africa, a giant who refuses to be born**". However, he remained faithful to his convictions until he was called back to God.

In tribute to his scientific rigour and his taste for a job well done, the Department of Economic Affairs has dedicated this book to him: **Domestic Resource Mobilization: Fighting against Corruption and Illicit Financial Flows**.

Dr. Kouassi, the seeds you have sown are starting to germinate, Africa will rise to the economic challenges it faces.

### **Prof. Victor Harison**

Commissioner for Economic Affairs  
African Union Commission

## Hommage à Dr. René N'Guettia Kouassi

Poussé par la fougue de la jeunesse, le désir de servir et la volonté de réussir, Dr. René N'Guettia Kouassi, appelé couramment Dr. Kouassi, a intégré la Commission de l'Union africaine et y a consacré le dernier tiers de sa vie.

Il a été un des fervents artisans de l'intégration continentale et a été un acteur de premier plan dans l'avènement du Traité d'Abuja que l'Afrique s'attèle à mettre en œuvre pour son émergence.

Dr. Kouassi a été parfois compris avec beaucoup de retard. Ce qui l'a amené à écrire le livre intitulé : "**L'Afrique, un géant qui refuse de naître**". Cependant, il est resté fidèle à ses convictions jusqu'à son rappel à Dieu.

En hommage à sa rigueur scientifique et à son goût pour le travail bien fait, le Département des Affaires économiques lui dédie le présent ouvrage : **Mobilisation des ressources internes : lutte contre la corruption et les flux financiers illicites**.

Dr. Kouassi, les graines que vous avez semées commencent à germer, l'Afrique sera au rendez-vous de son émergence.

### **Prof. Victor Harison**

Commissaire aux Affaires économiques  
Commission de l'Union africaine

## Acknowledgments

The report was prepared by the Department of Economic Affairs under the Leadership of the Commissioner H.E. Prof. Victor Harison and the supervision of the Director of Economic Affairs Department, Dr. René N'Guettia Kouassi. The preparation of this report was led and coordinated by Dr. Eng. Ligane Massamba Sène, Economist, Economic Policy and Research, Department of Economic Affairs. The report also benefited from the guidance of Dr. Yeo Dossina, Head of Economic Policy and Research Division.

The report is the result of the work of numerous specialists from international organizations and Member States, whose contributions are acknowledged. Contributions were received from the African Union Commission (AUC), the International Monetary Fund (IMF), the Organisation for Economic Co-operation and Development (OECD – Development Centre), the United Nations Office for South-South Cooperation, the South Centre (UNOSSC), the African Peer Review Mechanism (APRM), and Member States (Republic of Mauritius, Republic of Uganda, Burkina Faso, Republic of Cameroon, Kingdom of Morocco, People's of the Democratic Republic of Algeria and the Republic of Benin). The list of authors is presented in each chapter when made available and provided by the contributing organization and/or Member State. The report reflects as closely as possible the content and style of the different contributions received by the AUC.

Djeinaba Kane, Rumbidzai Manhando and Anais Georges provided valuable support co-ordinating the work. Special thanks to Yamrot Kifle, Kokobe Georges, Miora Niavo and Beenzu Monze for the administrative and logistical support.

# Executive Summary

## Finding Solutions to Illicit Financial Flows in Africa and Ways to Mobilize Domestic Resources

The African Union Agenda 2063, “The Africa we want” embodies the vision and plan for Africa to realise its potential blueprint and master plan for transforming Africa into a global powerhouse for future generations. While ideals such as unity, self-determination, freedom, progress and collective prosperity underpin the vision, planning is supported by a strategic framework to realise the goal of inclusive and sustainable development.

The African Union’s decision to dedicate 2018 to the theme, ‘Winning the Fight against Corruption: A Sustainable Path for Africa’s Transformation’, indicate the African Union’s commitment to rooting out corruption, therefore paving the way for socio-economic development.

It follows therefore that corruption and Illicit Financial Flows (IFFs), are a threat to development in Africa. While the authors of the different chapters in this book demonstrate excellent understanding of the nature of corruption and the effects of IFFs, and the many remedies that exist globally including in Africa and in Asia, advocacy for this cause requires us to highlight common elements and point to some efficacious recommendations.

## IFFs: The What, the How and the Where in Africa

IFFs are widespread and secretive by nature. No one quite knows how to quantify losses in Africa due to IFFs. Estimates of these amounts hover between USD 50 and 80 billion annually and seem to be on an upward trajectory. Shockingly, this amount is higher than the annual Official Development Assistance (ODA) that the continent receives. But how does this take place and who perpetuates these processes, which continue to stymie growth and development and is effectively impoverishing Africa?

The High Level Panel on Illicit Financial Flows from Africa, commissioned in 2011 by the Joint Annual Meetings of the African Union Specialized Technical Committee (STC) on Finance, Monetary Affairs, Economic Planning and Integration and the United Nations Economic Commission for Africa (UNECA) of African Ministers of Finance, Planning and Economic Development (COM), resulted in the Mbeki Panel Report in 2015.

IFFs can be traced back to commercial activities, such as tax evasion, trade mis-invoicing, and abusive transfer pricing. Next on the list are criminal activities, including the drug trade, human trafficking, illegal arms dealing, and smuggling of contraband. And last but not least in this litany of crimes, is bribery and theft.

The Mbeki Panel Report took the considered view that legal acts in one location with “the intent (...) to hide money [through facilities in another location] even if legitimately earned” constitute IFFs. The definition of IFFs is therefore broadened beyond activities and transactions, which are deemed violations of the law. IFFs affect not only Africa; all developing regions are vulnerable.

This should be seen against the backdrop of exacerbating factors such as poor governance, ‘grand corruption’ and the ubiquitous use of information and communication technology which is transborder and vulnerable. Put into this mix the so-called drivers of IFFs such as macroeconomic indicators (government deficits, inflation and inflationary expectations); structural variables (increasing trade openness, faster rates of economic growth and their impact on income distribution) and governance-related issues, and we seem to have all the symptoms of a perfect IFFs storm.

Do all African countries suffer from this malaise? From the evidence in the recent past, East and Central Africa have the lowest levels of IFFs, while the southern and West African region



have the highest amounts of IFFs. Oil-exporting countries have a prominent share of IFFs, while higher levels of IFFs are linked to the size of economic activity in countries and regions. There is even a 'top ten' of countries in Africa, all of which are implicated in approximately 75% of total IFFs. Dominant on this list are several resource-rich countries.

### IFFs: Their Effects

There is a view that access and deployment of a portion of the funds lost through IFFs could have helped African countries to achieve the Millennium Development Goals (MDGs) by 2015.

IFFs reduce and even eliminate expected growth benefits and undermine the development potential in Africa. As an outcome of corruption, particularly so-called 'petty corruption', the negative effects of IFFs are widespread.

Pernicious effects of IFFs and their underlying activities, which have been observed, are the creation of unfair barriers to doing business and precluding competition.

From a socio-economic perspective, IFFs wreak widespread damage at many levels. The erosion of the tax base of affected countries, deprive governments of financial resources needed for public goods, such as education, health and infrastructure. Governance structures and public institutions are weakened, with subsequent diminished public trust in the government and low tax morale.

These obstacles to economic activities and the creation of stable employment may lead the most vulnerable to resort to criminal activities, creating a vicious cycle of corruption and illicit financial flows, inequalities and unemployment.

### Where Do the Remedies Lie?

This book sets out in great detail both the problem of corruption and IFFs and the remedies and actions needed to eliminate these problems. It includes case studies of various countries where Government, State Institutions, the judiciary, the private sector and civil society have rallied to the call to eliminate corruption and IFFs.

**Domestic Resource Mobilization** – the process through which countries raise and spend their own funds to provide for their people – is cited as key to establishing a long-term path to sustainable development finance. The acknowledged lodestar for development in Africa is the Agenda 2063.

A dizzying number of options and recommendations for domestic resource mobilization exist. Most have in common three key elements: taxation; savings mobilization and financial inclusion; and curbing IFFs. Domestic resource mobilization can be enhanced through: improvement of the efficiency of existing tax systems by taking profit of opportunities abounding from digitalization and transparency initiatives, the optimization of tax incentives, the rationalization of tax exemptions, the expansion of the tax base, the implementation of specialized taxes, the establishment of solid domestic institutions and policy frameworks. There are many other sources and strategies to mobilize domestic resource discussed in this book.

The approach in this piece is to list selective measures that have been adopted by a number of African countries, rather than straying into a general discussion or comparative commentary. In all cases, the actions listed below are backed up by legislation, which is outlined in some detail in the book. The summary below is not inclusive and the reader is invited to peruse the relevant chapters in the book for more details.

At the onset, it should be stated that many jurisdictions in Africa have enacted anti-money laundering laws, consistent with the standards of the Financial Action Task Force, an inter-governmental organization in existence for 30 years.

Led by its President, **Kenya** has adopted policies and institutions to fight corruption and IFFs: the Kenya Anti-Corruption Commission and the Key Anti-Corruption Police Unit with the support of Kenya Anti-Corruption Advisory Board. The latter has membership from professional and business associations, as well as labour and religious organizations. There is also the Permanent National Anti-Corruption Campaign Steering Committee to coordinate a nationwide anti-corruption campaign.

**Uganda's** Inspector-General of Government is the principal institution tasked with a mandate to eradicate corruption. Initiatives by civil society include the Anti-Corruption Coalition of Uganda and the Centre for Corporate Governance. The Financial Intelligence Authority is mandated to combat money laundering.

A comprehensive anti-corruption strategy and instruments signal **Mozambique's** intention to curb levels of corruption. Within the Public Prosecution Service Office, the Central Office for Combating Corruption has been established as an anti-corruption unit.

**Algeria** was among the first Arab and African countries to ratify the United Nation's Convention against Corruption, as well as other international and regional instruments. Algeria is committed to reforming the judiciary in pursuit of better performance; the country has signed no less than 57 bilateral agreements and is backing up its intentions with legislation to promote good governance. Capacity building features as part of these plans.

Measures to combat corruption, money laundering and the financing of terrorism have been put in place by **Mauritius**. This includes a legal and an institutional framework, the latter which comprises the Independent Commission against Corruption. In addition, Mauritius has put in place mechanisms for greater transparency in financial systems. To facilitate international co-operation, Mauritius has adopted applicable and appropriate norms, standards and best practices by international bodies.

**Cameroon** is party to legal instruments adopted within the framework of the Economic Community of Central African States to fight corruption. To this it has added jurisdictional measures, institutional mechanisms and parliamentary mechanisms.

The case submitted by **Burkina Faso** has a refreshingly progressive approach through its emphasis on the institutional framework and new procedures to rationalize domestic resources. Its coherent and dynamic anti-corruption framework is supported by stream-lined administrative procedures regarding taxation and customs. Anti-corruption committees have been set up in the directorates of the Ministry of Economics, Finance and Development, for specific functions, including training and awareness. CENTIF, the National Financial Intelligence Processing Unit, plays an important watchdog role regarding money laundering and terrorist financing circuits.

**Morocco** is active at institutional and regulatory levels to combat corruption and established the Central Authority for the Prevention of Corruption. Its judiciary is independent. In 2015 the National Anti-Corruption Strategy (2015–2025) was adopted. Public and political governance have been reviewed and improved, and the Kingdom of Morocco has implemented several international conventions.

**Benin** has a legal and institutional framework covering anti-corruption issues. The former includes national, regional and international instruments, while institutional bodies are defined as either political or technical and specialized. The Front of National Anti-Corruption Organizations is a network of 25 organizations set up since 1998 to fight against corruption at state level and civil society; in addition, Benin has a National System of Integrity.

The list of capacities required to address IFFs are as follows: required soft and society-level capacity; required institutional capacity; and required human capacity. These are essential to bolster the establishment of appropriate rules and regulations. Legal reform covering taxation, banking and capital markets, and tax harmonization are equally essential.

Taxation plays a critical role in domestic resource mobilization. Three rules of thumb for African countries are to invest in programs to achieve the goals set out in the Agenda 2063 and the Sustainable Development Goals; set domestic revenue mobilization as a key component of a fiscal consolidation strategy; and develop adequate capacity to collect taxes to strengthen institutions and develop state capacity.

Interestingly, success stories of sustained revenue mobilization in some African countries (albeit a small sample) provide some clues on what is required for this positive development. An emphasis on the basic building blocks of the tax system is one key element, with a focus on tax policy effectiveness and expanding the tax base, and significant efforts to develop and modernize institutions constitute the ingredients of this effective approach.

## Way Forward

While evidence of both domestic resource mobilization and the fight against corruption and IFFs abounds, perhaps the most important driver for positive change in this morally fraught and emotionally charged context, are sustained political will and visionary leadership which is committed and accountable throughout a period of reform. This is critical in achieving a changed mind-set and embedding so-called 'soft capacities' that have been identified as essential for lasting change.

As Africans, we must make sense of what is happening on our continent. We must assimilate information; and we must rally to the cause of ridding Africa of these scourges, empowered by understanding, energy and optimism. Harnessing domestic resources and optimizing available spending would help reduce the dependence on external resources, narrow the huge African development resource gap, foster economic growth, create jobs, and reduce poverty and inequality substantially.

# CHAPTER I.

## Illicit Financial Flows in Africa: An Overview

### The African Union Commission<sup>1</sup>



#### 1.1. Introduction

Illicit financial flows (IFFs) and corruption have long been at the centre of discussions on development in Africa, particularly due to the existence of a wide consensus on their negative impacts on development financing in Africa. It is now so widespread that Africa loses USD 50 billion annually. However, this figure is well below reality due to the difficulty in obtaining reliable statistics, and the secretive nature of such funds.

The African Union (AU)'s initiative to dedicate the year 2018 to combating corruption under the theme, 'Winning the Fight against Corruption: A Sustainable Path for Africa's Transformation' is eloquent proof of the willingness of the AU to combat poor financial governance, which affects the continent's inclusive socio-economic development, as IFFs are obstacles to productive investments, resulting in distortions in allocations of budgetary resources, and systematically increasing inequalities.

The mobilization of adequate resources is essential in order for Africa to emerge from its weak economic conditions, and increase the level of development of its populations. Indeed, after two decades (1980s and 1990s) of weak growth with a nearly zero average, Africa has experienced strong economic growth, despite the recent downturn observed with the decline in commodity prices. The average growth rate has been around 5% since 2000, with considerable heterogeneity in growth patterns between countries, at a time when other regions have experienced a decline or stagnation in their economic activity. However, this growth has not substantially reduced poverty and inequality or led to job creation. The processes for industrialization, economic diversification and the modernization of agriculture have also been very limited. Despite progress made, more than 50% of the African population is living on less than USD 1.9/day, that is, about 389 million people (World Bank, 2016). In terms of income distribution, six of the top ten most unequal countries in the world were located in Africa, particularly in southern Africa, with a GINI coefficient increasing from 0.42 to 0.46 between 2000 and 2010 (AfDB, 2012). Africa's infrastructure needs range from USD 130 to 170 billion per year (AfDB, 2018).

On the basis of these findings and in view of the current limited budgetary resources and the scarcity of development aid, African countries should explore options for mobilizing domestic resources to finance productive activities, generate growth and mitigate the increasing social demands as a result of the continuing unprecedented population growth. This should start by combating IFFs and recovering funds lost to invest in the social sectors (education, health, and social safety nets, amongst others) in order to rapidly harness the demographic dividend, and to

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<sup>1</sup> This chapter has been prepared by Dr. Ligane Massamba Sène, Economist, Economic Policy and Research, Department of Economic Affairs, African Union Commission (AUC). This chapter benefited from the discussions held at the 2<sup>nd</sup> Ministerial Specialized Technical Committee (STC) of the AU on Finance, Monetary Affairs, Economic Planning and Integration in April 2018. Our gratitude goes to the late Dr. René N'Guettia Kouassi, Director of the Department of Economic Affairs. The views expressed in this chapter do not necessarily reflect those of the AU.

place the continent on the path to rapid, inclusive and sustainable growth. The AU could address the issue at a political level by putting in place a common continental strategy on which national strategies will be anchored, and by advocating for the strengthening of international cooperation in combating tax evasion, money laundering, crime, corruption, false invoicing and mispricing of imported or exported goods practices.

This chapter takes stock of IFFs and corruption in Africa, with a detailed presentation at regional and country levels. It is structured as follows: the first part essentially discusses the importance of domestic resource mobilization, and combating corruption and IFFs to ensure the sustainable development of Africa. The second part takes stock of the IFFs in Africa based on data provided by the organization, Global Financial Integrity (GFI). The third part addresses the issue of corruption and financial mismanagement in Africa, and the last part proposes recommendations.

## 1.2. Resource Mobilization in Africa and Impacts of Financial Flows

Domestic resource mobilization has become crucial in Africa due to increasingly urgent infrastructure needs and social demand. Low-income countries will need to increase their annual public expenditure by 30% of Gross Domestic Product (GDP) in order to achieve the Sustainable Development Goals (SDGs) (Baum *et al.*, 2017). However, the question that arises is whether these countries, particularly African countries, can do so in the current context marked by scarcity of public resources. The increasing decline in development aid due to financial problems in partner countries, unpredictability and dependence on external funding may limit the flexibility of countries in taking into account their own priorities in the efficient implementation of their development plans.

Conscious of this, the Heads of State and Government expressed the hope that internal sources of financing would be explored to achieve the objectives of the AU Agenda 2063, and those of the post-2015 SDGs in order to socio-economically transform the continent. In this respect, the proposed new tax for regular funding of the AU was adopted, with a 0.2% customs levy on imports. With these funds, Member States will cover 100% of the operational budget, 75% of the program budget, and 25% of the peace and security budget.

Africa also has other sources and strategies for mobilizing adequate resources. Efforts should therefore be intensified at country level to mobilize further national resources, thereby overcoming dependence on foreign aid. Africa must seek to improve the use of its available financial resources through a real improvement in the efficiency of public spending and good management of financial resources. Financing Africa's transformation requires strengthening public-private partnerships and improving the business environment and regulatory framework to further increase investments that are critical to infrastructure financing. The capacities of tax administrations should be strengthened, and the tax bases broadened, while supporting migration from the informal to the formal sector. One option for mobilizing more domestic resources will therefore be to reduce the size of the informal sector, which accounted for 90% of employment outside the agricultural sector, and 38% of GDP in sub-Saharan Africa over the 2010–2014 period (International Monetary Fund, 2017), the second largest in the world after Latin America and the Caribbean. However, the sector should not be seen as merely a niche opportunity to increase tax revenues. The development of the informal sector requires facilitating access to credit, in the context of low rate of use of the banking system (20%), through simplified administrative procedures, providing incentives for formalization, and establishing training programs for operators working in the sector.

Applying only these measures aimed at achieving development goals could prove to be insufficient in the long run. In fact, informality still persists in some developed countries and based on this observation, it would probably take years for Africa to fully ensure that the transition is made. The sustainability of Africa's internal development financing is highly dependent firstly on stopping the continent's haemorrhage due to IFFs, and secondly, reallocating them for optimum

use in order to achieve the continent's priority development goals in each sector. A reduction in non-optimal allocation would lead to an increase in the GDP of low-income countries by 0.9 percentage points (International Monetary Fund, 2017). Consequently, this would free up the additional resources needed to structurally transform economies, combat poverty and inequalities and to create jobs. These flows could have been used to boost African economies through the positive impacts they could have had on almost all components of domestic demand, including those of the public sector<sup>2</sup>, as well as boosting the external financial position, which would be reflected in improved fiscal and external trade balances. IFFs also tend to increase intra-country inequalities and global inequalities in development, possibly by widening income gaps between developed and developing countries, whose socio-economic progress is undermined. Some authors have shown that Africa's capital stock would have increased by over 60% if funds leaving Africa illegally had remained in the continent, while GDP per capita would have increased by 15% (Boyce and Ndikumana, 2012). The ratio of domestic investment to GDP in Africa would have increased from 19% to 30% if the capital stock leaving Africa remained available for investment within the continent (African Economic Outlook, 2012).

IFFs undermine the development potential of African countries to the extent that they no longer have all the resources required for financing their development. The expansion of criminal activities often associated with IFFs, increase insecurity, with harmful effects on economies.

### 1.3. Illicit Financial Flows in Africa

#### 1.3.1. Focusing on the Concept of IFFs

IFFs in Africa are defined as illegally earned, transferred or used resources moved from Africa to the rest of the world in violation of the laws. Developed countries are often the final destinations of these flows. These financial flows are generally categorized in three groups (see Kar and Cartwright-Smith, 2010; AU/UNECA, 2015 for more details).

##### 1.3.1.1. IFFs and Corruption

Combating corruption is a key element in improving governance in Africa and achieving structural transformation goals, since corruption leaves the door wide open for illicit financial flows. Corruption has to do mainly with the proceeds of financial malpractices and payment of bribes. Corruption is not only limited to the public sector; it can also originate from the private sector and affects all segments of society. It is, *inter alia*, attributable to weak institutions, ineffective enforcement mechanisms, and vulnerability of public officials. It is estimated that 5% of the world's IFFs stem from acts of active corruption and abuse of power. However, this figure may not specifically reflect the situation on the African continent where the phenomenon is becoming increasingly worrisome.

##### 1.3.1.2. IFFs and Criminal Activities

IFFs have to do with proceeds from criminal activities. These include money laundering and fraud in the financial sector, trafficking in persons and human organs, trafficking of arms, drugs and narcotics, counterfeiting and so on. Criminal acts are promoted by a range of actors including criminal networks, private sectors, both domestic and international, and public officials (OECD, 2018). Beyond leading to situations of insecurity and violence on the continent, these activities substantially reduce government resources, through concealment and laundering of profits by criminal organizations, and could deeply destabilize economies through their interactions with

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2 Although part of the illicitly acquired funds remain in the continent, they are earmarked for specific private consumption, with a multiplier effect on the economy that would probably be lower than that of public expenditure in key sectors.

macroeconomic and microeconomic factors, such as poverty and inequalities amongst populations (Merton, 1957; Agnew, 1985).<sup>3</sup>

### 1.3.1.3. IFFs and Commercial Activities

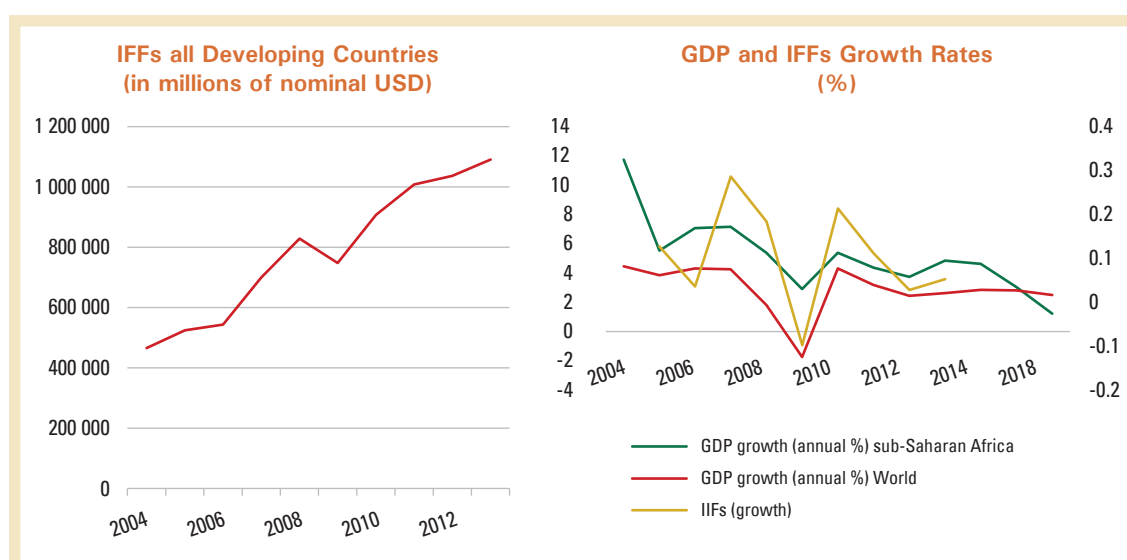
IFFs resulting from commercial activities serve several purposes such as the desire to hide wealth, aggressively avoid tax, and circumvent customs duties and internal taxes (AU/UNECA, 2015).

These financial flows are the result of false invoicing in commercial operations, fraud and tax evasion, and non-declaration or under-declaration of accounts and financial information in order to avoid customs duties and tax in general.

### 1.3.1.4. State of Play of IFFs in Africa

Estimates of financial flows vary considerably from one author to another and from one organization to another, depending on the methodology and areas covered. However, there is no argument regarding the fact that these flows, due to their size, reduce the economic potential of developing countries, particularly in Africa. Financial flows in developing countries according to data from the GFI, are estimated at USD 1 090 billion in 2013. The nominal rate of increase of these illicit flows between 2004 and 2013 is 9.9%. There is a link between the evolution of global financial flows and the evolution of economic activity, as can be seen in Figure 1.1, which shows a significant co-movement between GDP growth rates in Africa and the world, and that of the global illicit financial flows around the world. The recession of global activity with the 2008 crisis, for example, was marked by a decline in IFFs from USD 827 billion in 2008 to USD 747 billion in 2009. This is related with the dominance in global IFFs linked to false invoicing in trading activities (not less than 84%, Figure 1.8) and to the fact that trade is highly dependent on global economic activity. Financial flows could therefore reduce or even eliminate the expected growth benefits. False invoicing in commercial operations consists of falsification of price or quantity of imports or exports in order to conceal or accumulate figures in other areas. For example, inducements may include avoiding taxes, avoiding tariffs, transferring a bribe or laundering money (AU/UNECA, 2015).

**Figure 1.1: Evolution of IFFs and GDP**

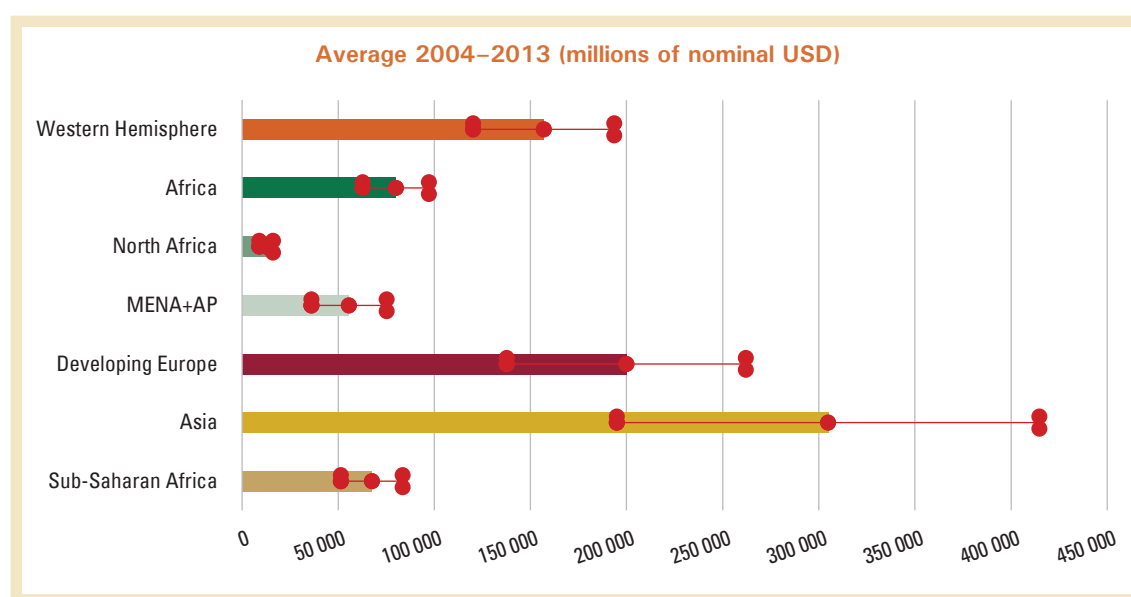


Source: Author from GFI data; IFFs not adjusted by inflation, nominal value

<sup>3</sup> Economic crises were due to criminal activities (Yakuza recession with the falsified multiple loans, 1980; American Savings Bank).

Asia is the region where average annual IFFs are higher at USD 305 billion over the period 2004 to 2013, with a great deal of year-to-year variability. It is followed by the group of developing countries of Europe and the region of the western hemisphere, in other words, Latin America, with respectively average values of USD 199 and USD 157 billion. The average annual financial flows in Africa are in the order of USD 80 billion and are mainly from sub-Saharan Africa with an average of USD 67 billion while it amounts to USD 12.5 billion in North Africa (Figure 1.2). IFFs in Africa are relatively stable over time compared to other regions, there is relatively little temporal variability. Sub-Saharan Africa contributed 9% of cumulative IFFs between 2004 and 2013. The largest contribution goes to Asia with almost 39% of illicit flows which have passed over the time (see Figure 1.4).

**Figure 1.2: IFFs around the World by Region**



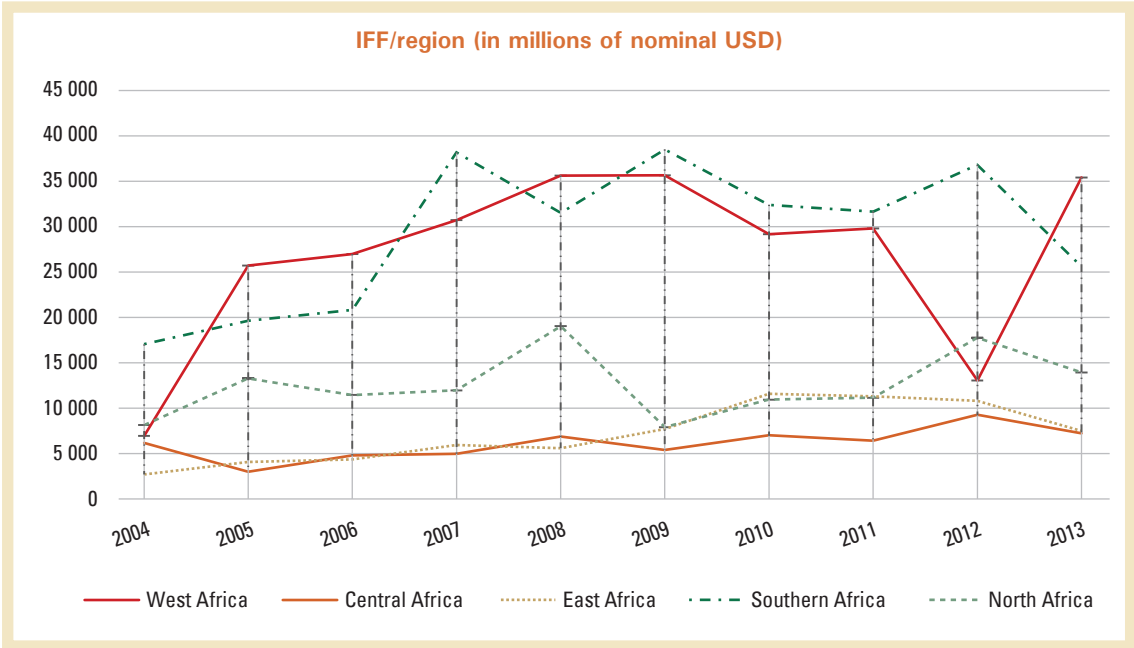
Source: Author from GFI data

At the continent level, there is a great heterogeneity in the geographical distribution of financial flows and in the dynamics of these flows. East and Central Africa have the lowest levels in Africa over the period 2004–2013. The southern and West African region are generally those with the highest amounts of IFFs (Figure 1.3). These two regions alone account for more than 80% of the cumulative IFFs in sub-Saharan Africa. These regional statistics hide disparities at the country level. As the scatter Figure 1.5 shows, Nigeria, Togo and Côte d'Ivoire are the countries with the highest levels of IFFs in West Africa. In southern Africa the most affected countries are South Africa and Zambia. In North Africa we have Egypt and Morocco which are the most affected. In Central Africa, Equatorial Guinea and Congo stand out from other countries by being very affected. In East Africa, Ethiopia has a large part of total IFFs. Financial flows in these countries, which weigh heavily on the amounts of global IFFs in their region, are also marked by high volatility, showing that these flows are often linked to transitional and episodic activities from one year to the next. In general, criminal methods are dynamic in nature, changing in response to global market opportunities and forces (OECD, 2018).

There is a predominance of oil-exporting countries with IFFs in the North African and West African regions. Thus, Nigeria accounts for the largest share of IFFs from West Africa (66.4% of total cumulative flows between 2004 and 2013 for this region). Egypt and Equatorial Guinea also contribute significantly to IFFs from North Africa and Central Africa with respectively 32% and 36% of regional cumulative flows.

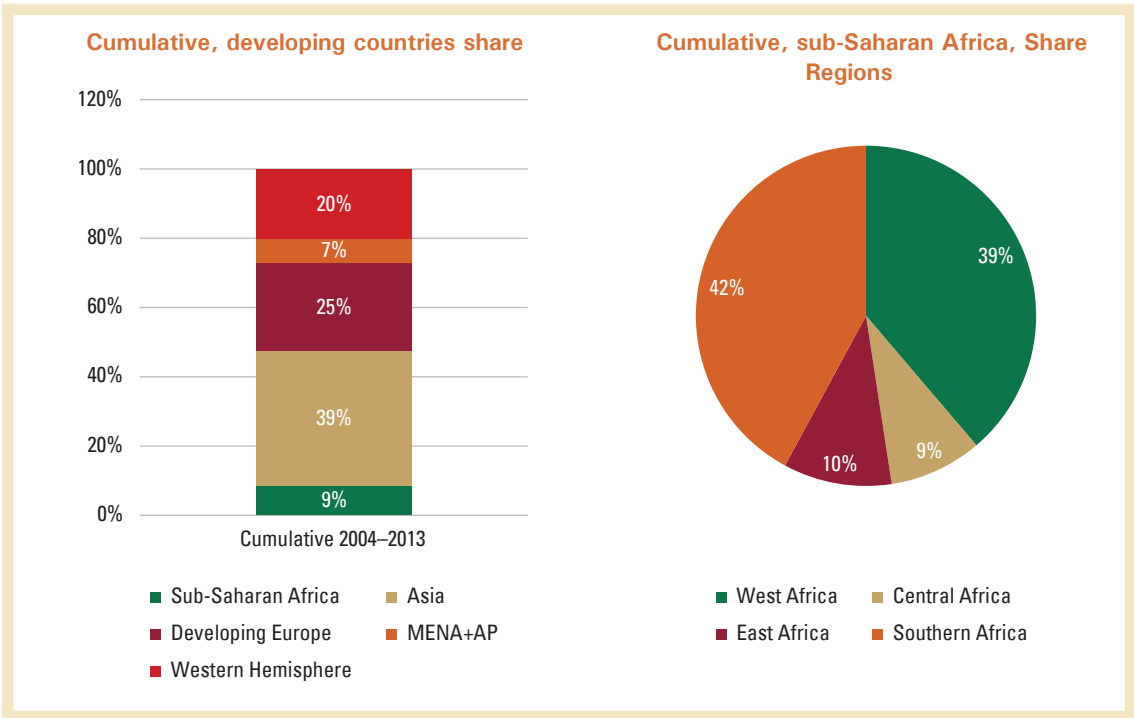


Figure 1.3: Evolution of IFFs in Africa by Geographical Region



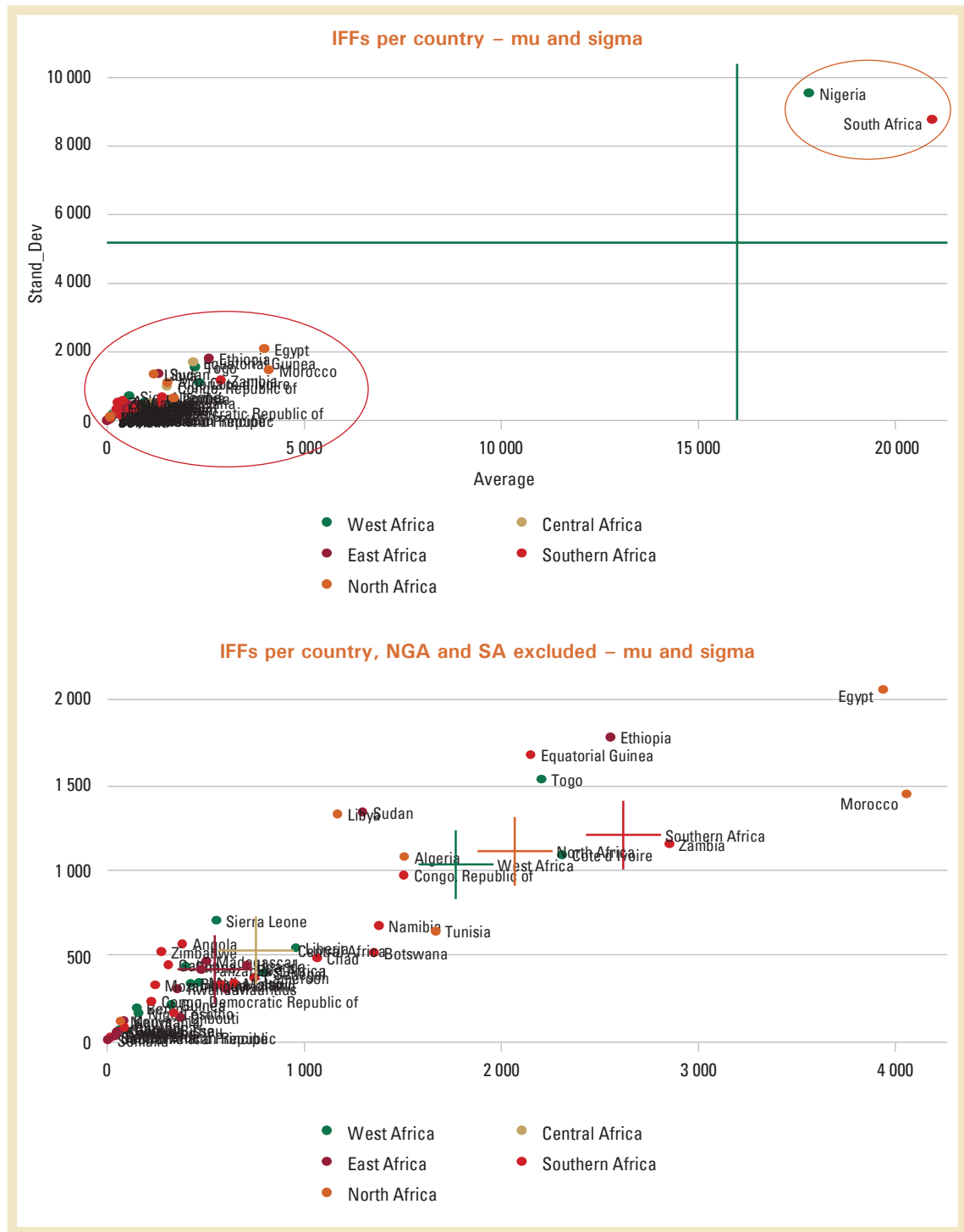
Source: Author from GFI data

Figure 1.4: Distribution of IFFs in the World and in sub-Saharan Africa



Source: Author from GFI data

Figure 1.5: IFFs per Country and Heterogeneity Per Zone

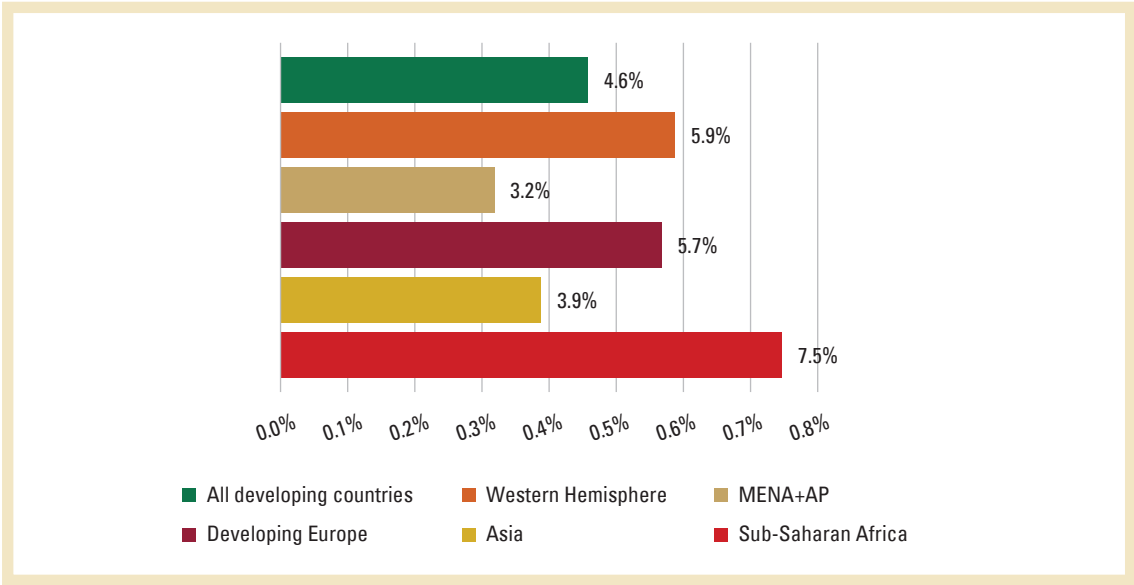


Source: Author from GFI data;

Note: The signs + represent the average regions; mu = annual average (X-axis) and sigma measures the temporal variability. NGA: Nigeria and SA: South Africa

However, as previously seen, the amounts of the IFFs are influenced by the size of the economic activity of the countries and regions. In fact, the strongest economies are subjected more to IFFs. Figure 1.6 provides the illicit flows share in total trade of regions and also classifies the geographical regions in the world after taking the size effect into consideration. The tendency is to observe that IFFs are higher in sub-Saharan Africa with 7.5% of its global trade.

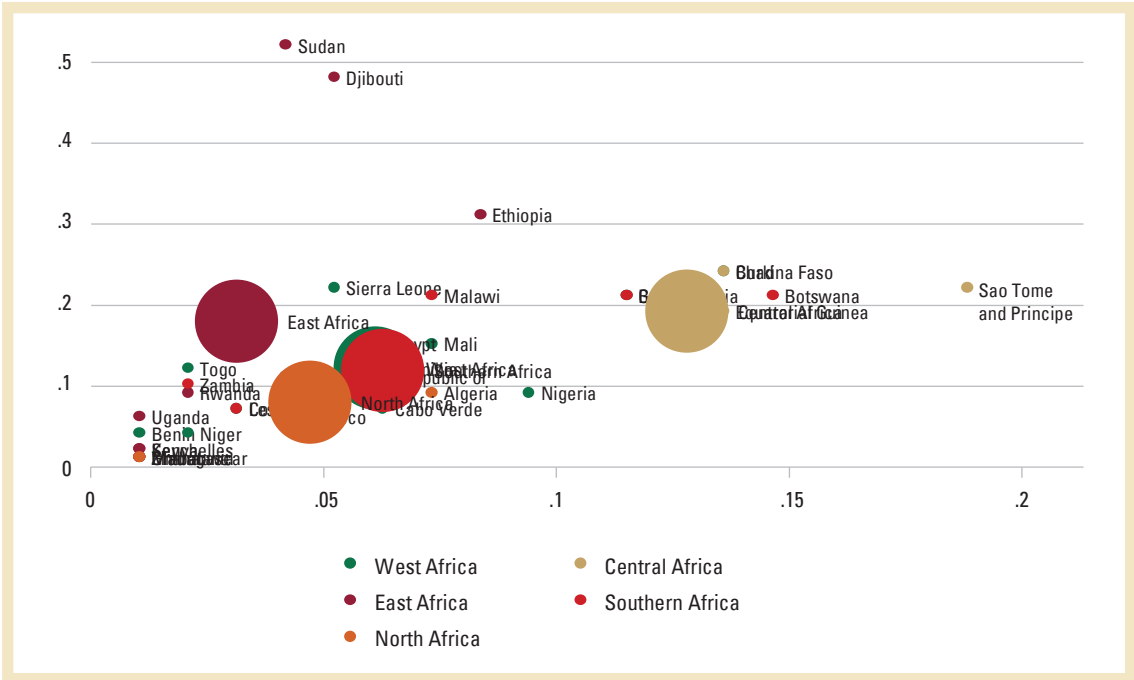
**Figure 1.6: IFFs, % in Trade, Averaged over the 2005–2014 Period**



Source: Author from GFI data; the classification is a priori consistent by deflating by the GDP

In Africa, this tendency is, on the average, higher for the Central African countries and lower for those of Eastern and Northern Africa, when only the flows between developing and developed countries are considered (São Tomé and Príncipe, Botswana, Equatorial Guinea, and Burkina Faso are the most affected), as illustrated by Figure 1.7, based on 2014 GFI data. Without taking this distinction into account, the IFFs share of trade is weaker on the average for North African countries while Sudan, Djibouti and Ethiopia are the most affected.

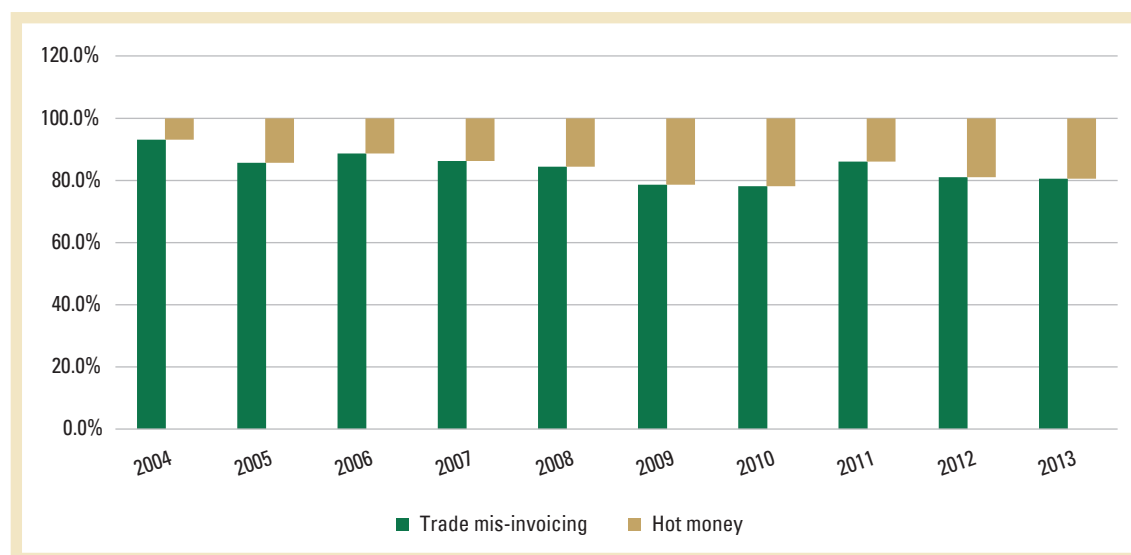
**Figure 1.7: IFFs, % of Trade, 2014**



Source: Author from GFI data;  
 Note: X-axis (restriction on flows between developing and developed countries)

The AU High Level Working Group and the United Nations Economic Commission for Africa (ECA) conducted studies on financial flows from some African countries (Algeria, Kenya, Liberia, Mozambique, Nigeria, Democratic Republic of Congo, South Africa and Mauritius) from consultations with some stakeholders (see AU/UNECA, 2015). The reader of this document is invited to consult the works of this Group in order to obtain tangible facts on the sources and the IFFs' idiosyncratic factors in these countries. Regarding West African countries, the works of the Organisation for Economic Co-operation and Development (OECD) on the IFFs, particularly on illicit trade, may be consulted. (See OECD, 2018).

**Figure 1.8: Composition of IFFs**



Source: Author from GFI data

## 1.4. Corruption and Governance in Africa

### 1.4.1. State Effectiveness and Corruption

The recognition of bad governance as a factor inhibiting the effective socio-economic transformation of African economies has further increased. Aware of this fact, the decision-makers have accorded an important place to governance in the AU Agenda 2063 and have already put in place several initiatives and advocacies in this respect. One of the seven aspirations of Agenda 2063 is 'An Africa of governance, democracy, and respect for human rights, justice and the rule of law' (AUC, 2015). It is difficult to measure corruption and bad governance since they often concern activities of a secret nature.

This part of the document evaluates governance by focusing on corruption and public management while using the database of the World Governance Indicators (WGI), which consists of a series of indicators for measuring governance. This includes an indicator on the management of corruption in countries and another factor on government effectiveness (Kaufmann *et al.* 2008)<sup>4</sup>.

4 The government effectiveness indicator reflects the perceptions on the quality of public services, the quality of the private sector and its degree of independence vis-à-vis pressures, the quality of the formulation and the implementation of policies and the credibility of the government's commitment in its policies.

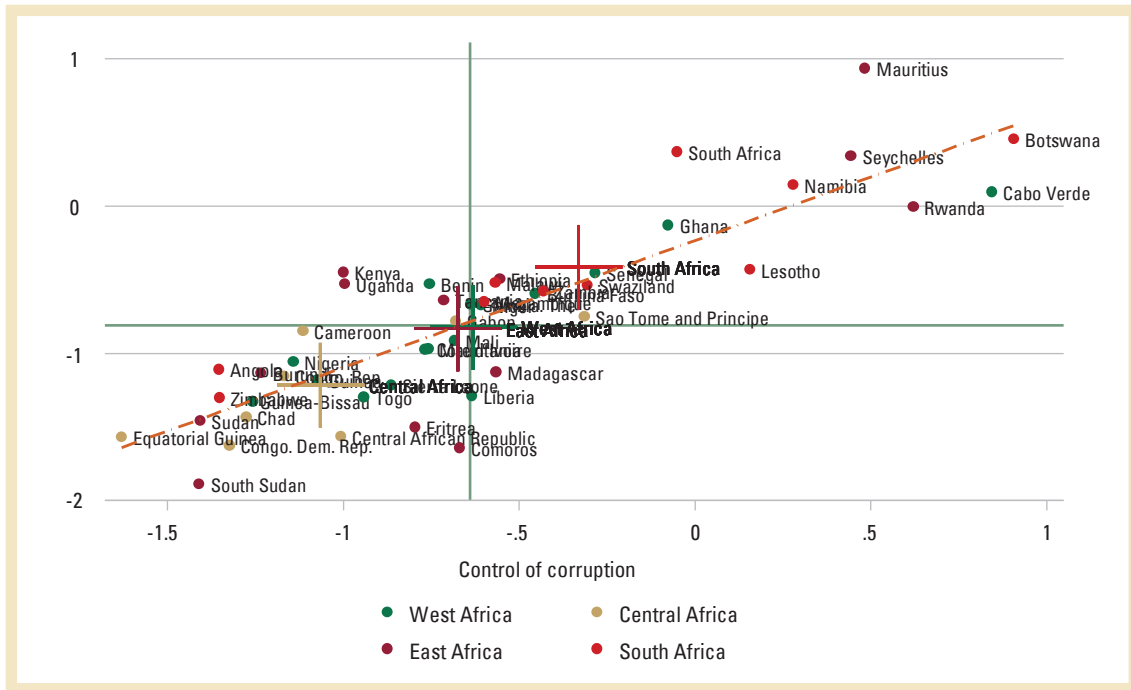
The control of corruption reflects a perception. It indicates to what extent the public authority is at the service of private interests and informs the phenomena of 'capture' of the State by the elites and private interests (Kaufmann *et al.* 2008). The indicators vary from -2.5 to +2.5 with -2.5 representing the lowest level and +2.5 the highest. The WGI are published annually by the World Bank Group. They are used by policy makers, academics and international bodies to evaluate the quality of governance in the country.

The data and indicators to measure corruption and governance are generally disputed to the extent that there is no universally accepted norm to measure these concepts. However, this document uses the WGI indicators on management of corruption in countries and on government effectiveness in order to make an assessment in sub-Saharan Africa. Figure 1.9 shows a strong correlation between the extent of management of corruption in a country and the effectiveness of its government thus showing that government effectiveness captures well a good part of governance. Corruption facilitates IFFs but also causes the deterioration of the business environment and the reputation of countries. IFFs of capital from the continent is generally done with the help of some local officials and this tends to further expand bad governance within public institutions.

Figure 1.9 generally presents the situation of sub-Saharan African countries and geographical areas in relation to governance, defined as government effectiveness and control of corruption. The average index between 2010 and 2015 is presented. The southern African region generally presents the best results on governance with an average score of -0.416, followed by West and East Africa with average scores of -0.833 and -0.822, respectively. Central Africa comes last with an average score of -1.216 considering the criteria of government effectiveness. A great variability of the index on the continent and within the different regions is also observed. According to the indicators used here, the most efficient countries in terms of public management and control of corruption are Mauritius, South Africa, Seychelles, Botswana, Cape Verde, Rwanda and Namibia.

Corruption, particularly so-called 'petty corruption' has become a societal issue because it practically affects all sections and areas. It impacts negatively on regional integration, particularly trade, as illustrated by Figure A.1.1 in the annex, which shows the scope of bad governance in terms of delays and bribes in West Africa. The phenomenon is observed in all countries. Generally, it has a negative impact on economic activity due to the delays caused, resulting in a slowdown in business pace but also by the loss of revenue generated (state, traders, transport owners, drivers and apprentices), which increases trade cost, resulting in heavy burdens for the development of activities. These practices are detrimental to the states and the selective nature of the beneficiaries and frustrations can constitute obstacles to the development of economic activity. These obstacles to economic activities and the creation of stable employment in this sector can push the most vulnerable to resort to criminal activities, creating a vicious cycle of corruption and IFFs, inequalities and unemployment.

**Figure 1.9: Corruption and Public Management in Countries and Regions**



Source: Author from GFI data;

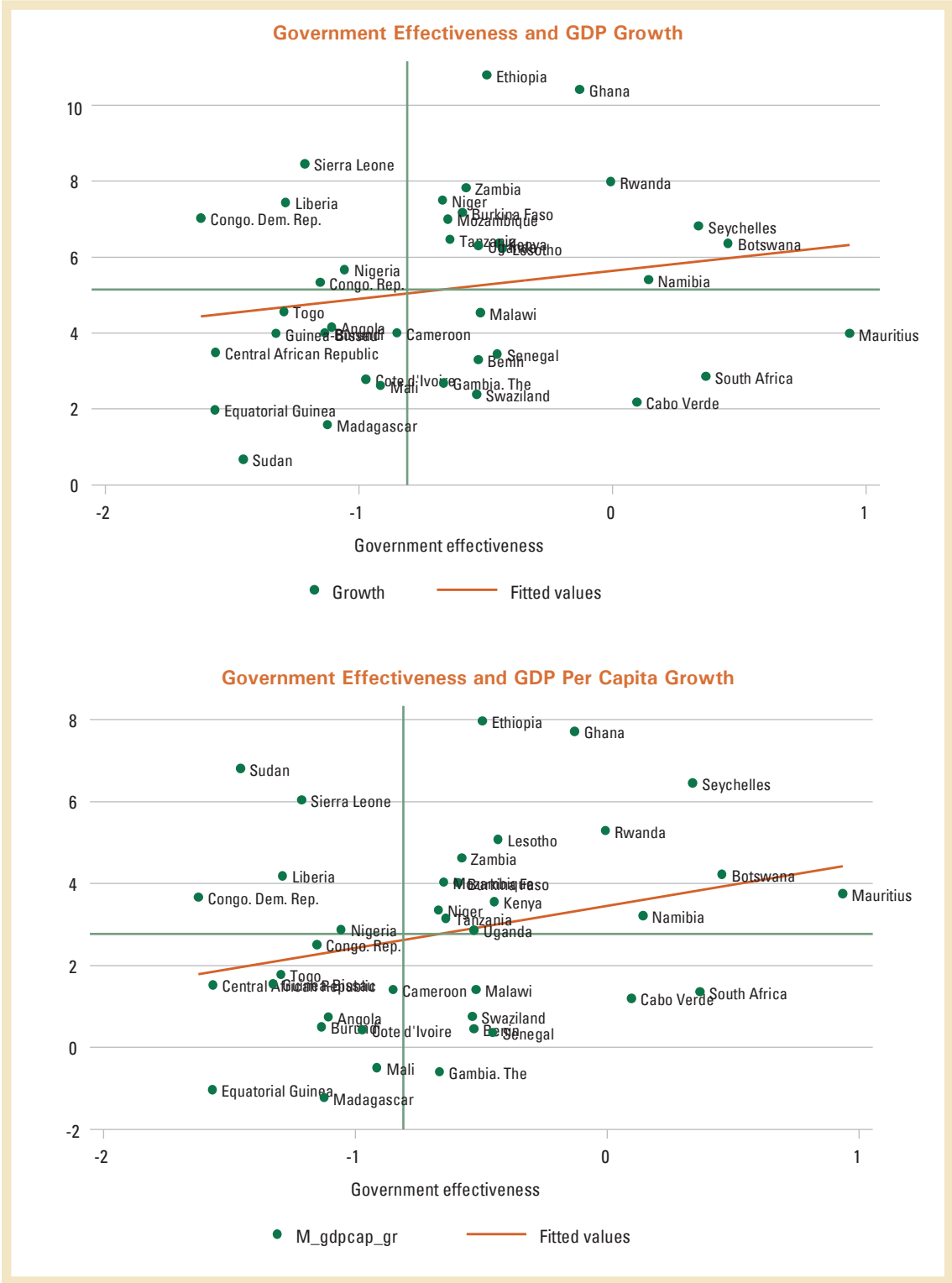
Note: The signs + represent the regional averages

### 1.4.2. Corruption, Governance in Africa and Economic Performance

The quadrants of Figure 1.10 show an association between governance, economic growth, increase in the per capita income and work productivity over the 2008, 2010–2015 post-crisis period. The countries with the best scores in terms of government effectiveness and therefore also efficiency in terms of corruption control are those who have had the tendency to have the highest economic performances. However, by considering the pre-crisis data, some of these relations become confusing and undoubtedly not linear. The relation seems to be dependent on the growth level observed and its variability between African countries is sometimes strong at certain periods.

However, the consideration of the effect of governance has shown that the impact of public expenditure on national production becomes higher for health and agriculture expenditure. In fact, production elasticity in relation to agriculture and health expenditure increased from 0.110 to 0.265 and from 0.196 to 0.237 (AUC/EAD, 2018).

Figure 1.10: Corruption, Public Management and Economic Performance





Source: Author from WGI



## 1.5. Conclusion and Recommendations

More than merely an exercise of statistical data presentation, unanimously acknowledged, and also a classification of countries and regions, this document intends to be a warning issued to the authorities to consider the scope of the phenomenon of illicit financial flows, corruption and governance in general.

Illicit financial flows are arousing increasing interest because they constitute net losses which greatly undermine efforts to finance Africa's development through the implementation of the Agenda 2063 and the Agenda 2030. It is high time to stop these illicit flows and to direct them to the financing of programs in order to revitalize African economies, improve the standard of living of the populations, and pursue integration programs at the continental level with the construction of large-scale infrastructures. The attainment of these objectives calls for strong and formal savings and a consistent capital stock on the continent.

To combat the IFFs and corruption, it is necessary to pay particular attention to the following measures and to ensure their effective implementation:

- a) International cooperation between African countries and Regional Economic Communities (RECs) to control IFFs:

This should start by the sharing of good practices since the countries and the zones are not at the same level in the scope of IFFs and in the implementation strategies for the fight. A local but uncoordinated solution in the fight against the IFFs would obviously only result in the shifting of the underlying problems into the neighbouring countries and regions. Regional integration should be at the heart of the fight against the IFFs.

It is also worthwhile to cooperate, particularly with the external world, in terms of the recovery of assets stolen and transferred abroad and this can be achieved by establishing, in countries, trained human resources who can carry out, thorough investigations and bluntly identify the stolen assets, through the collaboration between countries of origin and destination of the IFFs. It would also be necessary to strengthen the legal frameworks and cooperation frameworks in order to freeze and rapidly confiscate the huge illegally acquired financial stocks. Cooperation in the sharing of fiscal and data information on internationally traded prices of goods and services would allow a reduction in the bad practices related to commercial operations.

- b) The public administrations and the systems involved in the management of IFFs should also be strengthened (customs and security forces, tax departments, information services, financial institutions and fiscal administrations).
- c) Be equipped with human and financial resources in order to be able to identify the practice of false invoicing on transfer pricing and trade, since quantity and other characteristics are particularly aimed at avoiding taxes. The African Union Commission/United Nations Economic Commission for Africa (AUC/UNECA) High Level Working Group on Illicit Financial Flows reports that only three African countries had established fiscal administration departments in charge of transfer pricing at the time of their study. African countries do not have the official capacity to monitor this problem and are very vulnerable to the effects of falsified transfer pricing (AUC/UNECA, 2015).
- d) Strengthen the role and presence of organizations such as the African Union Convention on Preventing and Combating Corruption, and the United Nations Office against Drugs and Crime.
- e) Invest more financial and human resources to identify and dismantle the networks of criminal activities (drugs, arms and human trafficking, poaching, and stealing of oil and mineral products) and put in place very dissuasive measures against delinquency and avoid impunity.
- f) Undertake research on the cost-benefit analysis of tax incentives and exemptions to assist Member States and propose acceptable standards at the continental level for tax incentives, suspend certain tax exemptions and avoid unfair competition.
- g) Strengthen the capacity of Member States in the area of contract negotiations as African countries are foregoing enormous resources due to inequitable contracts.

- h) Help Member States improve the efficiency of their tax systems through digitalization and improved transparency, and expand the tax base by identifying and implementing specialized taxes such as property tax as well as modernizing the informal sector.
- i) Ensure that profits are taxed, based on where the economic activities take place.
- j) Strengthen transparency in the public sectors, in management and budgetary control and strengthen transparency in the international banking system. Establish good governance and coordination of policies at the regional and continental level.
- k) Support the accomplished work through civil society organizations, media and investigation journalists, and public bodies fighting against corruption by a change of collective consciences.
- l) Integrate the existing<sup>5</sup> initiatives in a coherent global architecture and promote a more inclusive discussion by including African countries in the fight against illicit financial flows and taking into account their own interests.
- m) Improve the measurement and provide updated statistics on IFFs.
- n) Promote inclusive growth, decent job creation and thus reduce poverty and inequalities to the extent where social, economic and political factors are likely to influence corruption and criminality, sources of the IFFs. It would be necessary to support the initiatives for the fight against inequalities and the strategies for job creation in order to ensure social and economic stability.

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5 The Global Forum on Transparency and Exchange of Information for fiscal purposes (OECD), the Multilateral Convention on Mutual Cooperation in Fiscal Matters (OECD), the Initiative for Transparency in the Extractive Industries, the International Action against Erosion of the Revenue Base and Transfer of Profits (OECD and G20), sections 1502 and 1504 of the Dodd Frank Law (United States), the Foreign Account Tax Compliance Act (United States), Automatic Exchange of Information (OECD, G20, G8), Convention on the Fight against Corruption (OECD), the Public Registry (United Kingdom), United Nations Convention against Corruption, Recommendations of the Financial Action Group, the Partnership for Open Government, United Nations Committee of Experts for International Cooperation in Fiscal Matters, the African Forum on Fiscal Administration, the African Union Convention on the Prevention and Fight against corruption, and others.

**Annex 1**

**Figure A1.1: Corruption and Governance of the Road Transport in West Africa**



Source: Author from data of the initiative for the improvement of governance of the road transport/Improved Road Transport Governance Initiative (IRTG)

# CHAPTER II.

## Taxation and Domestic Resource Mobilization

International Monetary Fund<sup>6</sup>



### 2.1. Introduction

Domestic revenue mobilization is one of the most pressing policy challenges facing African countries. Indeed, the African Union (AU) has elevated resource mobilization as one of its top priorities<sup>7</sup>. This chapter focuses on the role of taxation in domestic revenue mobilization. While the reasons may vary according to country-specific circumstances, there are at least three reasons why domestic revenue mobilization is so important.

First, African countries need to increase their resources to invest in programs that *support the achievement of the United Nations Sustainable Development Goals (SDGs)*. This includes efforts to reduce poverty and inequality, ensure adequate health and education, and develop basic infrastructure to support more inclusive growth. Having adequate resources is also essential to ensure that African countries can achieve other priorities and objectives identified by the African Union Commission (AUC), including peace and stability, food security, economic integration, and women and youth empowerment. In addition, as the chapter will demonstrate, developing human and institutional capacity, and pursuing effective communication strategies – which are also key objectives of the AU – typically play a decisive role in successful domestic revenue mobilization strategies.

Second, at a time when public debt levels have been rising rapidly, domestic revenue mobilization should be a *key component of any fiscal consolidation strategy*. In fact, without adequate efforts to raise domestic revenues, fiscal consolidation tends to rely excessively on reductions in public spending, which can have a more negative impact on growth<sup>8</sup> and can become politically more difficult to implement in practice and sustain over time.

Third, developing adequate capacity to collect taxes is also a way *to strengthen institutions and develop state capability*. Since tax collection is one of the most basic functions of the state, developing a capacity in this area can also support institutional development in other areas (Gaspar, Jaramillo and Wingender, 2016). This can operate through several channels. For example, an emphasis on clear and fair tax laws and regulations can support a related focus on public finance management to convince citizens that government taxation will be used to fund reasonably efficient and transparent spending programs. Similarly, establishing a revenue authority with highly trained

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6 This chapter has been prepared by Alex Segura-Ubiergo, Toomas Orav, Chuling Cheng and Ashan Rodriguez. The research is based on the International Monetary Fund's Regional Economic Outlook for sub-Saharan Africa (April 2018), which included inputs from John Hooley, Manuel Rosales, Gabriel Leost, Miguel Pereira Mendes, Marcos Poplawski-Ribeiro and Giovanni Melina. The analysis has been expanded to include members of the African Union that had not been included in previous research, namely: Algeria, Egypt, Mauritania, Sudan, Tunisia, Morocco, Libya, Djibouti and Somalia.

7 See African Union. "Resource Mobilization", <https://au.int/en/auc/priorities/resource-mobilization>

8 For example, Chapter 2 in the 2017 October Regional Economic Outlook showed that the negative effect of fiscal consolidation on growth is typically larger when the adjustment strategy relies more on expenditure cuts than on increases in revenue (that is, larger fiscal multipliers on the public spending side).

professional staff can support organizational innovations as countries extend successful reform efforts to other government areas<sup>9</sup>.

This chapter analyzes revenue collection efforts in Africa compared with other regions, with a special emphasis on non-resource revenues<sup>10</sup>. The chapter argues that sustained revenue mobilization is difficult because it requires consistent institutional development over time as well as attention to basic processes and reforms where reversals are frequent. In addition, robust reforms are those that focus not only on ways to increase revenue collection, but also consider the efficiency and equity impact of particular policy choices. The chapter is organized in three sections.

- The first section describes developments in revenue-to-GDP and tax-to-GDP ratios in Africa compared with other regions. It shows an improvement in revenue mobilization in African countries over the past two decades. However, the continent still has, on average, the lowest revenue-to-GDP ratio compared to other regions. The section also shows how low efficiency of some of the most important sources of taxation, such as the value-added tax (VAT) and the corporate income tax (CIT), are significant constraints to better performance. It also discusses other potential sources of additional revenue collection, including the role of excise and property taxes.
- The second section analyzes some of the structural conditions that may account for the lower tax-to-GDP ratios in Africa, including the level of development, trade openness, sectoral structure, income distribution and institutional quality. It shows that African countries could, on average, mobilize up to 5 percent of GDP in additional tax collection, through a combination of reforms that improve the efficiency of current systems (including through the reduction of tax exemptions), and through institutional changes (such as improvements in governance and measures to control corruption)<sup>11</sup>.
- The third section analyzes lessons from revenue mobilization case studies. It emphasizes the elements of successful medium-term strategies for revenue mobilization and the importance of political economy factors, such as building broad-based support for the reform process through proactive outreach strategies to both the public and private sectors. Finally, the chapter also discusses the role of recent technologies (that is, digitalization) to empower tax policymakers with quicker access to more reliable information and to deepen the tax base.

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9 The process of development of state capability is very complex and depends on a number of factors. Low state capability is often used as an argument to justify limited state capacity to collect taxes, but the experience of some post-conflict countries (for example, Liberia and Mozambique) suggests that building tax collection institutions may produce positive institutional spill-overs by helping to build state capability in other areas (for example, statistical agencies and public finance management (PFM) reform groups). Research by Prichard and Leonard (2010) also supports this hypothesis.

10 The chapter emphasizes mobilization of non-resource revenues. Resource revenues fluctuate with natural resource production levels and commodity prices and are much less subject to control by domestic policy makers. Adequate collection and management of resource revenues pose other challenges regarding fiscal regimes and fiscal frameworks that have been studied elsewhere (for example, IMF, 2012).

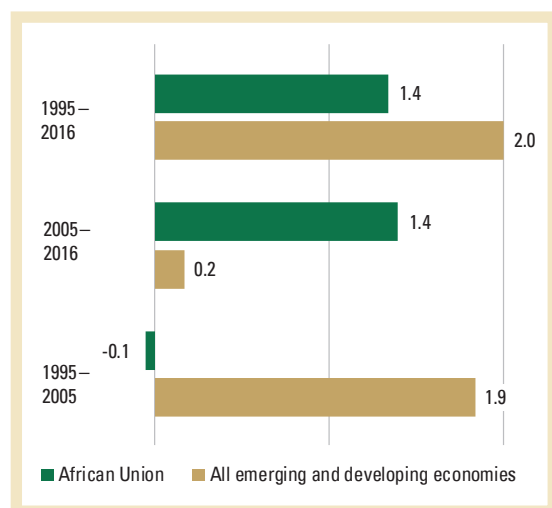
11 Corruption can reduce tax collection through several channels, including through the reduction in tax compliance (Baum *et al.*, 2017).

### 2.1.1. Recent Developments in Domestic Revenue Mobilization

Emerging and developing economies have made significant gains in revenue mobilization in recent years. From the mid-1990s through the mid-2010s, revenue-to-GDP ratios improved by about 2 percentage points across all emerging and developing economies. Africa mirrored this trend, albeit with a slightly lower gain of 1.5 percentage points. An encouraging development is that since 2005 countries in Africa have been converging with other emerging and developing economies. Indeed, after weak performance during the initial period (1995–2005), Africa’s revenue gains have overperformed those elsewhere (Figure 2.1).

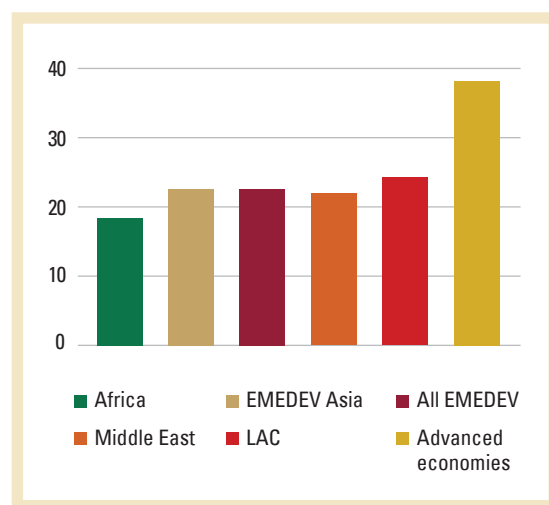
Nevertheless, the region’s headline revenue-to-GDP ratio remains lower than other regions in the world. The median revenue-to-GDP ratio among all emerging and developing economies is 23 percent, 5 percentage points higher than that of Africa (Figure 2.2). The region performs better in terms of tax revenue, with a median tax-to-GDP ratio only 2 percentage points lower than that of all emerging and developing economies, but it has the second lowest ratio among all regions (ahead of the Middle East) (Figure 2.3). As we shall see, underlying structural factors, especially the lower level of development, explain this weaker performance.

**Figure 2.1: Change in Revenue Excluding Grants, Percent of GDP, Median, 1995–2016**



Source: World Economic Outlook

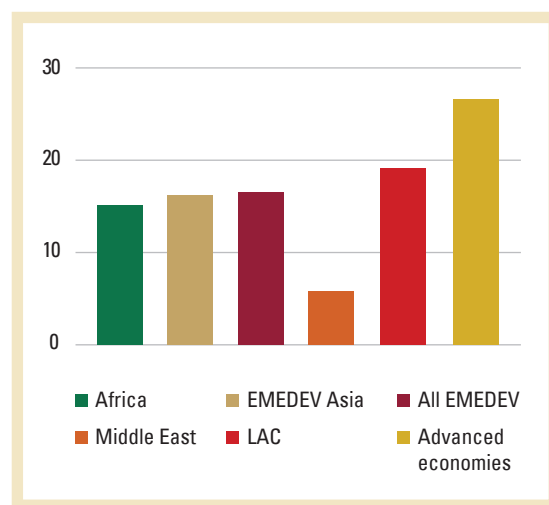
**Figure 2.2: Total Revenue Excluding Grants to GDP, Median, 2016**



Source: World Economic Outlook

Note: EMEDEV = Emerging and developing economies; LAC = Latin America and the Caribbean

**Figure 2.3: Tax Revenue to GDP, Median, 2016**

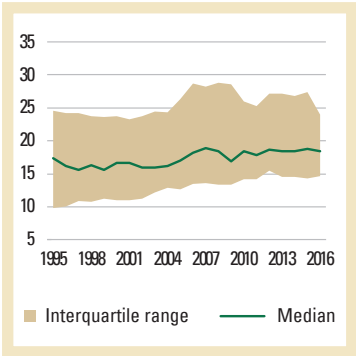


Source: World Economic Outlook

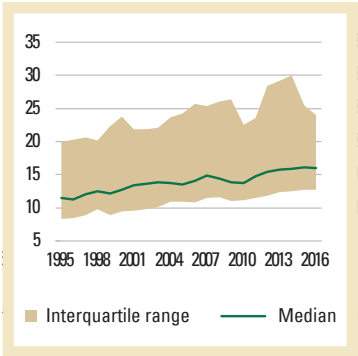
Note: EMEDEV = Emerging and developing economies; LAC = Latin America and the Caribbean

Several African economies have made substantial gains in revenue mobilization during recent decades. For the median African economy, total revenue excluding grants has increased from around 16.3 percent of GDP in the mid-1990s, to over 18.3 percent in 2016 while tax revenue increased from 11.5 to 16 percent (Figure 2.4–2.5).<sup>12</sup> Much of this latter gain has occurred in sub-Saharan Africa, where median tax revenue ratio increased by 4.4 percentage points, whereas amongst North African countries the median tax revenue ratio has remained static, albeit still some 3 percentage points of GDP higher than the sub-Saharan Africa average in 2016, likely due to more developed tax revenue administration across the region. These trends have been aided by non-resource revenues (Figure 2.6), which have increased steadily since the late 1990s<sup>13</sup>. From 1995 to 2015, in both Northern Africa and sub-Saharan Africa, non-resource revenues have increased by 3.0 percent and 4.6 percent of non-resource GDP, respectively. In contrast, revenues from natural resources, while representing important sources of overall revenue for many Africa countries, have not increased substantially. These revenues have also been volatile, particularly during the episodes of commodity price swings in the late 2000s and since 2014.

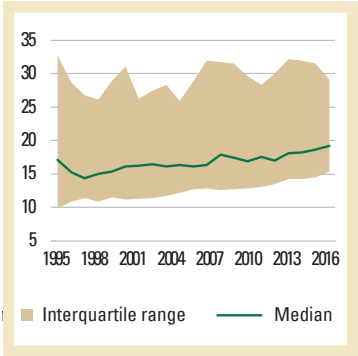
**Figure 2.4: Total<sup>1/</sup> Revenue (Percent of GDP)**



**Figure 2.5: Total Revenue (Percent of GDP)**



**Figure 2.6: Non-resource Revenue (Percent of Non-resource GDP)<sup>2/</sup>**



Sources: World Economic Outlook and IMF Fiscal Affairs Department Sub-Saharan Africa Tax Revenue Database

- 1/ Total revenue excludes grants
- 2/ Non-commodity GDP in Northern African countries does not exclude mining

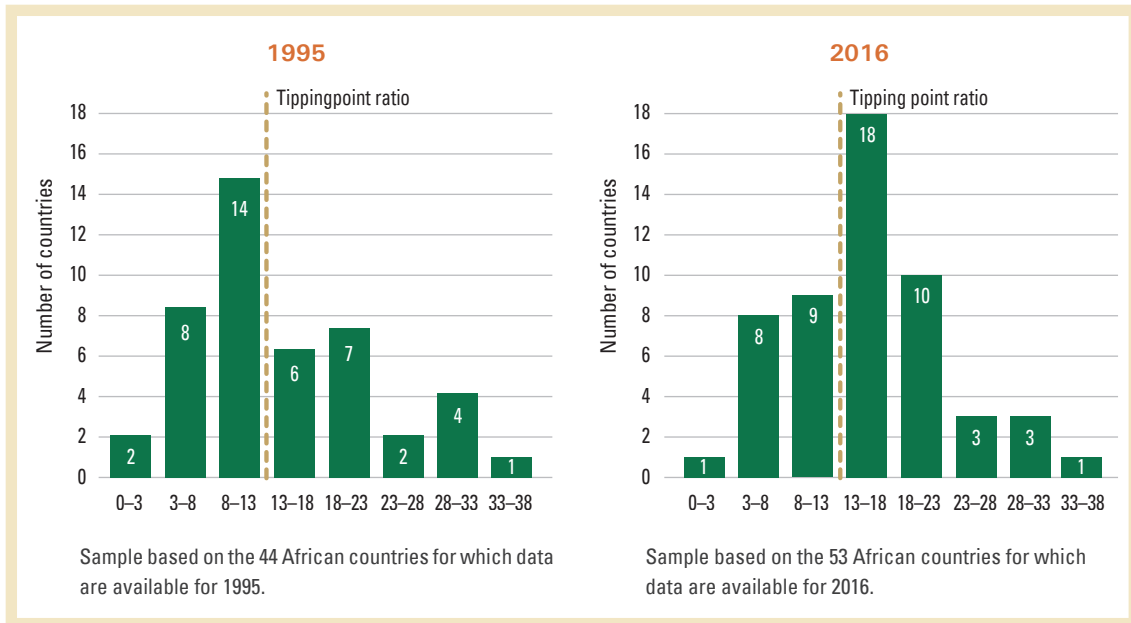
Since the mid-1990s, 13 African countries have successfully transitioned to tax-to-GDP ratios of about 13 percent and above, the minimum ratio that recent research has suggested can be associated with a significant acceleration in growth and development (Figure 2.7–2.8)<sup>14</sup>. Half the African countries now have revenue ratios above 15 percent, compared to a third in 1995, but given the relatively higher starting point of most Northern African countries, nearly all these gains have come from sub-Saharan African countries.

12 Based on a fixed sample of 52 African economies for which data are available from 1995 through 2016. Given the skewed distribution of revenue ratios across the region (see Figures 4 and 5), the median provides a more representative picture of revenue trends than the mean.

13 Data on resource and non-resource revenues are taken from the IMF Fiscal Affairs Department Sub-Saharan Africa Tax Revenue dataset and are available to 2015.

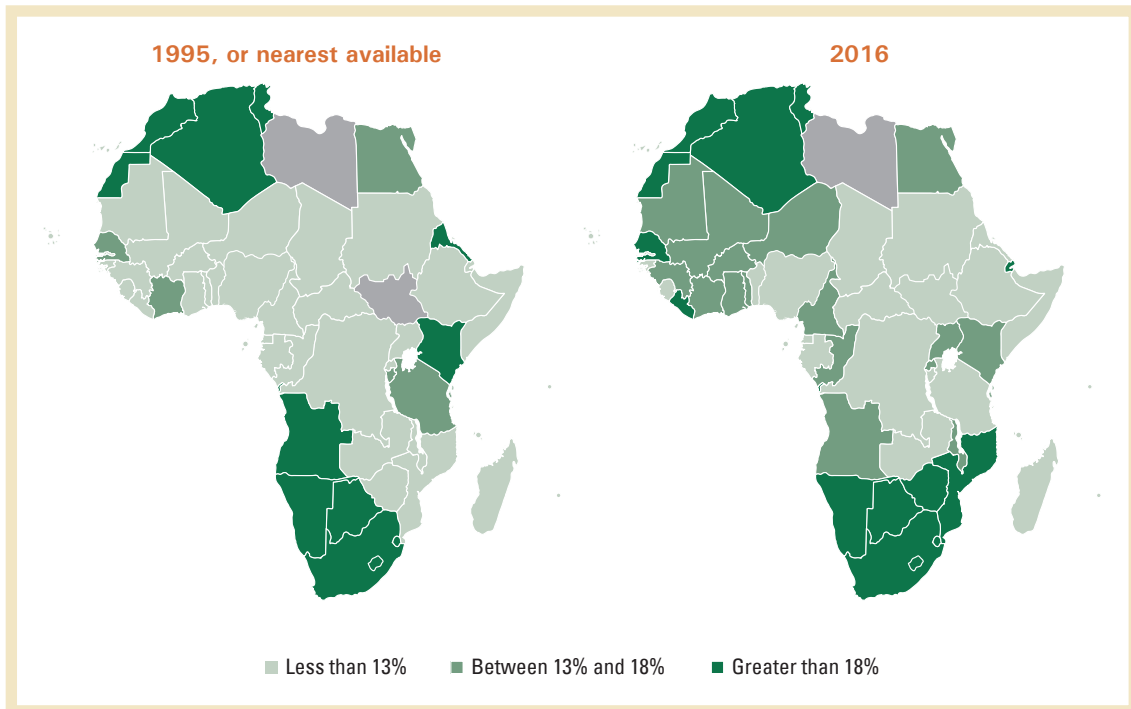
14 The tipping point in research from Gaspar, Jamarillo, and Wingender (2017) is a minimum tax-to-GDP ratio associated with a significant acceleration in the process of growth and development, estimated to be 12.88 percent. While this threshold is statistically significant, the precise number should be interpreted with caution, as it may vary country by country. Generally, a tax ratio of 12.5 to 13 percent of GDP would still be considered rather low to enable the state to perform some of its most important functions, especially adequate spending on developmental programs. With non-tax revenues typically averaging 2 percent of GDP, it can be argued that a tax-to-GDP revenue of 13 percent, and an overall revenue ratio of 15 percent of GDP should be viewed as minimum thresholds to allow the state to perform basic functions. Ratios should also be interpreted with care, given ongoing GDP-rebasing developments in some countries.

**Figure 2.7: Africa: Tax Revenue to GDP Ratio**



Source: World Economic Outlook

**Figure 2.8: Africa: Tax-to-GDP Ratio**



Source: World Economic Outlook



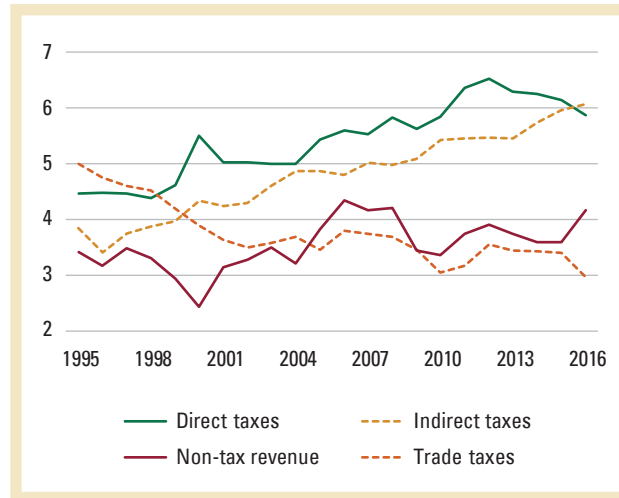
Africa's gains in revenue mobilization have mainly come from direct and indirect taxes (Figure 2.9). Indirect taxes have received a boost from the introduction of VAT in several countries. In contrast, the revenue from taxes on imports has declined as a share of GDP, reflecting increased trade liberalization over the period.

### 2.1.1.1. Trouble spots – Oil and fragility

There are different patterns of revenue mobilization among African economies. Oil exporters and fragile states differ from other economies in the region in both the level and sources of their revenue collection.

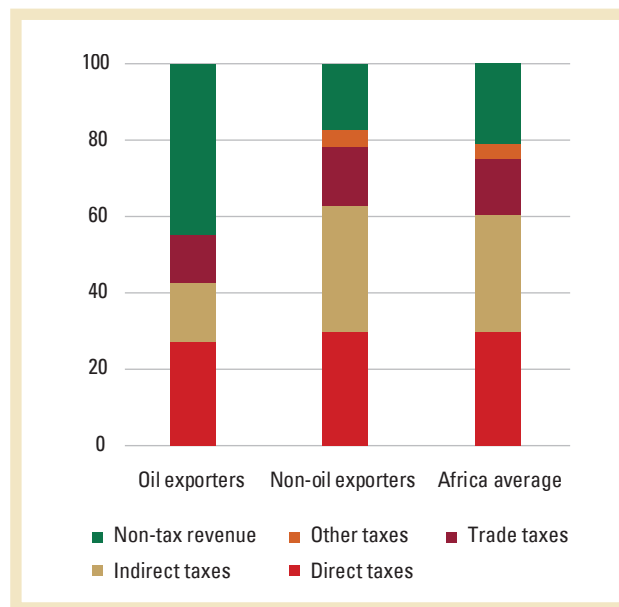
Oil exporters typically have higher overall revenues. The average revenue-to-GDP ratio was 27 percent in oil exporting economies over 2000–2016, compared to 18 percent for non-oil economies. Although oil exporters tend to have lower non-resource revenue-to-GDP ratios<sup>15</sup>, this is more than offset by substantial resource revenues from both non-tax sources (bonuses, royalties, and production sharing revenue) and direct taxes (corporate tax on oil companies' profits). On average, non-tax revenue accounts for almost half of oil-exporters' revenue, compared to less than 20 percent for non-oil exporters (Figure 2.10). But total revenue is also more volatile for oil exporters<sup>16</sup>. Declines in world oil prices can dramatically affect the level of resource revenue, most recently with the 2014 oil price shock. For example, the decline in the world oil price since 2014 has led to a sharp fall in the overall revenue-to-GDP ratio for oil exporters, from 31 percent in 2012 to 18 percent in 2016. Since non-resource revenue gains tend to be incremental, these efforts have been able to offset the impact of the immediate shock on total revenue (Figure 2.11).

Figure 2.9: Africa: Sources of Revenue, Percent of GDP



Source: IMF Fiscal Affairs Department Tax Revenue Database

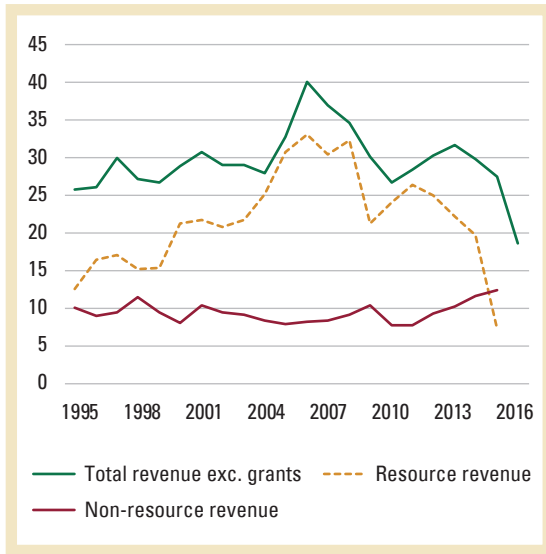
Figure 2.10: Africa: Decomposition of Revenue to GDP, 2016, Percent



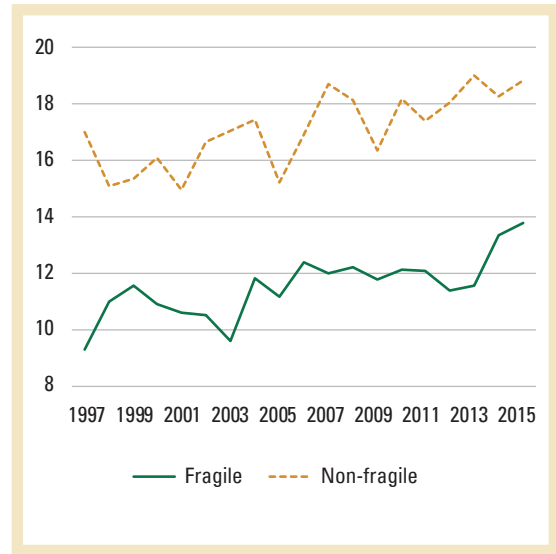
15 Thomas and Trevino (2013) find evidence that higher resource revenue is associated with lower tax effort in non-resource revenue categories.

16 Over the period 2000–2016, revenue volatility for resource-rich countries was much greater than for other country categories. The standard deviation of total revenue (excluding grants) for oil exporters was seven times that of non-oil exporters.

**Figure 2.11: Africa: Revenue to GDP, Oil Exporting Economies, Median**



**Figure 2.12: Africa: Non-resource Revenue to GDP, Fragile and Non-fragile States, Median**



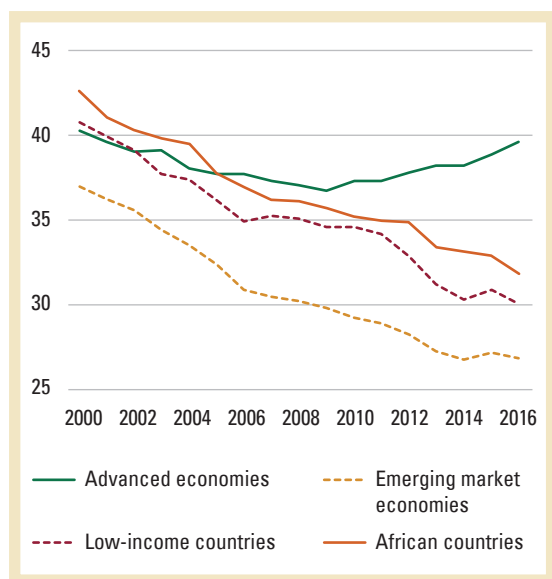
Sources: World Economic Outlook and IMF Fiscal Affairs Department Tax Revenue Database

Fragile states face unique challenges in revenue mobilization, given that their situations are often complicated by weak institutions and/or security and governance instability. Although several fragile states benefit from natural resource revenues, they all tend to struggle in non-resource revenue mobilization. These countries have made progress in recent decades, but setbacks appear common. The median non-resource revenue-to-GDP ratio climbed from less than 10 percent to about 14 percent in 2015, which remains substantially below the 18 percent level for non-fragile states (Figure 2.12).

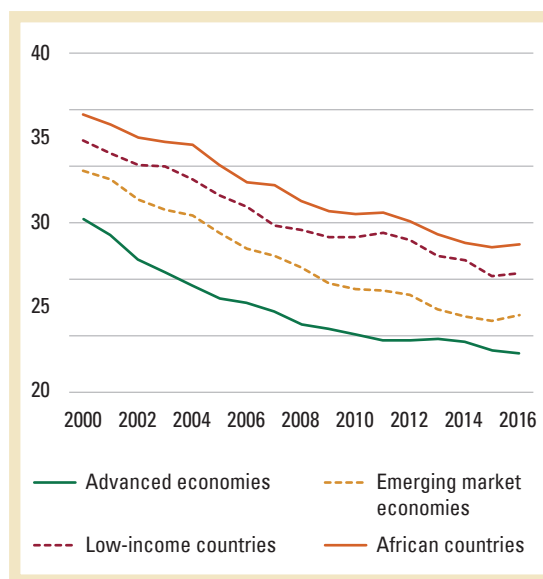
### 2.1.1.2 Tax Systems in Transition

As has occurred throughout much of the world, Africa has reduced rates for CIT and personal income tax (PIT). For African countries, the average top PIT rate has been reduced from about 40 to 30 percent since 2000 (Figure 2.13), while average top CIT rates have been reduced by more than 5 percentage points during the same period (Figure 2.14).

**Figure 2.13: Africa: Personal Income Tax Rate, Average Top Rate, 2000–2016**



**Figure 2.14: Africa: Corporate Income Tax Rate, Average Top Rate, 2000–2016**



Sources: IMF Fiscal Affairs Department Tax Rates Database

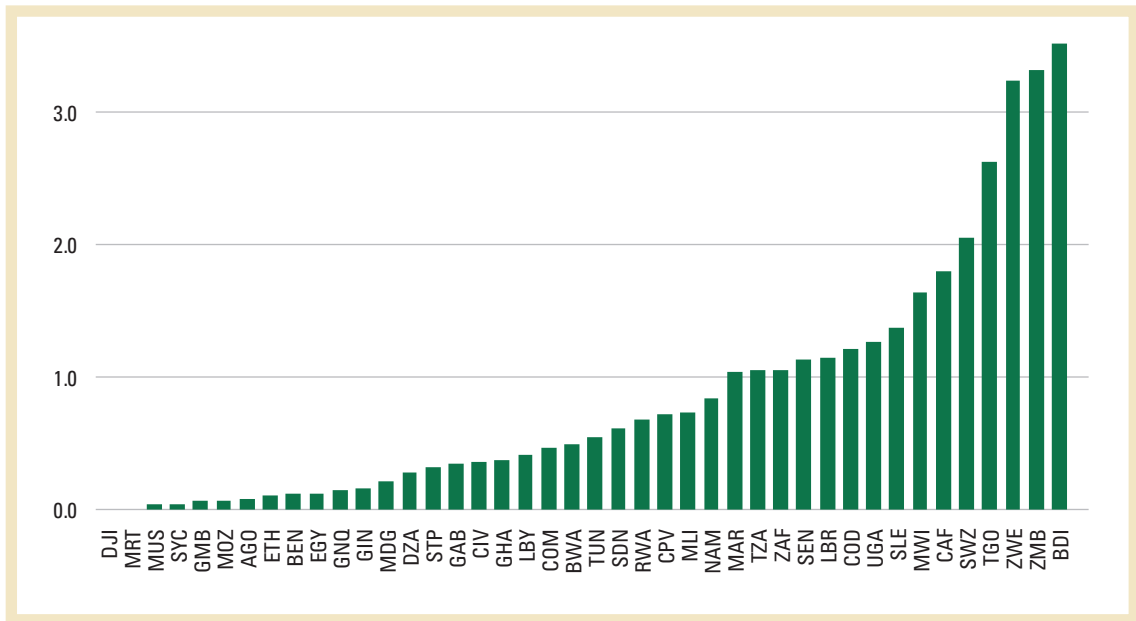
Despite this decline in rates<sup>17</sup>, total direct taxes (PIT and CIT) as a percentage of GDP have generally trended upward, though substantial potential remains in this area given the low level of productivity (Figure 2.15–2.18).<sup>18</sup> On average, African countries' CIT productivity lags behind that of advanced and emerging market economies. There are substantial differences in the productivity of the CIT across the region, with robust performance linked to more streamlined tax incentives. Different fiscal regimes for special economic zones (SEZs) are among several factors (such as differences in the tax base and administrative effort) impacting CIT productivity. Some countries, such as Senegal and South Africa, offer a reduced tax rate of 15 percent for companies located in SEZs, while others with lower productivity or a lower tax collection as a share of GDP offer a zero CIT rate, including Côte d'Ivoire, Rwanda, and the United Republic of Tanzania.

17 Despite the reduction in rates, the tax burden on households can still sometimes be substantial given the existence of fees, *ad hoc* taxes, and contributions imposed by various levels of government and/or officials.

18 CIT productivity is defined as the tax yield in percent of GDP relative to the standard CIT rate and given by:

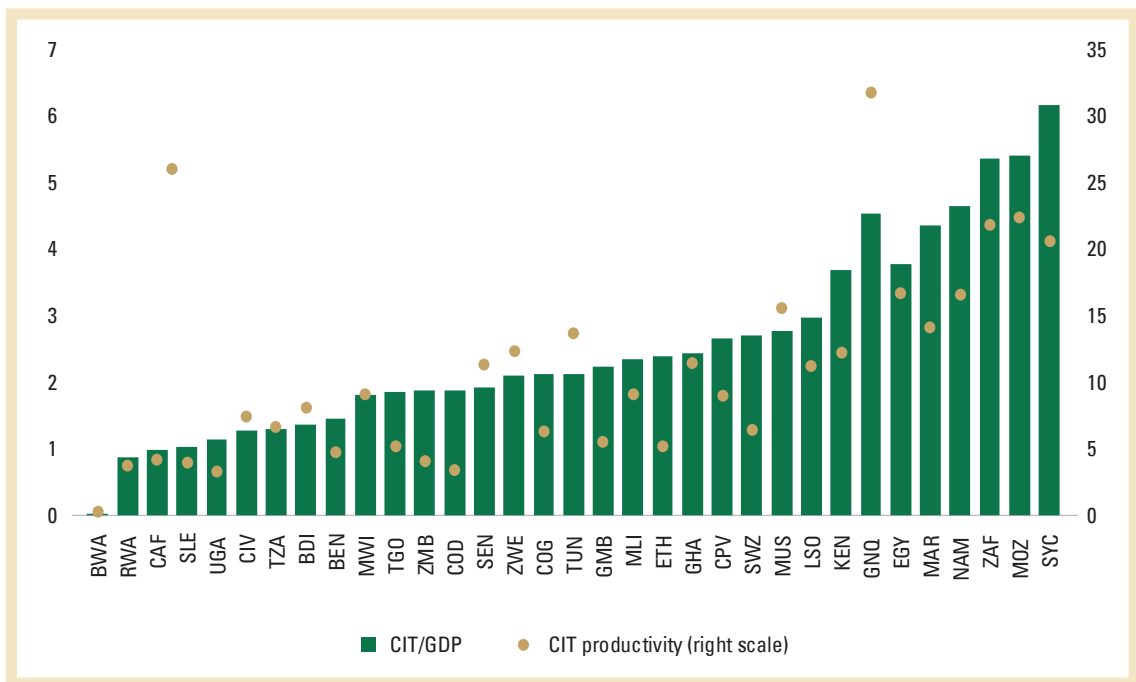
$$CIT\ productivity = \frac{CIT\ revenue\ as\ a\ share\ of\ GDP}{CIT\ rate}$$

**Figure 2.15: Africa: PIT Threshold Relative to Per Capita GDP, 2016 or Latest Available**



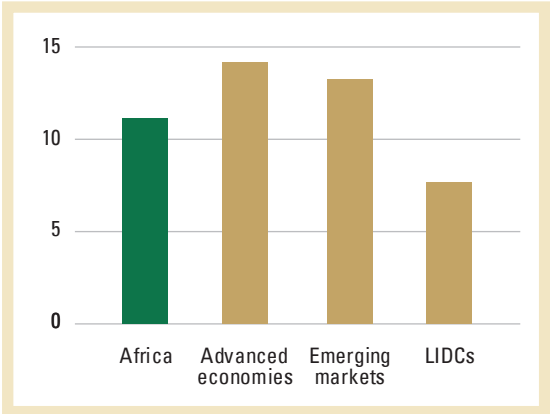
Sources: World Revenue Longitudinal Database (WoRLD), IMF Fiscal Affairs Department Tax Rates Database, and World Economic Outlook

**Figure 2.16: Africa: CIT Productivity and CIT to GDP, 2016 or Latest**

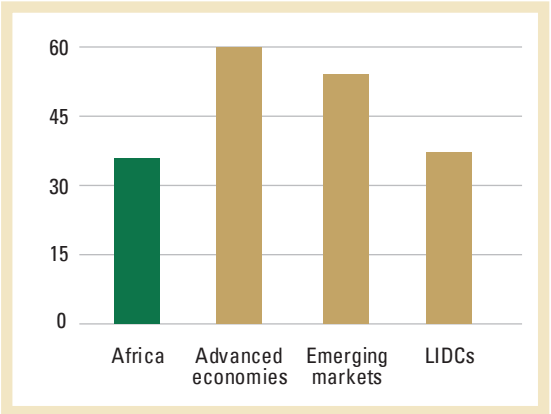


Sources: World Revenue Longitudinal Database (WoRLD), IMF Fiscal Affairs Department Tax Rates Database, and World Economic Outlook

**Figure 2.17: CIT Productivity, Percent, Average**



**Figure 2.18: VAT C-Efficiency, Percent, Average**

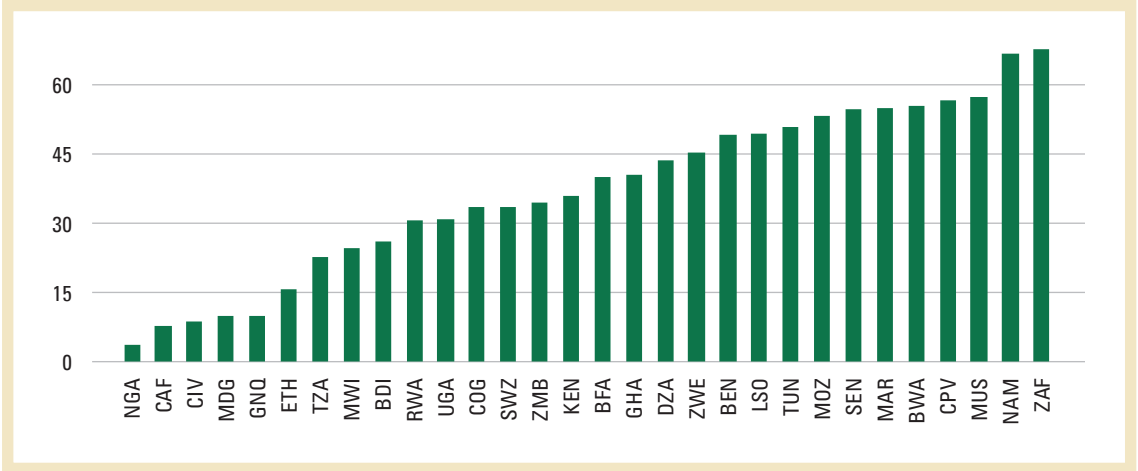


Sources: World Revenue Longitudinal Database (WoRLD), IMF Fiscal Affairs Department Tax Rates Database, and World Economic Outlook

Substantial progress has also been made regarding the collection of indirect taxes. Most African countries have introduced a VAT, replacing general sales taxes. The main advantage of a VAT is that it avoids tax cascading (tax paid on tax) by taxing only the value added at each stage of the supply chain. African countries that continue to rely on sales taxes, should look to introduce a modern VAT. These include Angola, Comoros, Guinea-Bissau, Liberia and São Tomé and Príncipe. However, before the introduction of the VAT, countries need to develop a capacity to administer the credit/debit system, which suggests that the process cannot be rushed.

One advantage of focusing on the VAT is that it is more growth-friendly than other types of taxes, especially direct taxes (IMF, 2015). In most cases this can be best achieved by a focus on the efficiency of the VAT, rather than through increases in VAT rates, as this is less likely to have a negative impact on growth. At the same time, in countries where the rate is below 13 percent, a two percent rate increase would have virtually no negative impact on growth, while in countries with a rate between 13–18 percent, a one percent increase would not have much effect on economic activity. With rates above 18 percent, even small increases in the VAT rate can have a substantial negative impact on growth (Gunter *et al.*, 2018a, 2018b).

**Figure 2.19: Africa: VAT C-Efficiency, 2016 or Latest Available**



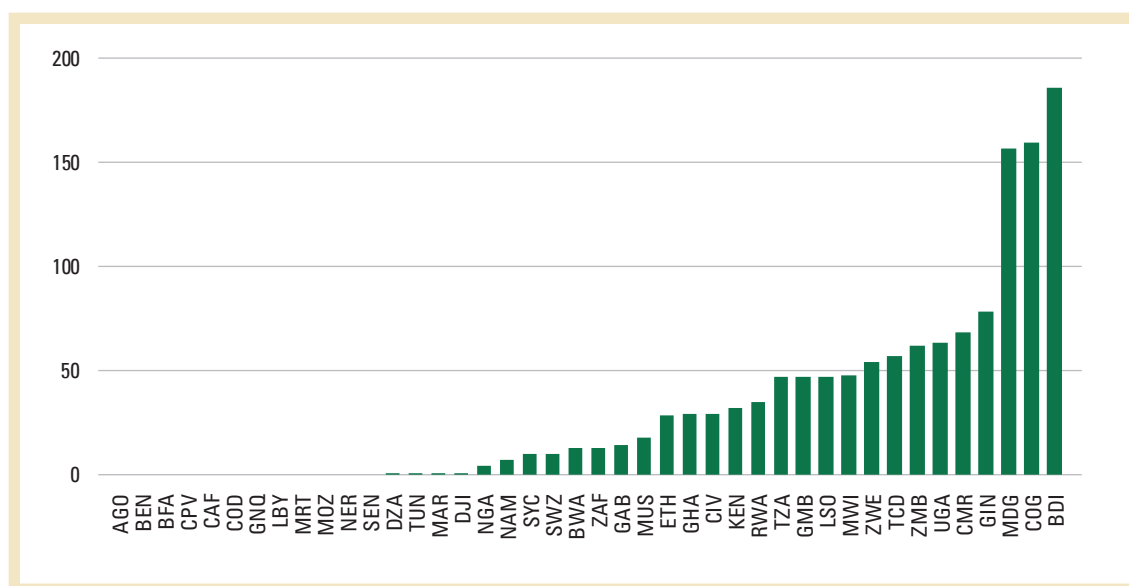
Sources: World Revenue Longitudinal Database (WoRLD) and IMF staff estimates

At the same time, the focus on the VAT also requires greater attention to pro-poor spending and social protection measures. Countries should use part of the resources raised through the VAT to ensure that any potentially negative distributional impact is adequately offset on the expenditure side.

In those African countries that have adopted a VAT, its efficiency is relatively low compared with other regions (Figure 2.18) and varies widely across the region (Figure 2.20)<sup>19</sup>. Several factors explain this performance. Narrow tax bases due to the proliferation of exemptions and zero rating for goods and services.<sup>20</sup> While all countries have some exemptions and zero-rated goods and services, there are substantial differences across countries. For example, Lesotho, Mauritius, Senegal, and South Africa have relatively short lists compared to countries like Cameroon, Malawi, and Zambia which have more extensive lists of exemptions.

Different thresholds for which a taxpayer is required to register (Figures 2.21 and 2.22). While it is usually advisable to have a relatively high threshold to allow the tax administration to focus on the larger taxpayers, more mature tax administrations can choose lower thresholds. Substantial differences can also be observed for the PIT thresholds. Burundi, Zambia, and Zimbabwe have very generous exempted thresholds that exceed three times their per capita GDP, compared to countries such as Botswana, Senegal, South Africa, and the United Republic of Tanzania, where exempted thresholds are similar to the level of per capita GDP.

**Figure 2.20: Africa: VAT Thresholds Relative to Per Capita GDP, 2016 or Latest Available**



Sources: IMF Fiscal Affairs Department Tax Rates Database, and World Economic Outlook

19 VAT C-efficiency is defined as actual VAT collections as share of its potential base (i.e., consumption) and is given by:

$$\text{VAT C-efficiency} = \frac{\text{VAT Revenue}}{(\text{Total finance consumption net of VAT revenue}) * \text{VAT rate}}$$

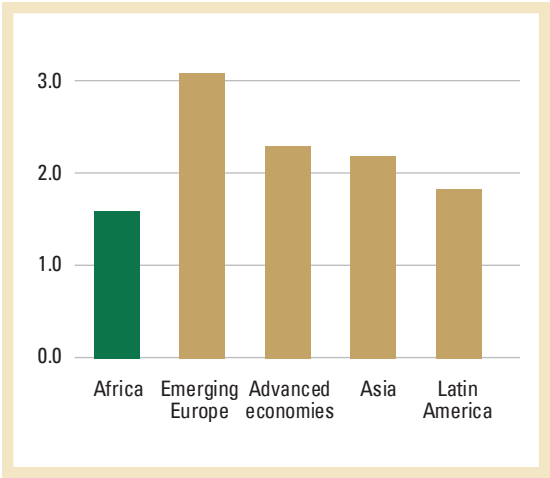
20 Zero-rating can have a more negative impact on collections than exemptions. In this case, the final consumption goods are not taxed and the seller can claim a VAT refund for the VAT paid on its inputs. When goods are 'exempt', the government does not tax the final sale, but producers cannot claim a VAT refund for the VAT they paid on the inputs used in the production process.

There are weaknesses in VAT refund systems. The VAT is a tax on consumption that requires both timely and accurate refunds. A variety of systems are used in African countries, including the use of VAT credits against future tax payments (Ghana, Kenya, Madagascar, Malawi, Mali, Mozambique, and Senegal), VAT refunds on a quarterly basis (Cameroon, Chad, Equatorial Guinea), and refunds following an audit verification (Mozambique, Namibia, and Nigeria). While the latter system can help to reduce refund fraud, administrative delays can result in a buildup of unpaid claims, as has been the case in Zambia and Zimbabwe. In this context, tax administrators should consider settling refunds out of gross VAT receipts, by establishing escrow accounts to satisfy future refunds and mitigate potential problems in cash management. The use of risk-based audit verification approaches, whereby audits are selective and based on an assessment of risks, can help expedite the settlement of VAT refunds.

In addition to a sound VAT, Africa also stands to benefit by tapping underexploited taxes (for example, excise and property taxes), accelerating customs administration reforms, and reviewing policies regarding international corporate taxation.

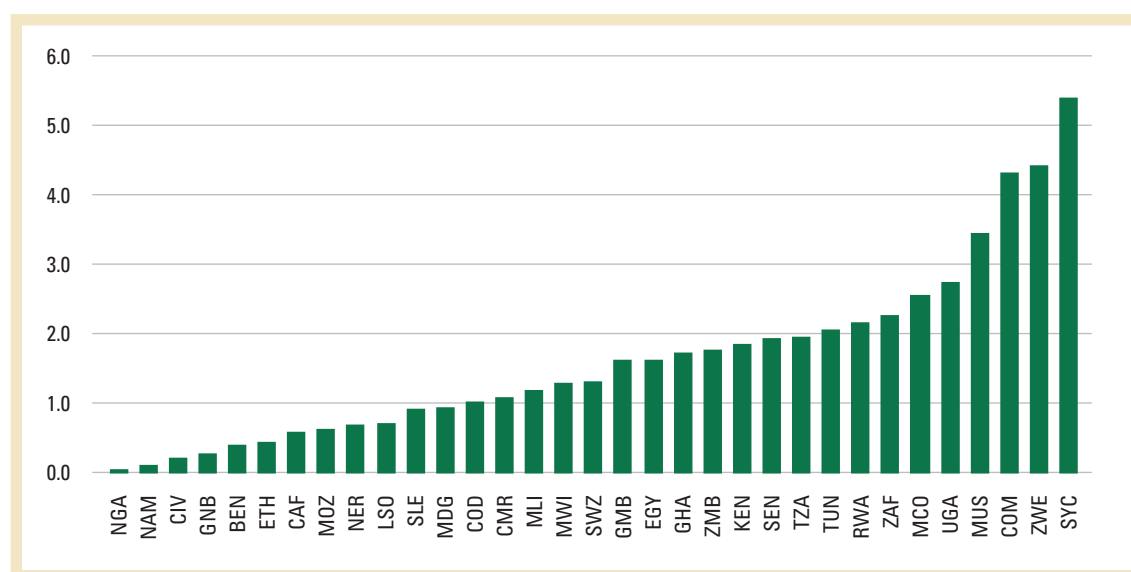
More specifically, the following observations are in order. The excise tax is an underexploited revenue source. In 2015, on average, African countries collected 1.4 percent of GDP from all forms of excise taxes. This level of excise tax collection is relatively low compared to other world regions, such as emerging Europe, where revenue related to excises accounted for around 3 percent of GDP in 2015 (Figure 2.21). There are also wide differences in excise collections across Africa, suggesting countries with excise revenues of less than 1 percent of GDP have scope to boost domestic revenue using this instrument, which is relatively simple to implement and does not require fundamental changes to the tax system (IMF, 2011). These countries include Benin, Côte d’Ivoire, Madagascar, Mozambique, Nigeria, Sierra Leone, and Zimbabwe (Figure 2.22). While specific advice will depend on country-specific circumstances, countries need to evaluate the products that can be subject to excise taxes (typically petroleum, cigarettes, alcohol, motor vehicles and sometimes telecoms) and the amount of tax levied. This is either through a specific tax (a monetary amount based on quantities) which is typically better suited to address externalities, tends to produce a more predictable revenue stream and is simpler to administer, or *ad valorem* (based on the value or price of the product), which can in some cases result in lower consumption prices (Delipalla and Keen, 1991).

**Figure 2.21: Excise Taxes as a Share of GDP, 2015, Average**



Sources: World Revenue Longitudinal Database (WoRLD) and Sub-Saharan Africa Tax Revenue Dataset

**Figure 2.22: Africa: Excise Taxes as Share of GDP, 2015 or Latest Available**



Sources: World Revenue Longitudinal Database (WoRLD) and Sub-Saharan Africa Tax Revenue Dataset

Property taxation is also underused. Property tax revenues are quite limited in Africa, and their potential toward revenue mobilization is considered modest<sup>21</sup>. Nonetheless, the case for property taxation is clear: it provides a stable and reliable source of revenue that is less susceptible to short-term economic fluctuations; and it is difficult to evade, since property taxes can be secured by the property itself. A further benefit is improved service delivery and accountability where property taxes are collected by local administrations<sup>22</sup>. Property taxation is becoming more common across Africa. Yet, many countries still rely solely on one-time payments (for example, Botswana, Lesotho, Malawi, Swaziland, and Zimbabwe, among others, depend on stamp duties or registration fees on property sales). The roll out of recurrent property taxation will require significant capacity-building around property registries and annual appraisal systems, as well as stronger coordination between central and subnational governments, but relatively rapid progress is possible in urbanized areas where information exists on ownership and reference valuations<sup>23</sup>.

African countries could also do more to leverage customs taxation, which rely on VAT on imports, trade taxes, and excise taxes on imported goods. In 2015, on average, African countries collected a third of their non-resource revenue through customs at their border (Figure 2.23). With a smaller number of taxpayers involved in international trade activities – as compared to a larger number of taxpayers involved in domestic operation – customs administration reforms can deliver results on revenue mobilization in a relatively short timeframe. At the same time, better customs administration is also critical to boost trade. Such reforms have often included the modernization of customs processes (that is, digitalization of transactions and payments) and measures to combat corruption and fraud (that is, strengthening clearance procedures and creating anti-smuggling units). Channeling goods through a few major ports with adequate custom controls can also facilitate custom administration and reduce potential for leakage.

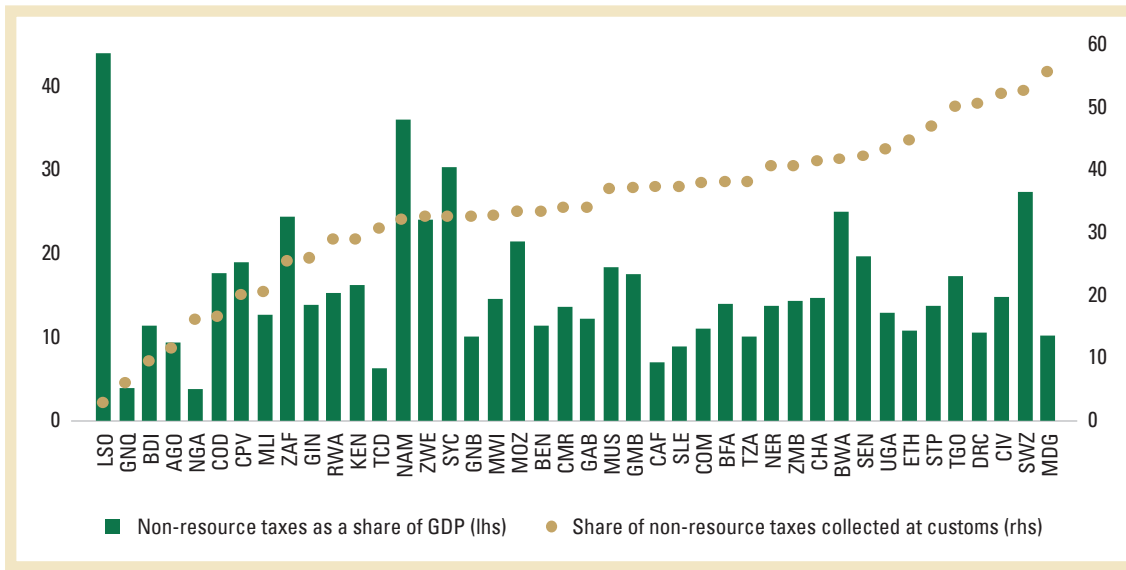
21 Studies have shown that property taxation has the potential to boost revenue mobilization from 0.5 to 1.0 percent of GDP in developing countries (Norregaard, 2013).

22 In Lesotho, property taxation accounts for half of local government revenue (IMF, 2011) and in Cabo Verde this is 70 percent (Norregaard, 2013).

23 In most African countries, the challenge of imposing property tax is the lack of a reliable address (or property location) system. In addition to computerizing existing land records, modern techniques help to extend their coverage by relying on geo-spatial data (for example, generated by global positioning system or remote sensing technology) and non-spatial data (for example, to capture a wide range of land rights).



Figure 2.23. Custom Taxes as a Share of GDP and Total Taxes, 2015



Sources: World Revenue Longitudinal Database (WoRLD) and IMF Fiscal Affairs Department SSA Tax Revenue Dataset

Cross-border tax rules also need to be reviewed. African countries need to stay abreast of evolving international corporate practices. With companies increasingly reliant on debt relative to equity, thin capitalization rules have been adopted to limit tax deductions on interest. By end 2016, thin capitalization rules across Africa set debt-to-equity (or ‘gearing’) ratios of up to 4:1, but recent international trends suggest that countries with rules allowing for ratios above 2 could look to further limit interest deductions (Botswana, Equatorial Guinea, Namibia, Rwanda, United Republic of Tanzania, Zambia and Zimbabwe). An additional international tax issue is intra-group transactions, also known as transfer pricing, which can distort taxable income. These new regulations typically embed the ‘arm’s length’ principle to ensure that transfer prices are transacted on a market value basis. To limit tax avoidance, tax rules and monitoring frameworks covering transactions between related parties need to be introduced where they are absent.

## 2.2. Structural Factors Affecting Tax Effort and Potential

One way to assess the amount of additional taxes that a state can potentially collect is to compare its tax-to-GDP ratio with a ‘tax frontier’. The tax frontier (or theoretical tax capacity) can be defined as the highest level of tax revenue (usually measured in percent of GDP) that a country can be expected to achieve, given certain underlying macroeconomic and institutional conditions. The distance between actual tax revenues (or tax effort) and the tax frontier in a particular year measures the theoretical tax gap or tax potential<sup>24</sup>. It measures how far a country is from the maximum level that can be expected from countries that would have similar characteristics.

Following Fenochietto and Pessino (2010, 2013), the tax frontier for African countries can be computed using a stochastic panel data model that covers 121 countries from 2002–2016 (Annex2). The model uses a set of independent variables commonly found to be associated with the level of tax revenue<sup>25</sup>

24 The idea is similar to the notion of a production function, which computes the expected level of output given a pre-determined level of input. Controlling for other factors, more efficient firms can produce a higher level of output with the same level of input. Estimations should be used with care, as they can be sensitive to modeling assumptions and estimation techniques.

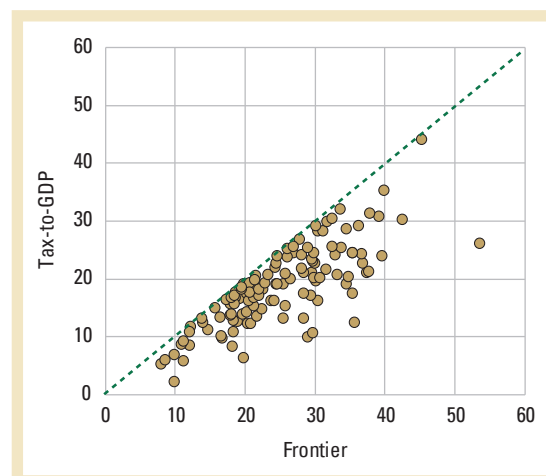
25 These include income per capita, trade openness, the share of agriculture in GDP, income inequality and public spending on education. To assess the impact of institutions, some variables measuring corruption and government effectiveness are also included.

and finds that countries differ widely in the height and distance to the frontier (Figures 2.24 and 2.26). In addition, the study finds that:

- Higher income levels, more trade openness, higher spending on education, and better government effectiveness are associated with higher tax-to-GDP ratios, as well as lower income inequality and lower corruption levels. These factors determine the height of the frontier for each country. Once the frontier has been calculated for each country, we can estimate the distance to the frontier as a measure of the inefficiency of the tax system to understand how the country fares compared with other countries that would share similar characteristics.
- The average tax frontier for African countries is around 8.5 percentage points of GDP lower than the average tax frontier for the rest of the world. This is not surprising, given the fact that African countries have lower levels of economic and institutional development than countries in other regions.
- The average tax gap is lower in Africa than elsewhere. This means that controlling for the effect of structural factors that affect tax collections, African countries are not showing, on average, higher levels of inefficiency in their tax collection efforts than other regions (Figure 2.25). The average tax gap (or tax potential) for African countries ranges between 3–5 percent of GDP<sup>26</sup>.
- Large variations exist in tax effort and tax gaps for African countries. Oil producers have the lowest tax effort and highest average tax potential at around 4.7 percent of GDP, while other resource and non-resource countries show lower levels of tax potential of around 3 percent of GDP. Similar pattern exists for non-African countries, but with substantially different tax frontiers (Figure 2.26).

Tax potential reflects the tax revenue gains that a country could achieve through tax policy changes or improvement in the efficiency of collection. While improving tax systems can help close tax gaps, this may not be enough to attain key fiscal objectives such as supporting higher levels of public spending to achieve the UN SDGs. Additional revenue mobilization would also require reforms to tackle the underlying structural factors – notably corruption, government effectiveness, and inequality – which are currently acting as constraints<sup>27</sup>.

**Figure 2.24: Tax effort, in percent of GDP**

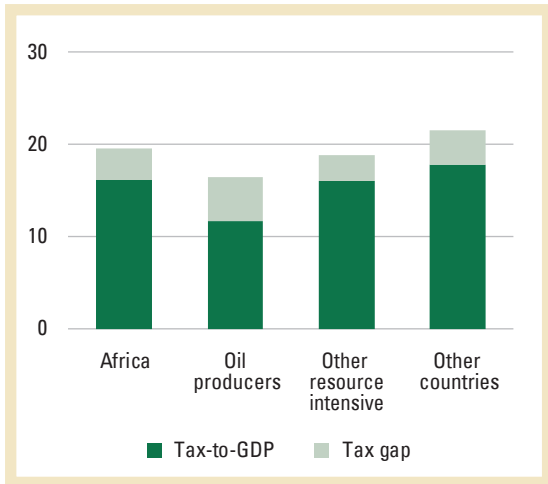


Sources: World Economic Outlook and IMF staff estimates

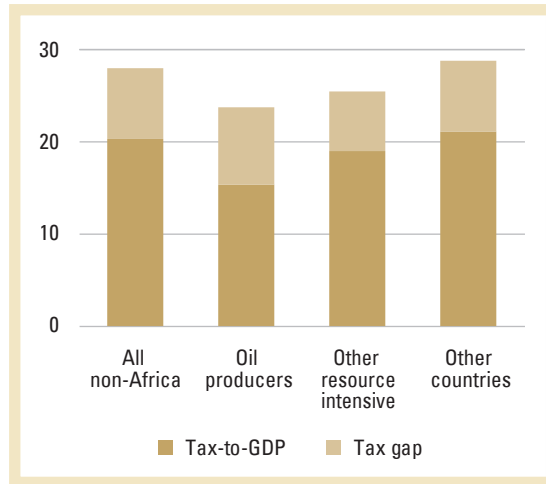
26 In most model specifications, the average tax gap exceeds 3 percent of GDP and it can reach up to 5 percent of GDP when using a global sample of countries (Annex 2).

27 The idea is again similar to the notion of a production function. A firm can produce more output with better technology that improves efficiency but can also increase its inputs. In the analysis of revenue mobilization, the 'inputs' are the factors that are associated with higher revenue collection. Some evolve slowly over time (like per capita GDP or the share of agriculture in GDP) but others (quality of governance, corruption) can change more quickly through decisive policy action, even if progress can be challenging in practice.

**Figure 2.25: Africa: Tax Frontier and Gap, Percent of GDP**



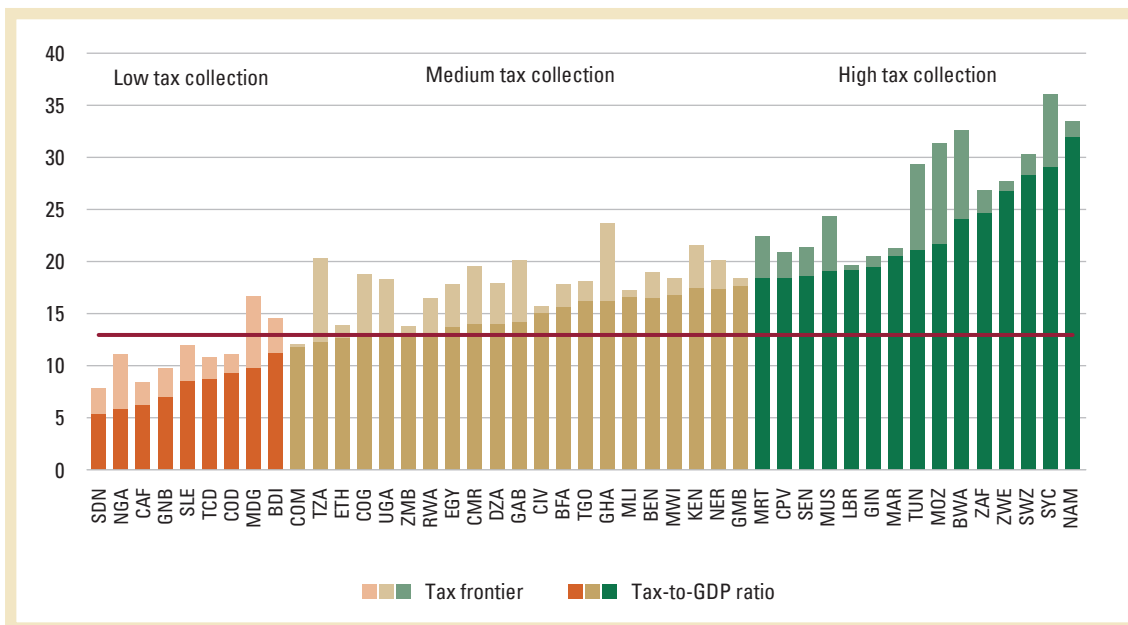
**Figure 2.26: Non-African Countries: Tax Frontier and Gap, Percent of GDP**



Sources: World Economic Outlook and IMF staff estimates

African countries still have considerable potential to collect higher taxes through reforms (Figure 2.27). On the other hand, the relatively lower tax frontier implies that improvement in macroeconomic fundamentals and institutional factors could also increase the tax frontier, and hence increase the possibilities to mobilize greater tax revenue. Regression analysis comparing the tax frontiers based on changes in income inequality, corruption, and government effectiveness show that policies addressing institutional weakness could help boost revenue collection. This can operate through several channels, including an increase in tax compliance, as citizens realize the government is more likely to use their taxes for more transparent and efficient spending programs (IMF, 2015b).

**Figure 2.27: Africa: Tax Ratio and Tax Frontiers, Percent of GDP, 2015**

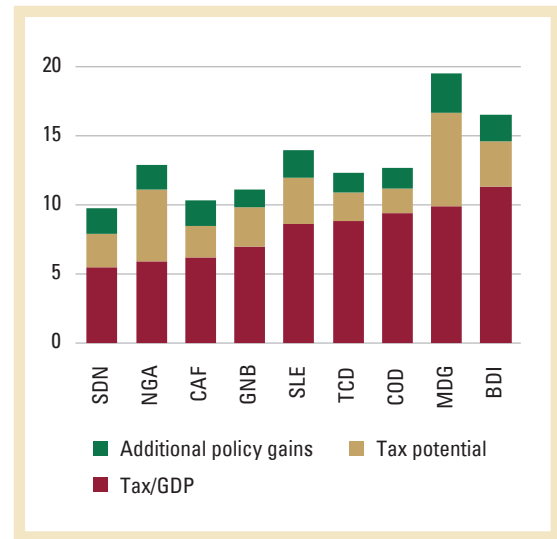


Sources: World Economic Outlook and IMF staff estimates

It is also useful to consider the revenue mobilization challenges facing countries with different tax collection levels.

- Countries with *low tax collection levels* (below the threshold of about 12.5 to 13 percent of GDP, earlier referred to a 'tipping point') will need reforms to both increase the efficiency of collection and push the tax frontier (Figure 2.28). For example, Nigeria could double its tax-to-GDP ratio to above 10 percent of GDP with efficiency reforms, but to reach the tipping point it would need to improve also structural factors, such as policies that reduce corruption and improve governance, or increase the level of spending on education, which could simultaneously help reduce inequality and create incentives to collect more taxes (for example through increases in the VAT rate)<sup>28</sup>.
- Countries with *medium tax collection levels* (tax-to-GDP ratio in the 13–18 percent range) could mobilize, on average, about 3.2 percent of GDP in additional revenues though reforms aimed at improving the efficiency of their current systems<sup>29</sup>. At the same time, for some countries relatively close to the tax frontier, such as Ethiopia, Côte d'Ivoire or Mali, efficiency gains could produce limited results and the focus should also be on structural reforms to push the frontier to a higher level. Policies that focus on more inclusive growth or tackle corruption can help in this regard.
- For countries with *higher tax collection levels* (tax-to-GDP ratio over 18 percent), the tax frontier is already relatively elevated, partially a result of substantial investment in developing stronger tax collection institutions despite still-modest per capita income levels (Mozambique and Liberia) or higher levels of development and good governance (Botswana, Mauritius, Namibia and Seychelles). For these countries, despite comparatively high tax-to-GDP ratios, average distance to the frontier stayed at around 4 percent of GDP, suggesting that there is also potential to mobilize additional revenues<sup>30</sup>.

**Figure 2.28: Tax Potential for Low Tax Revenue Countries, Percent of GDP**



Sources: World Economic Outlook and IMF staff estimates

### 2.3. Lessons from Successful Revenue Mobilization Episodes

It is clear there are ample tools and scope to increase government revenues, but given the complexity of the task, how should potential be turned into practice. Here it is useful to look for success stories in Africa to discern lessons. The focus is on non-resource revenues, where country authorities have

28 Figure 2.30 simulates the impact of increasing the level of the key policy variables (especially the variables that measure good governance and corruption) to the average level of the countries in the medium tax collection category (that is, tax ratios in the 13–18 percent range). The results do not show a significant endogeneity problem with the inclusion of education spending as an explanatory variable.

29 For example, a thorough review of existing taxes and exemptions.

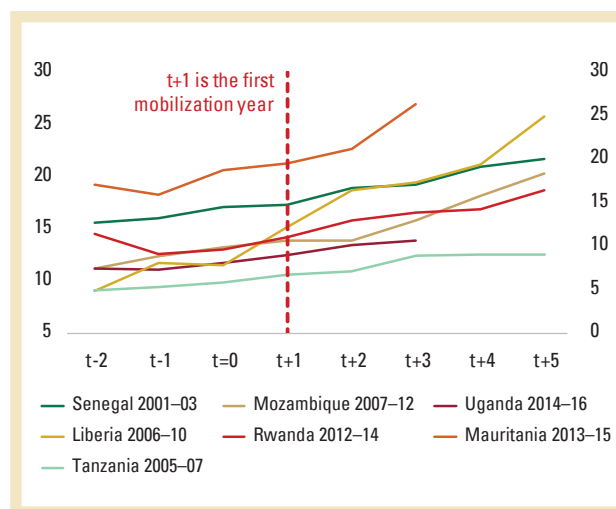
30 In these cases, however, there are other considerations to take into account. When the tax-to-GDP ratio has already reached a relatively higher level, increasing it further can also be a matter of public choice. For example, some countries may decide to lower their fiscal pressure (for example, by reducing tax rates). This will show a higher tax gap for a given year, compared with an earlier historical period when the country was collecting higher taxes but does not necessarily imply an inefficiency in the system.

greatest control over outcomes. A simple algorithm helps to identify the high-quality examples of strong and steady improvement in non-resource revenues. In this instance, an episode is defined as a total increase of 2 percentage points of non-resource GDP over a three-year period, with no substantial declines in the revenue ratio within or following the period<sup>31</sup>.

Based on these criteria, sustained revenue mobilization is difficult. Using a dataset covering 52 Africa countries from 2000–2016, the analysis finds seven episodes of sustained revenue mobilization (Figure 2.29)<sup>32</sup>. The non-resource revenue gain during the three-year episodes ranges to as much as 8 percentage points of non-resource GDP, with an average annual increase of 1.3 percentage points and an average total revenue gain of 3.5 percentage points. In nearly all cases, gains continued in subsequent years, with increases averaging 1 percentage point per year over the next three years<sup>33</sup>. Data for 2016 indicate that the current level of revenue is an average 2.7 percent of non-resource GDP higher than the episode endpoint, suggesting that the gains have solidified.

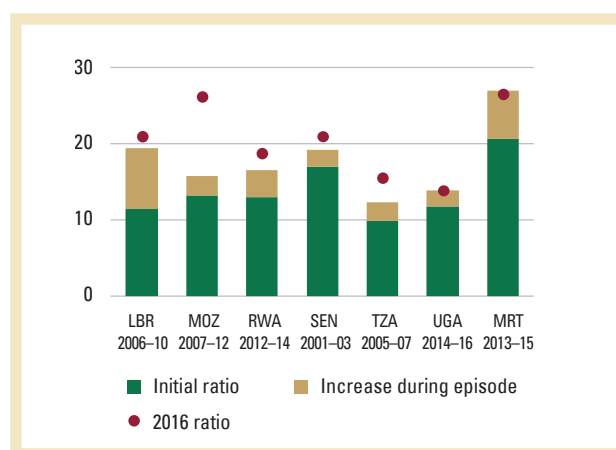
The success stories reflect a diverse cross-section of countries (Figure 2.30), encompassing all Africa’s geographic regions, and diverse levels of income, fragility, resource-intensity, and tax effort (Table 2.1). Most of these countries experienced robust growth during the revenue mobilization episode, so tax buoyancy could partly explain the results. However, an acceleration in growth was not required. Only Liberia saw a significant acceleration in growth, and growth in

**Figure 2.29: Africa: Revenue Mobilization Episodes, Non-resource Revenue to Non-resource GDP**



Sources: IMF, World Economic Outlook database and IMF Fiscal Affairs Department Tax Revenue database

**Figure 2.30: Africa: Revenue Mobilization Episodes, Non-resource Revenue to Non-resource GDP Ratio**



Sources: IMF, World Economic Outlook database and IMF Fiscal Affairs Department Tax Revenue database

31 To help ensure that the episode is due to underlying rather than ephemeral factors, the algorithm rules out instances where the mobilization episode is preceded by large drops in non-resource revenue, possibly suggesting a bounce-back recovery, and rules out episodes that are followed by significant deterioration of performance during the subsequent two years.

32 Oil producers are omitted from the group of case studies in view of the potentially large spill-over impact of cyclical commodity price swings on economic activity and non-resource revenues.

33 The exception is Mauritania, where there was a modest decrease of 0.5 percentage points during the year following the episode. Non-extractive revenue mobilization strengthened in 2017–2018, including measures pursued under the IMF-supported program agreed in late 2017, which sought to consolidate gains through improved oversight of exemptions, modernizing CIT, and a range of tax and customs administrative reforms.

the other six countries decelerated during the episodes relative to the previous five-year average (falling by nearly 1 percentage point to 5.3 percent). The focus of macroeconomic policies differed across the cases. Notably, most episodes overlapped with intensified engagements with the IMF in the form of both lending and non-lending programs and substantial technical assistance efforts.

The countries did not appear to follow a set formula for boosting revenues, but rather seem to have developed home-grown strategies (Table 2.2)<sup>34</sup>. Nonetheless, all employed a variety of tax policy and revenue administrative reforms before and during the episode.

**Table 2.1: African Revenue Mobilization Episodes**

Country	Episode	Income	Resource Intensity	Fragile	IMF Program	Real growth		Macroeconomic Objectives	Fiscal Objectives
						Preceding 5 year Average	In Episode		
Liberia	2006–10	LIC	Other	Yes	Yes	-2.3	7.6	<ul style="list-style-type: none"> <li>Sustain economic reconstruction by creating a stable macroeconomic environment</li> </ul>	<ul style="list-style-type: none"> <li>Strengthen revenue collection and expenditure control to channel resources poverty reduction; ensure transparency and accountability</li> </ul>
Mauritania <sup>1/</sup>	2013–15	LMIC	Other	No	Yes	3.6	3.0	<ul style="list-style-type: none"> <li>Consolidate macroeconomic stability, support sustainable economic growth, diversify the economy, and achieve a significant reduction in poverty</li> </ul>	<ul style="list-style-type: none"> <li>Keep domestic demand growth in check and maximize social spending (tax and expenditure reforms increase fiscal space gradually)</li> </ul>
Mozambique	2007–12	LIC	Non	No	Yes	9.1	6.9	<ul style="list-style-type: none"> <li>Consolidate macroeconomic stability; strengthen the financial sector and improve the lending environment</li> </ul>	<ul style="list-style-type: none"> <li>Sustain growth, strengthen revenue, enhance efficiency and transparency of government operations, and improve social service delivery</li> </ul>
Rwanda	2012–14	LIC	Non	No	Yes	8.0	7.0	<ul style="list-style-type: none"> <li>Consolidate macroeconomic stability while reducing aid dependency</li> </ul>	<ul style="list-style-type: none"> <li>Maintain a sustainable fiscal position while increasing domestic revenues</li> </ul>
Senegal	2001–03	LMIC	Non	No	Yes	4.1	4.0	<ul style="list-style-type: none"> <li>High and equitable growth via better service delivery and a more attractive investment climate</li> </ul>	<ul style="list-style-type: none"> <li>Expand infrastructure and social services while safeguarding macroeconomic and debt sustainability</li> </ul>
Tanzania	2005–07	LIC	Other	No	Yes	6.3	6.5	<ul style="list-style-type: none"> <li>Contain inflation and support broad based growth via infrastructure investment</li> </ul>	<ul style="list-style-type: none"> <li>Steadily increase the revenue ratio to bolster macroeconomic performance and reduce aid dependency</li> </ul>
Uganda	2014–16	LIC	Other	No	Yes	5.9	4.2	<ul style="list-style-type: none"> <li>Support the reform agenda for growth, focused on institutions, financial sector, and investment climate</li> </ul>	<ul style="list-style-type: none"> <li>Scale up investment; Broaden and deepen tax base; PFM effectiveness; preparing for oil</li> </ul>

Source: IMF staff documents

1/ Mauritania's increase on tax revenue exceeded 2 percent of non-commodity GDP, although a small decline (0.5 percentage points) occurred after the episode.

34 The selected episodes are explored in more depth through a comprehensive review of IMF country documents, covering the years preceding and through the episode. This review includes staff reports, memoranda on economic and financial policies prepared by the authorities, and reports by technical assistance missions focusing on revenue mobilization efforts. The aim was to establish a sense of objectives, sequencing, and implementation.

**Table 2.2: African Revenue Mobilization Episodes: Timeline of Tax Policy and Administrative Reforms**

Liberia 2006–2010	Mauritania 2013–2015	Mozambique 2007–2012	Rwanda 2012–2014	Senegal 2001–2003	Tanzania 2005–2007	Uganda 2014–2016
Prior Reforms	VAT (1996); VAT rate unification (2009); LTO (2000); Taxpayer ID number (2001); MTO (2007)	Outsourcing of customs administration (1998); VAT (2001); RRA functional reorganization (2003); SIGTAS (2003–07); Income tax reform (2005); excise tax amended (2006); segmentation (2009)	Revenue Authority (1998); VAT (2001); RRA functional reorganization (2003); SIGTAS (2003–07); Income tax reform (2005); excise tax amended (2006); segmentation (2009)	VAT (1980); VAT administration computerization (1999); LTO (2000); WAEEMU common external tariff (2000)	Revenue authority (1996); VAT (1998); Trade tariffs reduced (1999); LTO (2001); Taxpayer ID number	Revenue Authority (1991); VAT (1996); LTO (2005); MTO (2008); PIT top rate increase (2012)
<p>2005 Created single tax operation</p> <p>2006 Strengthen large-taxpayer audit function; increase large taxpayer base</p> <p>2006 Web posting of financial statements of revenue-generating agencies</p> <p>2007 Broadened tax base by voiding tax concessions and duty exemptions</p> <p>2007 Implement new taxpayer identification number</p> <p>2008 Reorganize domestic tax administration by taxpayer segmentation</p> <p>2010 Restart taxpayer audits</p> <p>2010 Developed new Investment Act</p> <p>2010 Automated administration of tax (ITAS)</p> <p>2010 Customs automation (ASYCUDA) and roll out of one-stop customs at ports</p> <p>2010 Lowered CIT/PIT from 35 percent to 25 percent, broadly aligned to region</p> <p>2010 Increased taxes and excise on alcohol, airlines, cell phone usage, and hotels</p>	<p>2011 Corporate tax arrears recovery plan; census of potential taxpayers; new taxpayer codes</p> <p>2011 Implement ASYCUDA++ at major customs offices; restore excises on tobacco</p> <p>2011 Conduct a census of all businesses (including medium-sized companies) (Sep 2011)</p> <p>2012 Establish independent joint committees for tax audit appeals</p> <p>2012 New customs code; information sharing MoU between customs and tax</p> <p>2012 End CIT exemption; minimum tax revenue collected by customs</p> <p>2013 Withholding tax of 15 percent to non-residents to limit profit shifting</p> <p>2013 Raise minimum threshold for LTO</p> <p>2013 Eliminate global income tax; raise PIT exemption; increase marginal tax rate for richest</p> <p>2013 Increased resources for tax and customs; performance indicators for customs staff.</p> <p>2013 Inventory of all exemptions (tax expenditures) presented in budget</p> <p>2015 Increase VAT rate by 2 percentage points to 16 percent</p>	<p>2004 PIT rate increased from 20 to 27.6 percent</p> <p>2004 Organic Law for Tax Tribunals</p> <p>2006 PIT rate increased to 32 percent</p> <p>2006 Established Revenue Authority, developed medium-term strategic plan</p> <p>2008 Specific taxes on fuel increased, automatic quarterly adjustment</p> <p>2008 Large taxpayers unit created; expanded large taxpayer base</p> <p>2009 Initiated payment of taxes through banks</p> <p>2010 Revisions to excise taxes on alcohol and tobacco</p> <p>2011 Deployed registration system for VAT module of e-Tax system</p> <p>2013 Simplified tax system for small taxpayers</p>	<p>2010 RRA starts collecting social security contributions, improving coverage</p> <p>2011 Customer satisfaction survey inform strategic focus</p> <p>2012 Revised investment code to reduce exemptions</p> <p>2012 Electronic single window system at customs</p> <p>2012 Introduced special tax regime for small and micro enterprises</p> <p>2012 E-filing and e-payment systems; pension and medical insurance in e-Tax system</p> <p>2013 Medium-term revenue mobilization plan</p> <p>2013 One-stop border posts</p> <p>2014 New property tax legislation</p> <p>2014 Expanding use of electronic billing machines</p> <p>2014 Revised exemption and zero-rating schedules under the VAT-code</p> <p>2014 Tax expenditure budget</p> <p>2014 The RRA starts collecting decentralized taxes</p>	<p>2000 Single rate VAT at 18 percent</p> <p>2000 Management of central and local government taxes in a single directorate</p> <p>2000 Single taxpayer registration system at tax and customs departments</p> <p>2001 Study on revenue impact, beneficiaries, and legal basis tax exemptions</p> <p>2003 Integration of the IT systems of the tax, customs, and treasury directorates</p> <p>2003 Single taxpayer ID number</p> <p>2003 Synthetic tax for small businesses in lieu of the VAT, the CIT, and the business licensing fee</p> <p>2004 Streamlined investment Code to focus on priority industries</p> <p>2004 New software for property tax base; digitization of land and forest registry</p> <p>2005 Simplified CIT and reduced its effective rate from 35 to 33 percent</p>	<p>2003 Revenue authority adopts medium-term corporate plan for modernization</p> <p>2004 New tax law; self assessment, simplify small business tax, restore capital gains tax</p> <p>2004 Double VAT threshold, increase presumptive tax</p> <p>2004 Implement function-based large taxpayers dept, expand coverage</p> <p>2005 VAT and income tax administration under Domestic Revenue Department</p> <p>2005 Amended Investment Act, limits fiscal stability clauses to at most 5 years</p> <p>2005 Publicize beneficiaries of tax exemptions under voucher scheme</p> <p>2006 ASYCUDA++, create risk and post-customs audit policy</p> <p>2006 Index excises on non-petrol items, e.g. alcohol, tobacco, and mobile airtime</p> <p>2007 Establish dedicated units at six RA offices to serve medium-sized taxpayers</p>	<p>2012 Roll out e-tax services to upcountry stations; taxpayer education on e-tax</p> <p>2013 Issuance of national IDs and new levy on mobile money transfers</p> <p>2013 Increase fuel excise and new levy on mobile money transfers</p> <p>2013 Improve risk profiles for taxpayer segments focusing on key actors</p> <p>2013 Transition to ASYCUDA World</p> <p>2014 Publication of tax exemption beneficiaries; tax procedure code</p> <p>2014 National-subnational coordination on taxpayer identification</p> <p>2014 CIT expanded to eligible property, interest earned on loans to certain sectors</p> <p>2014 VAT gap analysis and strategy; review VAT register and ledger</p> <p>2014 Eliminate specific statutory income and VAT exemptions; cut number of zero rate goods</p> <p>2015 Higher VAT threshold</p> <p>2015 Established National Targeting Centre</p>

Source: IMF staff documents

■ Foundational reforms ■ Intermediate reforms ■ Advanced reforms

### 2.3.2. Comprehensive Reform Strategy

Each of these countries implemented multi-year reform strategies. Among the common features were a focus on basic institutions, tax base broadening, and modernization.

A key element was an emphasis on the basic building blocks of the tax system. The foundational elements of an effective tax system (which provide the base for more complex administrative and technological applications) include taxpayer identification numbers, a semi-autonomous revenue authority, the VAT, and taxpayer segmentation. Ex post assessments have found that the introduction of such reforms have been associated with increased revenue in a wide range of low-income countries<sup>35</sup>. These institutions were largely well entrenched before the revenue mobilization episodes. The exceptions were post-conflict cases, Liberia and Mozambique. The former was somewhat more advanced, having already implemented a broad reform agenda since the mid-1990s that started with overhauls of customs and domestic indirect taxes and introduction of a VAT, before shifting to the establishment of a revenue authority and a large taxpayer unit early in the episode. Although these institutions were well established in the other countries, the record indicates continued work to improve organization and medium-term strategies to strengthen capacity and coverage.

All countries paid special attention to measures to build the tax base, simplify the tax system and tackle exemptions and incentives. Instead of tax policy rate adjustments, the focus was on tax policy effectiveness and expanding the tax base. Research on developing countries has suggested that weaknesses in the design and implementation of various taxes has been a factor behind relatively low revenue productivity (IMF 2011). The reform mix taken by countries in the study included measures to reduce base-narrowing exemptions by voiding or suspending certain tax exemptions, revising investment codes, and eliminating distortions on VAT. Measures were also adopted with an aim to reach certain 'hard to tax sectors' by introducing simpler small business taxes, changes to VAT thresholds to focus on high-value businesses, and strengthening specialized taxes, such as those on property and investment income.

Finally, the countries made significant efforts to develop and modernize institutions. This included administrative reforms to strengthen core operations as well as effective information and communications technology (ICT) systems. This initiative included efforts to customize services and enforcement to different taxpayer segments (small, medium, and large). In fact, all countries in the study adopted some form of taxpayer segmentation, while several also implemented specific risk-based compliance strategies for different taxpayer segments. ICT reforms have helped several of these countries to jump from manual processed to automated processing (i.e. 'leap frog') as part of broader efforts to reduce compliance costs. Among several examples, these innovations have helped to simplify taxpayer registration, filing and payment, audit, collection enforcement, and appeals. Several rolled out their first e-tax platforms during 2011–2013. Rwanda further advanced with the introduction of mobile tax payments, integration of social contributions into the e-tax system, and the rollout of electronic billing machines to underpin the buoyancy of the VAT.

### 2.3.2 Sustained Political Commitment

It is essential to have a sound reform strategy that seeks to build effective and modern institutions, but its ultimate implementation requires sustained political will, since the process is likely to take years. Transparency can be a helpful tool to maintain the momentum of reform.

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35 Ebeke, Mansour, and Rota Graziosi (2016) found an unambiguously large and positive effect of semi-autonomous revenue agencies and VATs on non-resource taxes in sub-Saharan Africa countries. While the impact of a large taxpayer unit was not significant in their empirical model, it appears to have been an important precondition for the adoption of the first two reforms.



Revenue gains are usually incremental. It is not unusual to experience quick results in cases where a country is recovering from war and pursuing ambitious plans, as in Liberia. However, the norm is a slowly accruing dividend from structural reform. Amongst this group of strong performers, where considerable progress had been made on several foundational reforms even before the revenue episode, average annual increases in non-resource revenue were around 0.9 percentage points of GDP per year during the episode. After the episode, gains tended to slow to 0.7 percentage points, although there has been considerable variation in the outcomes.

Perseverance and the capacity to sustain reform momentum over time are essential. It is therefore not surprising that the countries studied here each pursued a broad range of policy and administrative reforms over a prolonged period, highlighting the importance of strong political commitment. Such reforms are ultimately a product of the political process and are likely to face resistance from entrenched interests. Sustained commitment is needed to enact new laws, effect policy changes, and find sufficient resources for effective implementation. Although it is difficult to assess the strength of political will, and countries have had a variety of experiences, some proxies can be used to assess positive political intent:

- *Medium-Term Revenue Strategies:* A multi-year revenue mobilization strategy enhances the impetus and commitment for reform. Such plans were adopted ahead of or concurrent with the mobilization episodes in Senegal (2003), Tanzania (2003), Mozambique (2006), and Rwanda (2013). An important aspect to ensure the success of the strategy is the focus on taxpayer-centric policies to improve compliance, which typically includes more consultation with the private sector and more accountability and responsiveness of tax authorities to taxpayers.
- *Political Stability and Reform Commitment:* Peace and stability are preconditions for success. Fragile countries subject to frequent coups d'état, armed conflict, or the incapacity of the state to maintain law and order in a substantial part of the territory tend to have very low tax-to-GDP ratios (often below 10 percent of GDP). At the same time, consistent commitment of the political leadership to the reform strategy played a key role in several cases. While ministerial level changes can energize reforms, they often result in delays or disruptions as plans are reassessed. The mobilization episodes in Mozambique and Senegal coincided with long-tenured ministers of finance, both in office for more than 10 years. The other case studies had at most two ministers of finance in the years leading up to and during the episode. Rapid turnover in key revenue administration staff, or inadequate attention to human resource management (for example, not providing adequate training or some degree of autonomy to the revenue authority) can also prevent progress.
- *Technical assistance and IMF engagement:* All the countries discussed here were engaged in a technical assistance dialogue with the IMF and with IMF-supported programs containing a substantial emphasis on revenue mobilization efforts. This helped generate incentives for countries to undertake revenue reforms<sup>36</sup>. An intensified engagement with the IMF, as was the case across this group of countries, can provide a useful sounding board in the development and implementation of a strategy. However, it cannot be a substitute for steadfast political will. In the cases under study, there were considerable technical challenges in the implementation of revenue mobilization measures.

Transparency and outreach can play a decisive role. Explaining the importance of reform objectives to the public and private sectors can build support for the reforms and help develop a change in the taxpayers' culture and in taxpayer compliance. Several of the countries emphasized outreach strategies to help build support for key reforms. The United Republic of Tanzania and Uganda regularly

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36 An assessment of technical assistance to African countries identified Liberia and Mozambique as notably heavy users of technical assistance in the years ahead of their mobilization episodes. At the same time, technical assistance per se is not sufficient to succeed as there are cases of heavy users of technical assistance that achieved limited progress.

published the names of beneficiaries of tax breaks to help support efforts to reduce the prevalence of exemptions<sup>37</sup>, and Uganda published a VAT-compliance gap analysis<sup>38</sup>. Liberia published the financial accounts of revenue-generating agencies to address mismanagement of public funds. Rwanda and Uganda launched taxpayer education programs to foster compliance and improve service delivery.

## 2.4. Conclusion and Policy Implications

African countries could mobilize, on average, up to 5 percent of GDP in additional tax revenues in the next few years<sup>39</sup>. However, historical experience suggests that the conditions for success require attention to many factors related to policy design, institutional development, and political support. Not surprisingly, economic and political stability are pre-conditions for success.

Policy design is key, and inadequate tax policies cannot be offset by institutional reforms. If a country does not have a sound VAT, provides excessive tax incentives, and does not have a framework to ensure tax-compliance, there is little the revenue administration can do to close tax gaps. Successful experiences in revenue mobilization have relied on efforts to implement broad-based VATs, gradually expand the base for direct taxes (CIT and PIT) and implement a system to tax small businesses and levy excises on a few key items (IMF, 2011). While the specifics may vary by country, these are basic tax policy principles that have endured the test of time. Attention to contemporary issues like the role of property taxes or modern technologies is useful but getting the basics right is a pre-condition for success.

Institutional development and ongoing revenue administration reforms based on a medium-term plan are essential. Countries have shown progress when they focus on adequate risk management (that is, allocating resources where revenue potential is greatest) and taxpayer segmentation (starting with a large taxpayer office<sup>40</sup>). This requires developing the capacity to study which economic sectors offer the greatest potential, building a reliable registry of the largest taxpayers, and developing the capacity to conduct well-targeted audits. In countries with very low tax-to-GDP ratios, the potential gains from institutional reforms are larger, but the capacity to implement them is also more limited. However, the experience of Mozambique and Liberia, two post-conflict countries, suggests that sustained reforms over time are possible even when the initial level of capacity is low.

Improving governance, controlling corruption and focusing on the efficiency and transparency of public spending also appear to be pre-conditions for success. The level of tax compliance depends on the availability of mechanisms to ensure enforcement and the willingness of citizens to accept the legitimacy of the state to collect taxes. When citizens perceive that the tax system is fair (for example, it does not exclude powerful individuals and politically connected firms) and that revenues are used to finance productive spending programs, they are more likely to accept their tax obligations. Therefore, the transparent publication of who benefits from tax exemptions or incentives, as well as public financial management reforms that increase the efficiency and transparency of public spending, can be helpful instruments to support tax reform efforts. At the same time, customs and tax officials are more likely to remain professional and preserve the integrity of the system when political leaders, at the highest level, show their commitment to reform through an adequate system of incentives and sanctions. This is illustrated by the case

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37 The United Republic of Tanzania ended the practice of regularly publishing the beneficiaries of tax breaks in 2010.

38 Uganda is among the relatively few developing countries (along with Kenya and South Africa) that has undertaken VAT compliance gap analysis to inform its efforts to improve compliance.

39 This is the upper estimate of the tax frontier analysis presented in the previous section and has also been highlighted as a benchmark to aim for in recent policy discussions (Gaspar and Selassie, 2017)

40 The creation of a revenue authority is not always necessary. What matters is the specific institutional innovations that are introduced. For example, allowing tax collection agencies to have an adequate level of operational autonomy and flexibility to hire and train professional staff.

of Rwanda, a country that has one of the best track records in its anti-corruption efforts and has made remarkable progress in revenue mobilization efforts.

Specific reform efforts and policies need to be defined at the country level using local knowledge, and country authorities are best placed to lead this exercise. There are, however, five steps that could usefully guide this process. First, identify the taxes that offer the greatest potential. For most sub-Saharan Africa countries, improving the VAT offers substantial potential, given its current low efficiency in most cases. But there should be a systematic assessment of the potential associated with other taxes, including the CIT (where excessive tax exemptions/incentives have been eroding the base), the PIT (where there should be an effort to gradually expand coverage), and excise taxes. Second, review the legal framework and tax policy design. Once the potential of the various taxes has been established, there will be a need to align tax policies with the new objectives. Third, assess the institutional framework. This includes a greater emphasis on improving governance and controlling corruption, and institutional arrangements that have proven effective, such as the establishment of a Revenue Authority. Fourth, develop a medium-term revenue strategy that defines medium-term objectives, short-term goals, and capacity-building needs. Finally, build a constituency for reform. The success of the medium-term strategy will depend on capacity of the government to convince other political parties and society that revenue mobilization is in the broader interest of the country. This is important to avoid reversals in cases of government changes after elections, given that revenue mobilization takes time.

## **Annex 2: Estimating Tax Effort and Tax Potential**

### **Definitions**

The tax frontier is defined as the maximum tax revenue (measured in percent of GDP) that a country can achieve at certain given specific conditions (level of development, trade openness, sectoral structure, income distribution, and institutions, amongst others).

Tax effort is defined as the ratio between actual tax revenue and corresponding frontier tax revenue.

Tax potential reflects the distance between the tax frontier and the actual tax revenue level.

Tax potential can be fulfilled through higher taxation or better collection efficiency, which is a result of policy choice.

### **Estimation Strategy**

Step 1: Estimate the tax frontier from a cross country panel data set

$$y_{it} = \alpha_i + \beta' X_{it} + \vartheta_{it} - \mu_{it}$$

where

$y_{it}$  is the log of the tax revenue-to-GDP ratio for country  $i$  at period year  $t$

$X_{it}$  is a vector of independent variables that affect  $y_{it}$

$\mu_{it}$  is the inefficiency, which is correlated with  $X_{it}$ , but independent from  $\vartheta_{it}$ , and

$\vartheta_{it}$  is the residual, and normal distribution with  $N(0,1)$

Step 2: Determine the tax effort

$$TE_{it} = \frac{\exp(y_{it})}{\exp(y_{it|\mu_{it}=0})} = \frac{\exp(\alpha_i + \beta' X_{it} + \vartheta_{it} - \mu_{it})}{\exp(\alpha_i + \beta' X_{it} + \vartheta_{it})} = \exp(-\mu_{it})$$

Step 3: Determine the tax frontier and tax potential

$$TP_{it} = TF_{it} - y_{it} = \frac{y_{it}}{TE_{it}} - y_{it}$$

## Data and Variables

Log of tax-to-GDP: World Economic Outlook (WEO)

Log of tax on goods and services to GDP: WEO

Lag of log of real GDP per capita: WEO

Lag of log of real GDP per capita squared: WEO

Trade openness – sum of imports and exports in percent of GDP: WEO

Agriculture: Value added of agriculture in percent of GDP: World Bank, World Development Indicators (WDI)

Gini coefficient: WDI

Oil: dummy for oil exporters

Corruption: WDI

Governance: WDI

## Main Results

	All Sample			Emerging and Developing Countries		
Log of real GDP per capita	2.939 ***	2.866 ***	2.885 ***	2.781 ***	2.691 ***	2.716 ***
Trade openness	0.002 ***	0.002 ***	0.002 ***	0.002 ***	0.002 ***	0.002 ***
Agriculture	-0.001	-0.001	-0.001	-0.001	-0.001	-0.001
Gini coefficient	-0.006 ***	-0.006 ***	-0.007 ***	-0.006 ***	-0.006 ***	-0.006 ***
General government dummy	0.105 **	0.109 ***	0.110 ***	0.091 **	0.093 **	0.098 **
Education	0.015 ***	0.016 ***	0.016 ***	0.016 ***	0.018 ***	0.017 ***
Oil dummy	0.080 **	0.035	0.031	0.043	0.030	0.026
Log of real GDP per capita squared	-0.152 ***	-0.148 ***	-0.150 ***	-0.142 ***	-0.138 ***	-0.140 ***
Corruption		0.117 ***	0.083 *		0.134 ***	0.100 **
Government effectiveness			0.091 *			0.088 *
Constant	4.165 ***	4.186 ***	4.256 ***	5.279 ***	4.945 **	5.267 **
Sigma_u	0.515 ***	0.515 ***	0.516 ***	0.525 ***	0.526 ***	0.526 ***
Sigma_u	0.099 ***	0.098 ***	0.098 ***	0.106 ***	0.106 ***	0.105 ***
Number of observations	1366	1360	1360	1109	1103	1103
Number of countries	122	121	121	99	98	98

Note: \*, \*\*, \*\*\* correspond to significance levels at 10, 5 and 1 percent

	All Sample			Emerging and Developing Countries		
Log of real GDP per capita	2.379 ***	2.332 ***	2.353 ***	2.228 ***	2.173 ***	2.207 ***
Trade openness	0.002 ***	0.002 ***	0.002 ***	0.002 ***	0.002 ***	0.002 ***
Agriculture	0.000	0.001	0.001	0.000	0.001	0.001
Gini coefficient	-0.008 ***	-0.008 ***	-0.008 ***	-0.009 ***	-0.009 ***	-0.009 ***
General government dummy	0.142	0.146	0.152	0.140	0.164 *	0.168 *
Education	0.003	0.007	0.006	0.004	0.009	0.008
Oil dummy	-0.642 ***	-0.626 ***	-0.634 ***	-0.646 ***	-0.581 ***	-0.587 ***
Log of real GDP per capita squared	-0.122 ***	-0.120 ***	-0.122 ***	-0.113 ***	-0.111 ***	-0.114 ***
Corruption		0.123	0.052		0.140	0.065
Government effectiveness			0.170 **			0.172 *
Constant	-0.615	-0.636	-0.615	0.621	1.258	1.075
Sigma_u	0.660 ***	0.665 ***	0.665 ***	0.667 ***	0.672 ***	0.672 ***
Sigma_u	0.162 ***	0.159 ***	0.159 ***	0.177 ***	0.174 ***	0.174 ***
Number of observations	1152	1146	1146	930	924	924
Number of countries	105	104	104	85	84	84

Note: \*, \*\*, \*\*\* correspond to significance levels at 10, 5 and 1 percent

**Table A2.1: Estimates of African Countries' Tax Frontier, Percent of GDP**

Country	Tax-to-GDP	All Countries			Emerging and Developing Countries		
		A	B	C	A	B	C
Sudan	5.5	7.9	8.0	8.6	7.6	7.6	8.0
Nigeria	5.9	11.1	11.1	12.0	10.7	10.4	12.0
Central African Rep	6.2	8.4	8.5	9.7	8.0	8.2	8.8
Guinea-Bissau	7.0	9.8	9.7	9.8	9.6	9.5	9.5
Sierra Leone	8.6	12.0	11.9	11.7	11.6	11.5	11.3
Chad	8.9	10.9	10.4	11.5	10.2	10.1	11.5
Congo, Dem Rep	9.4	11.2	11.1	12.2	11.0	11.1	11.8
Madagascar	9.9	16.7	17.3	19.5	16.6	16.7	19.4
Burundi	11.3	14.6	15.2	13.9	14.7	14.5	12.4
Comoros	11.8	12.1	14.7	14.2	12.1	14.5	14.0
Tanzania	12.4	20.3	20.9	19.5	20.2	19.8	19.7
Ethiopia	12.7	13.8	14.2	13.2	13.9	13.8	13.1
Congo, Rep	12.8	19.3	18.6	19.5	19.0	19.1	19.6
Uganda	13.0	18.3	19.1	22.1	18.9	18.4	21.0
Zambia	13.3	13.7	14.1	21.2	13.8	13.9	21.5
Rwanda	13.5	16.4	17.2	16.0	16.5	16.3	15.7
Egypt	13.8	17.8	18.2	19.6	18.1	18.7	19.7
Cameroon	14.0	19.6	19.0	20.7	18.9	18.6	21.3
Algeria	14.1	18.0	18.5	19.8	18.3	18.9	19.9
Gabon	14.3	20.2	19.3	26.6	20.3	20.6	24.1
Côte d'Ivoire	15.1	15.7	15.6	15.7	15.7	15.7	15.8
Burkina Faso	15.7	17.9	18.3	18.8	17.7	17.8	17.8
Togo	16.2	18.2	17.7	18.9	17.6	17.8	18.6
Ghana	16.3	23.7	25.2	21.4	25.0	23.9	22.0
Mali	16.6	17.3	17.2	17.4	17.1	17.1	17.2
Benin	16.7	19.1	19.2	19.2	19.0	18.8	19.4
Malawi	16.8	18.5	20.1	21.4	19.3	18.9	19.6
Kenya	17.5	21.6	22.2	19.3	22.0	21.0	19.3
Niger	17.6	20.2	20.6	20.3	20.4	20.3	18.7
Gambia, The	17.7	18.5	18.7	22.4	18.6	18.5	21.9
Mauritania	18.3	22.5	22.5	24.2	22.1	22.3	23.5
Cabo Verde	18.4	20.9	21.0	22.0	21.1	21.2	22.7
Senegal	18.7	21.4	21.8	22.6	21.7	21.8	22.5
Mauritius	19.2	24.4	24.2	29.3	26.0	25.7	28.5
Liberia	19.2	19.7	19.7	23.0	19.9	19.9	22.3
Guinea	19.5	20.6	21.3	24.1	20.7	20.6	23.1
Morocco	20.7	21.4	21.3	22.9	21.4	21.5	23.5
Tunisia	21.2	29.5	29.3	31.4	30.6	30.4	32.0
Mozambique	21.7	31.5	33.4	36.1	32.7	32.3	33.9
Botswana	24.3	32.8	33.3	32.7	34.8	34.8	31.4
South Africa	24.7	26.9	26.9	31.1	27.9	27.6	30.5
Zimbabwe	26.9	27.7	27.6	27.5	27.7	27.6	27.5
Swaziland	28.3	30.4	29.8	30.1	30.4	30.4	30.5
Seychelles	29.2	36.2	34.8	49.4	39.4	39.0	48.3
Namibia	32.1	33.5	33.4	33.9	34.2	33.9	35.4
<i>Average</i>	<i>16.2</i>	<i>19.6</i>	<i>19.8</i>	<i>21.2</i>	<i>19.8</i>	<i>19.8</i>	<i>20.9</i>

*Notes:*

Model A includes institutional factors and public spending on education.

Model B includes public spending on education but not corruption or government effectiveness.

Model C does not include corruption, government effectiveness or public spending on education.

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# CHAPTER III.

## Policies for Fighting Illicit Financial Flows in Africa: The Centrality of Capacity Development

The African Capacity Building Foundation<sup>41</sup>



### 3.1. Introduction

African countries are now implementing Agenda 2063 and the Sustainable Development Goals (SDGs), which both highlight the importance of domestic resource mobilization (DRM) as a core priority for sustainable development. For instance, the 2015 Addis Ababa Action Agenda (AAAA) on Financing for Development emphasized that “for all countries, public policies and the mobilization and effective use of domestic resources, underscored by the principle of national ownership, are central to our common pursuit of sustainable development, including achieving the sustainable development goals” (UN, 2015). Moreover, DRM is also a priority for the Africa Union (AU)’s Agenda 2063 as African countries resolved “to look inwards to mobilize domestic resources to finance and accelerate its transformation, integration, peace, security, infrastructure, industrialization, and democratic governance and strengthen continental institutions” (AUC, 2015a). While the cost for implementation of Agenda 2063 has not been examined, it is planned that DRM should account for 75% to 90% of the Agenda 2063 financing for every country, with other sources (official development assistance and the international financial markets) contributing the remaining capital requirements (AUC, 2015b; Nnadozie *et al.*, 2017).

The concept of DRM, defined as the generation of revenues from domestic resources and their allocation to economically and socially productive activities, implies mobilizing human capital and innovative capabilities of the public and private sectors as well as non-state actors (Nnadozie *et al.* 2017). DRM encompasses three key elements, namely taxation; savings mobilization and financial inclusion; and curbing illicit financial flows (IFFs) (ACBF 2015; Nnadozie *et al.*, 2017). Evidence shows that over the past decade, revenues from taxation have increased significantly in absolute terms. Tax revenues increased by 2.3% in absolute terms between 2006 and 2016. The increase notwithstanding, the average tax-to-GDP ratio in Africa was approximately 17.1% in 2014, below the optimal threshold of about 25% required to finance development (AfDB, 2018).

Evidence show that among all developing regions, sub-Saharan Africa has the lowest savings rate which has been trending downwards over the years (Nnadozie *et al.* 2017). Most African countries still have lower domestic savings rates and per capita GDPs than their East Asian and Pacific counterparts (AfDB, 2018). For instance, in 2017, gross domestic savings (in percentage of the gross domestic product (GDP)) in sub-Saharan Africa was 16.62%; the corresponding numbers were 27.13% in South Asia, 34.25% in East Asia and the Pacific, 18.52% in Latin America and the Caribbean, and 32.75% in the Middle East and North Africa (World Bank, 2018).

If successfully tackled, IFFs – defined as money illegally earned, transferred or utilized – can retain significant resources for Africa’s socio-economic transformation (AfDB, OECD, UNDP and

<sup>41</sup> This chapter has been prepared by Prof. Emmanuel Nnadozie, Dr. Thomas Munthali, Dr. Robert Nantchouang and Dr. Barassou Diawara.



ECA, 2013; ACBF, 2015; Nnadozie *et al.*, 2017). Evidence shows that IFFs from sub-Saharan Africa ranged from 5.3% to 9.9% of total trade in 2014, a ratio higher than any other geographic region covered in the 2017 Global Financial Integrity Report (Spanjers and Salomon, 2017). It is estimated that, the regions and countries' varied performances notwithstanding, African economies have lost on average approximately USD 60.3 billion to IFFs over the period 2003-2012 (Kar and Spanjers, 2015), whereas the average official development assistance for the same period was USD 56 billion (ACBF, 2015; Nnadozie, *et al.* 2017). IFFs, if curbed, could be used for development, potentially leading to at least 16% higher GDP (AUC/ECA 2015).

This chapter focuses on IFFs – given the importance of the phenomenon (AUC/ECA, 2015; ACBF, 2015; Spanjers and Salomon, 2017; Nnadozie *et al.*, 2017) – as well as the fact that African countries are searching for policies and programs to track and bring back any illicit capital outflows (AUC, 2015b). With special attention to the capacity dimension, the objective is to propose actionable policies and recommendations to help policymakers across governments, as well as competent authorities, to successfully combat IFFs in Africa. The chapter draws extensively on the Africa Capacity Report (ACBF, 2015), the Global Financial Integrity Report (Spanjers and Salomon, 2017), and the Report of the High-Level Panel on Illicit Financial Flows from Africa (AUC/ECA, 2015).

## 3.2. Illicit Financial Flows: Understanding the Facts and Figures for Effective Policy-making

### 3.2.1. Facts and Figures

IFFs mainly originate from three sources, namely (i) commercial tax evasion, trade mis-invoicing and abusive transfer pricing; (ii) criminal activities, including the drug trade, human trafficking, illegal arms dealing, and smuggling of contraband; and (iii) bribery and theft by corrupt government officials (AUC/ECA, 2015). While it is tricky to measure IFFs (because the nature of the activities involved stem mainly from commercial, criminal, and corrupt activities), there is a consensus that they involve large amount of money and have grown over the years (Table 3.1).

While sub-Saharan African countries account for relatively lower amount of IFFs than other developing countries (Table 3.1), the agreement is that the estimates of losses through IFFs are high and a cause for concern in view of Africa's development challenges. Some researchers argue that a fraction of the amount lost in IFFs could have enabled African countries to achieve the Millennium Development Goals by 2015 (Fröberg and Waris, 2010; ECA, 2018).

**Table 3.1: IFFs from Developing Countries, 2004–2013 (in Millions of USD, Nominal)**

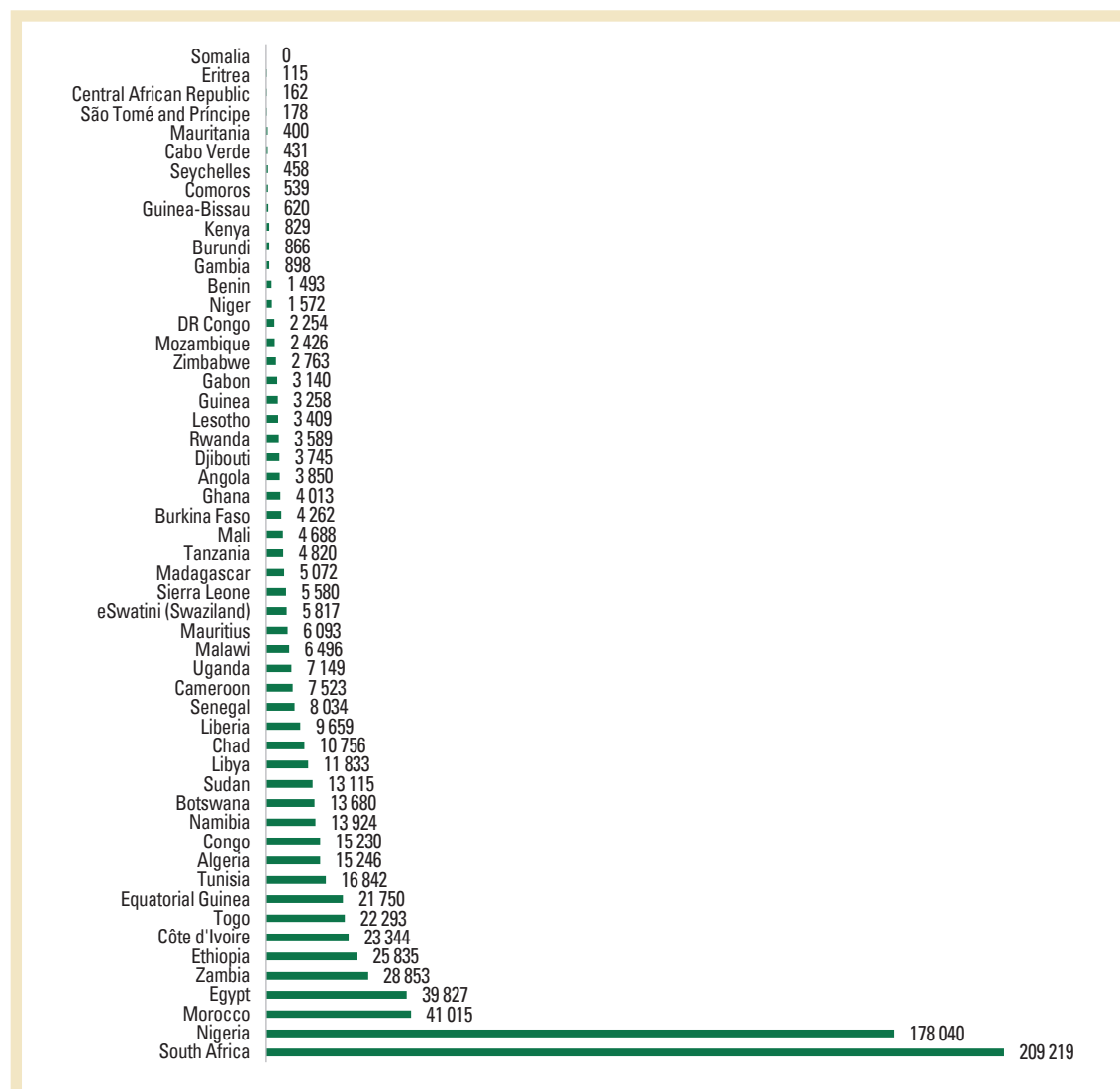
	Sub-Saharan Africa	Asia	Developing Europe	All Developing Countries
2004	32 550	174 612	107 277	465 269
2005	51 874	191 888	118 404	524 588
2006	56 351	209 112	133 758	543 524
2007	77 012	236 485	190 551	699 145
2008	78 599	277 530	233 753	827 959
2009	85 002	277 124	204 852	747 026
2010	78 038	381 729	221 845	906 631
2011	74 281	361 101	295 463	1 007 744
2012	66 678	456 709	242 530	1 035 904
2013	74 593	481 988	250 437	1 090 130
<b>Cumulative</b>	<b>674 978</b>	<b>3 048 278</b>	<b>1 998 870</b>	<b>7 847 920</b>
<b>Average</b>	<b>67 498</b>	<b>304 828</b>	<b>199 887</b>	<b>784 792</b>

Source: Spanjers and Salomon (2017)

In Africa, IFFs are highly concentrated in some countries. Available data show that for the period 2004–2013, the top-ten countries for illicit flows in Africa accounts for approximately 75% of the total and is dominated by several resource-rich countries (see Figure 3.1; Nnadozie *et al.* 2017).

Recent analyses of IFFs suggest that, besides providing figures on the volume of IFFs, extending the discussions to the multidimensional nature of the harm caused by criminal economies remains critical for targeted policy interventions. OECD (2018) shows that other types of illicit activities have greater and more damaging development impacts on African countries. For instance, the Organisation for Economic Co-operation and Development (OECD) report estimates that cocaine trafficking in West Africa may represent a criminal flow worth over USD 3 billion annually. Moreover, while trade in kidnapping for ransom has generated around USD 100 million in the last decade, its impact is manifold, directly providing huge resources to terrorist groups (OECD, 2018).

**Figure 3.1: IFFs from Africa, Cumulative 2004–2013 (in Millions of USD, Nominal)**



Source: Spanjers and Salomon (2017)

### 3.2.2. Drivers of IFFs

Drivers of IFFs have been examined in the literature (Kar and Spanjers, 2014; 2015; Kar and Leblanc, 2013; Kar and Cartwright-Smith, 2010; Nnadozie *et al.*, 2017) and include macroeconomic indicators (such as government deficits, inflation and inflationary expectations); structural variables (such as increasing trade openness and faster rates of economic growth and their impact on income distribution); and overall governance-related issues (Table 3.2).

In the case of African countries, the convention of breaking IFFs into the three components of commercial activities, criminal activities and corruption is substantially correct with commercial activities accounting for 65% of IFFs, criminal activities for 30% and corruption for around 5% (AUC/ECA, 2015). Further estimates show that two factors (namely, invoice faking and mispricing involving trade in services) are the key drivers of IFFs and increase illicit outflows by 46 percent (Kar and Cartwright-Smith, 2010). While some authors argue that the poor governance and 'grand corruption' are the most principal factors (AUC/ECA 2015; ACSC, 2015), other researchers show that the existence of information technologies and their vulnerable and trans-border nature are the primary drivers of IFFs (Tropina, 2016).

**Table 3.2: Drivers of IFFs**

Factor	Expected Effect	Explanation
<b>1. Structural factors</b>		
Natural resources	Positive correlation	Opportunities for embezzlement, bribery, etc.
Natural disasters	Positive correlation	Increases uncertainty and investment risk
International trade	Positive correlation	Opportunities for trade mis-invoicing; facilitated by weak regulation; import-dependency among low-income countries
<b>2. Macroeconomic environment, macroeconomic policy and the regulatory framework</b>		
Growth	Negative correlation	High growth indicates high returns to domestic investment
Inflation	Positive correlation	High inflation and high inflation volatility raise investment risk
Fiscal deficits	Positive correlation	High budget deficits signal high future taxes and lack of control over macroeconomic policy
Taxation	Positive correlation	High taxes reduce net profitability of domestic investment; increases rewards for tax evasion
Capital account openness	Ambiguous	An open capital account may either induce (easy to transfer money abroad) or reduce (less risk of capital being 'locked' in the country, ease to make payments for international transactions) capital flight.
<b>3. Risk and returns to investment</b>		
Interest rate differential (foreign rate minus domestic rate)	Positive correlation	Opportunity for arbitrage in favor of foreign assets
Real exchange rate	Overvaluation positively correlated with capital flight	Cheaper to buy foreign currency; exchange rate instability also induces capital flight
Black market premium	Positive correlation	
Financial depth	Positive correlation; possibly ambiguous	On the one hand, financial depth offers more domestic investment opportunities; on the other, financial depth and loose regulation may facilitate outflows of capital
Public infrastructure	Negative correlation	Good infrastructure reduces the cost of production and raises returns to domestic investment
<b>4. Governance and political factors</b>		
Corruption	Positive correlation	Raises investment risk, including risk of expropriation
Political instability; civil unrest, conflicts	Positive correlation	
Democracy, political freedom	Negative correlation	Reduces investment risk
Government effectiveness	Negative correlation	Reduces the cost of doing business in the country
<b>5. Information technologies</b>		
Digital economy & telecom sector	Negative correlation	Foster cybercrime and "crime as a service"
	Positive correlation	Tackle crime activities: detection, prevention, digital investigations

Sources: UNDP (2014); AUC/ECA (2015); Nnadozie *et al.* (2017)

### 3.2.3. Initiatives to Curb IFFs in Africa

In view of the seriousness of IFF issues and their potential impacts on African and global economies, measures and initiatives at the global, continental, regional and national levels have been taken to address the challenge (AUC/ECA, 2015; Nnadozie *et al.*, 2017). Measures at the global level have been proposed to combat IFFs (AUC/ECA 2015; Spanjers and Salomon, 2017). They are related to: (i) *Automatic Exchange of Tax Information* aimed at exchanging information on financial transactions and assets of non-residents (2001 OECD Global Forum on Transparency and Exchange of Information for Tax Purposes; 2010 USA Foreign Account Tax Compliance Act); (ii) *Anti Money Laundering Laws* which criminalize money laundering, or the movement of proceeds of criminal activity through the legitimate financial system (1989 Financial Action Task Force; 2011 USA Combating Money Laundering, Terrorist Financing and Counterfeiting Act); (iii) *Beneficial Ownership* requiring anonymous shell companies to disclose their 'beneficial owners' to government officials (2006 USA Incorporation Transparency and Law Enforcement Assistance Act; 2011 Open Government Partnership National Action Plan); (iv) *Anti-Bribery and Corruption Conventions* to monitor and report as well as punish bribery and corruption (1997 OECD Anti-Bribery Convention; 2008 Stolen Asset Recovery Initiative (StAR); 2003 UN Convention on Corruption); (v) *Country-by-Country Reporting* requiring companies to report income and other financial indicators for each country in which they operate, enabling tax authorities and the public to hold them accountable (1999 Publish What You Pay; 2002 Extractive Industries Transparency Initiative; 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act Section 1504); and (vi) *Tax, Transfer Pricing, and Profit Shifting* to ensure that multinational corporations do not shift profits and avoid taxes in developing countries (2010 OECD Task Force on Tax and Development; 2004 UN Committee of Experts on International Cooperation in Tax Matters; 2013 OECD Base Erosion and Profit Shifting).

At the continental (African) level, the High Level Panel on Illicit Financial Flows from Africa established in 2011 has received a lot of attention while raising awareness on the strategic importance of IFFs and related issues. Under the auspices of the AU/African Union Commission (AUC), various conventions such as the Convention on Preventing and Combating Corruption and the Yaoundé Declaration on Combating Illicit Financial Flows from Africa have been adopted but not ratified by all African countries (ACBF and AUC, 2016). Other Africa-specific initiatives include the African Tax Administration Forum (ATAF) and the Collaborative African Budget Reform Initiatives (CABRI) aimed at ensuring sound budgeting as well as improving the efficacy of tax legislations and administrations in Africa, but they are yet to have full membership of all African countries (ACBF 2015). Moreover, it is also worth mentioning the African Organization of Supreme Audit Institutions (AFROSAI) in the area of external financial control and auditing and the African Organization of Public Accounts Committees (AFROPAC) in the area of legislative oversight, all aimed at contributing to combating IFFs in Africa.

Regional initiatives aimed at curbing IFFs in Africa include, for instance, the Middle East and North Africa Financial Action Task Force against Money Laundering and Terrorism Financing; the Eastern and Southern Africa Anti-Money Laundering Group; and the Inter-governmental Action Group against Money Laundering and Terrorism Financing in West Africa. At the country level, national task forces have been established with the objective of facilitating the development of robust and effective anti-money laundering programs through education and sensitization campaigns. ACBF (2015) shows that many countries have put in place initiatives to optimize tax revenues and reduce inefficiencies such as tax exemptions. For example, in Tanzania electronic fiscal devices (EFDs) machines were introduced as a measure of improving revenue collection (ACBF and AfDB, 2018). Moreover, to tackle IFFs, measures have been introduced, for example, to prohibit the use of transfer pricing to evade taxes and to train staff to conduct forensic audits. Thirty-five of the 44 countries surveyed had put in place an agency to fight IFFs (ACBF, 2015).

### 3.2.4. Challenges Associated with Combating IFFs

Challenges in successfully tackling IFFs in the African context have been identified by the Mbeki Report (AUC/ECA, 2015) and include (i) the inadequate regulatory framework; (ii) the lack of information and telecommunication facilities, transportation and other relevant infrastructure; (iii) the inadequate funding and over-reliance on unpredictable foreign assistance; (iv) the duplication, overlapping of functions and lack of coordination among different agencies; and (v) the lack of technical and human capacity to deal with crime perpetuated by sophisticated individuals.

#### 3.2.4.1. Inadequate regulatory framework

Evidence shows that some of the most serious challenges associated with illicit outflows in Africa are bad governance, weak and corrupt regulatory structures, poorly structured double taxation treaties, criminality, tax expenditure, banking secrecy and tax havens, and lack of social cohesion, which provide unpatriotic partners for those abetting IFFs (ACBF, 2015). Box 3.1 illustrates the inadequacy of regulatory setups in Uganda with the creation of various institutions aimed at curbing IFFs.

#### **Box 3.1: Initiatives to Curb IFFs in Uganda**

The government of Uganda has, over the years, established agencies and passed laws with the aim to curb IFFs. They include the following:

- Financial Intelligence Authority
- Capital Markets Authority, Director of Public Prosecutions
- Inspector General of Government
- Insurance Regulatory Authority
- Uganda Revenue Authority
- Anti-Money Laundering Act, 2013
- Institutions Act, 2004
- Financial Institutions Regulations, 2010
- Anti-Corruption Act, 2009
- Anti-Terrorist Act, 2002
- Capital Markets Authority Act.

The efforts and created agencies and laws notwithstanding, IFFs are still problematic, in part because of weak regulatory and law-enforcement capacity.

*Source: ACBF (2015)*

#### 3.2.4.2. Lack of information and telecommunication facilities, transportation and other relevant infrastructure.

Africa's infrastructure requirements run to USD 130–170 billion a year – far higher than the long-accepted figure of USD 93 billion a year – leaving a financing gap of as much as USD 108 billion (AfDB, 2018). In fact, while information technologies are evolving, the very existence of these technologies and their vulnerable and transborder nature, especially in the context of African countries, are the primary factors for the evolution of illegal activity carried out with the use of digital networks or facilitated by such use.

#### 3.2.4.3. Duplication, overlapping of functions and lack of coordination among different agencies.

In many African countries, regulatory agencies and institutions have been established with responsibilities that cut across various dimensions of IFFs. Box 3.2 showcases the example of Nigeria where various institutions and agencies have been created to tackle IFFs and related issues, without marked results, in part due to the lack of coordination.

### **Box 3.2: Lack of Coordination in Combating IFFs in Nigeria**

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 established to tackle IFFs and related problems, the magnitude of the challenges overwhelm implementation capacities. 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.

*Source: AUC/ECA (2015)*

#### **3.2.4.4. Lack of technical and human capacity to deal with crime perpetrated by sophisticated individuals**

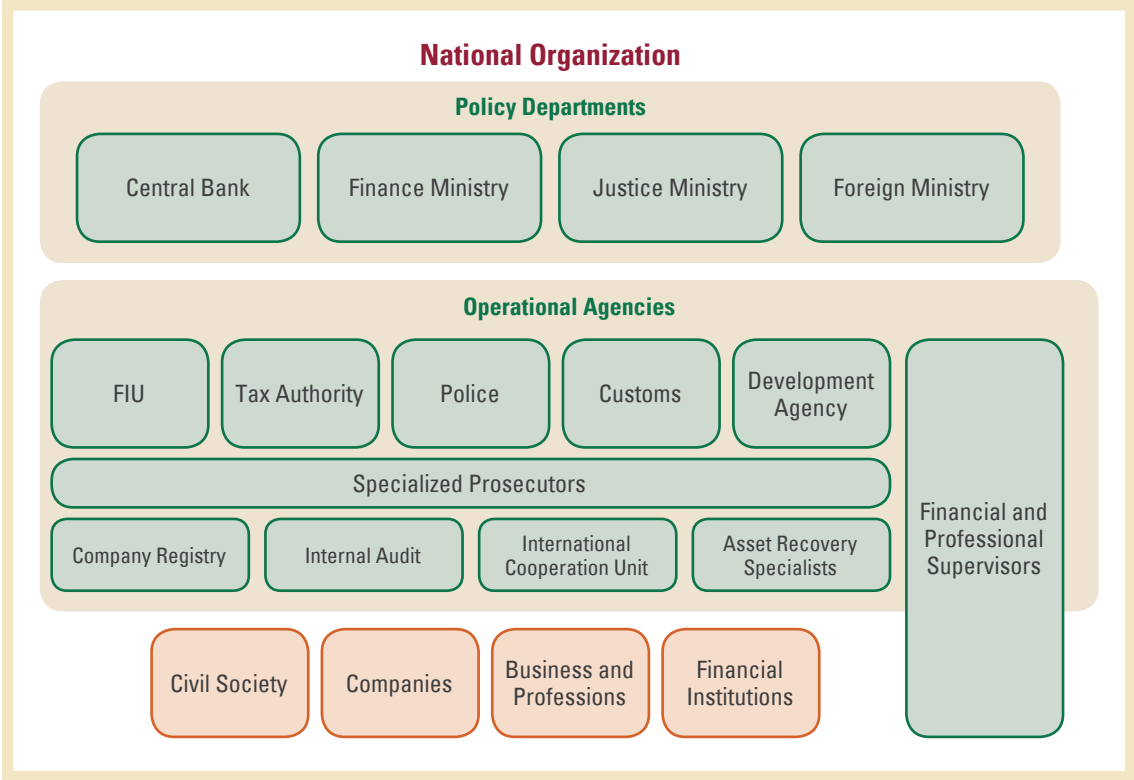
Evidence shows that most African countries lack an adequate stock of qualified forensic statisticians, investigators and financial crime prosecutors. Moreover, countries also lack an adequate supply of specialized technology and equipment for collecting, processing and storing specialized information on financial crime (AUC/ECA, 2015; ACBF, 2015; ECA, 2018). Human capacity has to do with sufficient skills for assessment, formulation and implementation of IFFs-specific policies and measures, as well as for monitoring, reporting and reviewing the same. ACBF (2015) shows that most countries (31 of 42) surveyed for the Africa Capacity Report indicated that their tax administration was either understaffed or moderately staffed, and 10 were adequately staffed. The Democratic Republic of Congo was the only country reporting a case of overstaffing, possibly an indication of inefficiency (a bloated bureaucracy). In addition, the lack of adequate capacity is also reflected at various other levels, such as the lack of accurate data and up-to-date information, inadequate understanding of the various mechanisms used on IFFs-related transactions (AUC/ECA, 2015).

### **3.3. Policy Options to Combat IFFs in Africa**

#### **3.3.1. Understanding the Policy Arena: Actors Involved**

Combating IFFs requires a wide range of actors to design and implement different (albeit mutually reinforcing) policies and actions at various levels of government. The various actors have different stakes, with some of them implicated as perpetrators while others are actively engaged in combating the scourge (AUC/ECA, 2015; ACBF and AfDB, 2018). UNODC and OECD (2016) shows that law enforcement and customs authorities need to increase awareness while the financial sector and vulnerable professions need to take preventive measures. It is important to have transparency in corporate structures, with important steps taken to promote public sector integrity and support asset recovery (see Figure 3.2 for the various actors involved in the fight against IFFs).

Figure 3.2: Key Actors Involved in Fighting IFFs



Source: UNODC and OECD (2016)

Note: FIU stands for Financial Intelligence Unit

While various actors are involved, the findings of the 2018 *African Financial Governance Outlook* show that in general, centers of powers exist, which are key points in the financial architecture of influence. These centers can be grouped into two categories: the change facilitators, with positive influence, and the dissenters, with negative influence. Identifying these centers and then persuading them to back essential reforms (especially toward curbing IFFs) is a key step in supporting Africa’s socio-economic transformation (ACBF and AfDB, 2018).

Table 3.3: Centers of Powers in Revenue Governance: Country Cases Examples

Area	Change Facilitators	Dissenters
Revenue governance	<ul style="list-style-type: none"> <li>The most important facilitators here are the revenue authorities, given their mandate for collecting government revenue.</li> <li>The Ethiopian Revenue and Customs Authority provides a good example of a major driver of reform, as it introduced reforms including a biometric-based tax identification number for all taxpayers. The Rwandan Revenue Authority is part of the Treasury Committee, along with the Central Bank and the Ministry of Finance, which is a strong mechanism for initiating taxation policy. It meets regularly to review tax matters and to identify reform areas. Significantly, the Chief Economist and the Accountant General from the Rwandan Revenue Authority have key roles in this committee.</li> <li>Sometimes the key facilitators include institutions like the Policy Study and Research Centre in Ethiopia, which derives its influence from its connections to the ruling Ethiopian People’s Revolutionary Democratic Front (EPDRF).</li> </ul>	<ul style="list-style-type: none"> <li>An important group of dissenters comes from businesses, which are generally loath to pay higher taxes and either lobby the government to limit reforms or seek other ways to keep their tax bills down.</li> <li>Many private actors restrict facilitators who typically want to reform the tax system by making it more rational, transparent, and inclusive and by reducing the discretionary aspects that permit rent seeking.</li> <li>In Tanzania, to circumvent their negative influence, EFDs were introduced as the modality for remitting tax revenue to the Tanzania Revenue Authority (TRA), with the aim of improving revenue collection.</li> </ul>

Source: ACBF and AfDB (2018)

### 3.4. Selected Country Initiatives to Curb IFFs

African countries are in one way or another implementing policies to combat IFFs and thereafter mobilize more resources to address their development challenges. To deal with IFFs, measures such as transfer pricing legislation and the training of staff to conduct forensic audits have been introduced. Several African governments have liberalized their financial sectors and focused on products innovations and financial inclusion (ACBF, 2015).

Some examples of strategies and initiatives on IFFs include the integration of revenue collection agencies in one coherent institution (for example, Ghana and Togo); the optimizing of revenue collection from the mining sector and the introduction of presumptive taxes (whereby indirect methods are used to determine tax liability rather than rules based on the accounts of taxpayers) on informal activities (for example, Zambia); the implementation of anti-smuggling measures to curb tax evasion and avoidance (see Box 8.3 for the case of Uganda); and the use of ICT in Kenya. Box 3.3 illustrates the measures taken by Zambia to fight corruption and hence address IFFs issues.

#### **Box 3.3: Anti-Corruption Commission Integrity Committee Initiative (Zambia) and Implementation of Anti-Smuggling Measures by the Uganda Revenue Authority (URA)**

**Zambia.** In 2006, the Anti-Corruption Commission (ACC) through the National Anti-Corruption Policy (NACP) implemented the Integrity Committee Initiative. This was aimed at achieving a significant reduction in the levels of corruption in Zambia. The Integrity Committees are ‘watchdog’ units in public and private organizations with the role of receiving complaints from the public and referring them to appropriate authorities. The Integrity Committees also monitor and investigate suspicious behavior, enforce service delivery standards and promote internal policies to combat corruption.

The selection of the institutions was based on the National Governance Baseline Survey Report findings. At the time of establishment only eight institutions were selected and have over the years steadily increased to 37. The Integrity Committees are made up of four members who are generally the directors of each department in the institution and are appointed by the Chief Executive. Amongst some of the institutions selected were the Zambia Revenue Authority, Konkola Copper Mines, Department of Immigration, Ministry of Mines, Energy and Water Development, Judiciary, Workers Compensation Fund Control Board, Livingstone City Council and the Department of National Registration, Passport and Citizenship.

The Integrity Committee initiative has been a success because the number of corruption cases being reported and prosecuted has increased. In 2014, a total of 2 245 reports of suspected corruption were received, compared to 1 987 reports received in 2013, translating into an increase of 258 reports. Furthermore, in 2014, 35 arrests were made countrywide while 64 prosecution cases were brought before the courts of law. A total of 10 convictions were also secured, with five acquittals and 12 cases pending judgment.

The formal linkages and partnerships between the ACC and the selected institutions made this initiative a success. In addition, the institutions’ commitment to the program systems and procedures, as well as readiness to openly look at other options of curbing corruption internally made it possible. This has been evidenced by the involvement of the boards and the engagement of the directors or department heads in the Integrity Committees. Other known factors that have made this possible are the inclusion of the human and financial resources in the various institutional budgets. A key lesson to be learnt is that continued capacity building and institutional collaboration are key for the country’s success in fighting against corruption.

**Uganda.** The URA has implemented a series of anti-smuggling measures to curb tax evasion and avoidance, especially on imported goods entering and traded in the country. Examples of such measures include: a 24-hour border patrol (by a paramilitary unit operated by the URA) at the main border points of Busia, Malaba, Katuna and Entebbe International Airport, and the implementation of a Revenue Authority Digital Data Exchange (RADDEX) system to provide cargo details in a standardized electronic format – minimizing data errors and saving time. The anti-smuggling measures are partially credited with a reduction in tax evasion. The increase in international trade taxes from Ug.Shs 1 trillion in 2004/05 to Ug.Shs 3.6 trillion in 2013/14 was as a result of the anti-smuggling measures.

Source: ACBF (2015)



While individual countries have put in place measures to combat IFFs, the reality of that challenge remains: a key missing link being the lack of capacity, in general, and capacity for implementation, in particular (ACBF, 2015). African leaders and citizens might need a mindset change that bravely embraces experimentation, learning and risk-taking. This implies embracing broad strategies on IFFs, namely a holistic transformational approach that builds on traditional strategies and considers national systems of innovation, imitative learning or special harnessing of human capital – hence, the proposed policy options.

### 3.4.1. Proposed policy options

To successfully win the fight against IFFs in Africa, many policies are proposed (see Box 3.4 for the immediate policy measures under the ‘Accelerated IFF Agenda in Africa’). However, the policy options aimed at effectively tackling IFFs need to pay special attention to capacity related issues because, as highlighted in the Report of the High Level Panel on Illicit Financial Flows from Africa, “the biggest cross-cutting challenge found through [our] country case studies is the lack of appropriate capacity to ensure that illicit outflows are curtailed” (AUC/ECA, 2015). The proposed policy options are twofold, namely, to build the capacities to reduce IFFs, and to strengthen global coalitions to reduce IFFs.

#### Box 3.4: The Accelerated IFF Agenda in Africa

Fourteen measures are proposed for African governments to take in the immediate term to catalyze their efforts to combat IFFs. They are clustered under five broad areas as follows:

##### (1) Create governmental IFF policy

1. Establish multi-agency units within governments to address IFFs
2. Include IFF accountability within the African Peer Review Mechanism and Open Government Partnership commitments

##### (2) Promote financial transparency

3. Establish or enhance online corporate registries, make information publicly available, and require beneficial ownership information as part of the registration process
4. Adopt the Open Contracting Data Standard
5. Require disclosure of beneficial ownership information from all government contract bidders
6. Require disclosure of beneficial ownership information in political asset declarations
7. Establish government/independent measurement mechanisms for extracted natural resources

##### (3) Increase enforcement efforts and powers

8. Adopt a law clearly prohibiting trade mis-invoicing
9. Establish Specialized Asset Forfeiture and Recovery Units and/or advocate for the creation of a Special Office of Asset Recovery within the African Union

##### (4) Tackle tax evasion and avoidance

10. Join African Tax Information Sharing Networks
11. Establish Transfer Pricing Units within Tax Authorities
12. Require public country-by-country reporting by multinationals

##### (5) Prevent financial crime

13. Mandate rigorous customer due diligence and suspicious activity reporting programs within banks
14. Empower strong and effective Financial Intelligence Units (and create them if not yet established)

Source: GFI, TrustAfrica, TJN-A, PALU, CRADEC and CISLAC (2017)

### 3.4.1.1. Build the capacities to reduce IFFs

Drawing on the findings and recommendations of the Africa Capacity Report (ACBF, 2015), countries need to establish appropriate rules and regulations while enhancing the capacity of institutions in the IFFs value chain. Rules and regulations must encompass sound public financial management which is integral to the process of preventing IFFs and ensuring that recovered resources are allocated to development priorities. Moreover, it is important to: (i) have legal system reforms aimed at law reform, especially where the laws are inadequate, or poorly functioning; (ii) reduce crime and criminal activities of all kinds; (iii) undertake reforms in the areas of taxation, banking and capital markets; (iv) have flexible yet effective laws and regulations to curb IFFs; and (v) work more on tax reforms that will ensure tax harmonization and a move away from tax exemptions, concessions and holidays.

Another critical component of the capacity building efforts would be to strengthen the capacities of key continental, regional and national institutions to effectively combat IFFs. Targeted institutions include the AUC and its organs, especially those dealing with legal, audit, tax and parliament related issues; the specialized Agencies such as the African Capacity Building Foundation (ACBF), the African Development Bank (AfDB), the African Tax Administration Forum (ATAF), the Collaborative Africa Budget Reform Initiative (CABRI) and the UN Economic Commission for Africa (ECA) in charge of implementing the recommendations of the Mbeki Report on IFFs; and the Regional Economic Communities (RECs), specially the AU-recognized ones which will play a great role at the regional level in the IFFs value chain; and national tax administration and revenue authorities.

Equally important is the need to foster visionary leadership, change mindsets and address other soft capacities. A key element for successfully combating IFFs starts with a transformative, visionary, committed and accountable leadership that sets the right tone at the top. While there is a need for positive social norms, values and practices against IFFs, the ability and willingness to learn from experience is equally important (see Box 3.5 for the required human, institutional and societal capacities).

#### **Box 3.5: Capacities required to address IFFs**

##### ***Required soft and society-level capacity:***

- Understanding the development issues
- Understanding the importance of paying tax
- Following positive social norms, values and practices preventing IFFs
- Building strong political leadership
- Operational capacities
- Adaptive capacities.

##### ***Required institutional capacity:***

- Ability to design, implement, monitor and evaluate policies against IFFs
- Ability to effectively plan expenditures and delivery of public services
- Establishment and operationalization of appropriate regulatory and/or prudential frameworks for conducting productive business
- Ability to collect statistical information
- Managerial capacity to ensure the recruitment and retention of specialists in areas such as ICT, accounting and finance, audit, and legal.

##### ***Required human capacity:***

- Sufficient skills for assessment, formulation and implementation of IFFs-specific policies and measures, as well as for monitoring, reporting and reviewing the same
- Technical skills to detect and prevent tax evasion, especially in high-risk sectors such as extractive industries
- Competencies to determine the true ownership of firms to prevent and detect corrupt behavior and the recovery of stolen assets.

Source: ACBF (2015)

### 3.4.1.2. Strengthen global partnerships and collaboration to reduce IFFs

“By 2030, significantly reduce illicit financial and arms flows, strengthen the recovery and return of stolen assets and combat all forms of organized crime” has been the target set under SDG 16 to combat IFFs. This positive development should be complemented by a more rigorous effort in support of a unified global architecture on the issue of IFFs with accountability and reporting requirements – the AUC can be supported with the required expertise to drive this agenda and ensure the achievement of the set targets. Critical to stopping IFFs is the information exchange which requires international cooperation at the investigation stage, even if legal action is taken in only one country.

African countries and non-African governments and institutions need to collaborate in mutual exchanges of data available on international banking assets by country of origin and destination in a matrix format, along the lines of the data published by the International Monetary Fund (IMF) for bilateral trade; foreign direct investment and portfolio investment, so that it can inform the analysis of IFFs from Africa (AUC/ECA, 2015). Moreover, the global community together with the various institutions, including parliaments, need to collaborate and take all necessary steps to eliminate secrecy jurisdictions, introduce transparency in financial transfers and crack down on money laundering. The AU, the G20, the IMF and OECD should provide the required leadership in these efforts. In addition, the AU should be equipped with the required capacities to engage partner institutions around the world to put in place a global governance framework that will determine the conditions under which identified assets or funds are frozen, managed and repatriated as well as appropriately allocated to Africa’s development priorities (AUC/ECA, 2015).

## 3.5. Proposed Actionable Recommendations

While the policy options proposed to combat IFFs in Africa can be implemented, the priority being the effective implementation of the recommendations of the Report of the High Level Panel on Illicit Financial Flows from Africa, some non-exhaustive actionable recommendations are put forward for the key actors (governments, private sector, civil society and academia) – see, ACBF (2015), AUC/ECA (2015), Muchhala (2018).

All **African governments** are advised to establish and/or strengthen institutions responsible for preventing IFFs – through the establishment of financial intelligence units, anti-fraud agencies, customs and border agencies, revenue agencies, anti-corruption agencies and financial crime agencies. Moreover, besides the creation of regulatory frameworks, they should develop 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 (FIU). Equally important, it is recommended that countries pay special attention to the extractive sector and join voluntary initiatives such as the Extractive Industries Transparency Initiative (EITI) while pushing for mandatory country-by-country and project-by-project reporting requirements immediately in the extractive sectors and in the near term across all sectors.

As commercial activities by the **private sector** are by far the largest contributor to IFFs, the actors have a critical role to play in tackling IFFs and related issues. Actions include having robust regimes for the supervision of banks and non-bank financial institutions by central banks and financial supervision agencies. Such regimes must require mandatory reporting of transactions that may involve activities regarding IFFs. Moreover, there is also a need to publish the taxes paid to every state of operation as part of corporate social responsibility reporting.

**Civil society organizations** (media, non-governmental organizations, academia and think tanks) in Africa have a role to play in building capacity for combating IFFs. The actions required would be to promote greater dialogue on tax-related issues and efforts at curbing IFFs; demand

transparency and accountability in multinationals and tax authorities' operations; monitor performance indicators to assess the progress made in fighting IFFs; and advocate for information exchange and transparency. It is also recommended that they support enforcing accountability to taxpayers on how money is spent, by exercising strong oversight (ensure that tax incentives are granted and managed in a transparent manner and serve the best interests of countries). Providing evidence supporting African countries coordinating efforts and unified positions in response to international negotiations, consultations and meetings, is also recommended. More research needs to be conducted to advise African governments on the various measures to be taken to counter profit-shifting practices detrimental to African countries.

The **Consortium of Stakeholders working together to stem IFFs** established in 2016 with the purpose to leverage its partnerships, providing a platform for experience sharing and overall strategic direction on the efforts mandated in the AU Special Declaration to stem IFFs from Africa, should be revived, with the development of capacity building programs around IFFs.<sup>42</sup> A program can be developed around four components, namely (i) support policy formulation, implementation and monitoring to prevent, track and recover IFFs through a network of think tanks, research institutions and RECs; (ii) skills development and training at national and sub-regional levels through partnership with networks of higher education and regional training institutions/programs (enhancing skills in various areas related to IFFs); (iii) generation of knowledge, promotion of learning and dissemination activities on capacity related to IFFs; and (iv) strengthening of the Secretariat of the IFFs Consortium, the AUC and the Secretariats of RECs to better coordinate continental and regional efforts around IFFs.

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42 The Consortium currently consists of the AUC, the United Nations ECA, the NEPAD Planning and Coordinating Agency, the African Peer Review Mechanism Secretariat, the Thabo Mbeki Foundation, the African Capacity Building Foundation, the African Tax Administration Forum, the African Legal Support Facility, the African Mineral Development Center, the World Bank, the Pan African Lawyers Union, the African Parliamentarian Network on Illicit Financial Flows, TrustAfrica and the Tax Justice Network – Africa. The consortium includes partners from non-African institutions such as the Global Financial Integrity, the World Customs Organization, the OECD, the European Union Parliament, the United Nations Interregional Crime, the Open Society Foundation and the Justice Research Institute.

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# CHAPTER IV.

## Illicit Financial Flows in Africa: How can Governments Respond?

Organisation for Economic Co-operation and Development –  
Development Centre<sup>43</sup>



**The United Nations (UN)'s Agenda 2030 for Sustainable Development and the African Union (AU)'s Agenda 2063 acknowledges that combating illicit financial flows (IFFs) as inherently linked to development.** The Sustainable Development Goals (SDGs) target 16.4 commits to “significantly reduce illicit financial and arms flows, strengthen the recovery and return of stolen assets and combat all forms of organized crime” by 2030. The first 10-year implementation plan for the AU's Agenda 2063 seeks to halve IFFs by 2023. The Addis Ababa Action Agenda (AAAA) of the Third International Conference on Financing for Development also aims to substantially reduce IFFs by 2030 with a view to eventually eliminating them (UN, 2015). The agenda calls for doubling efforts to combat corruption, tax evasion, money laundering and criminal activities.

**IFFs can be broadly defined as “methods, practices and crimes that aim to transfer financial capital out of a country in contravention of national or international laws” (OECD, 2014b).** Tax crime and other financial crimes, corruption and transnational organized crimes are well-known sources of these flows. Africa's large informal economy makes it hard to measure illicit financial activities. IFFs and underlying activities generating them, hamper economic activities and trade by creating unfair hindrances to doing business and thwarting competition. They also erode public institutions, weaken governance structures, reduce citizens' trust in the government, and reduce tax morale. In many cases, such as corruption in the extractive sector, IFFs serve to benefit the politically connected and thus widen income inequality.

**IFFs also represent vast losses in revenue that could have been used for Africa's development.** The High Level Panel on Illicit Financial Flows has estimated that losses from IFFs in Africa could amount to USD 50 billion per year (UNECA, 2015). However, estimation of IFFs in Africa are highly disputed due to the lack of consensus in defining IFFs and due to the difficulties in measuring illicit activities. IFFs drain government finances by eroding the tax base of affected countries, depriving governments of financial resources needed for public goods such as education, health and infrastructure (OECD, 2017a).

**This chapter analyses current policies and tools to combat IFFs in Africa.** It first analyses the main types of IFFs in Africa by briefly studying their relevance and specificities in the African context, and their impacts on African development. For each type of flow, the chapter highlights the policy challenges, assesses the current policy responses, and identifies the main policy gaps in tackling IFFs in Africa. The chapter concludes by proposing high-level policy recommendations

43 This chapter was prepared by Arthur Minsat, Thang Nguyen-Quoc and Dieu-Donné Gameli under the supervision of Federico Bonaglia, Deputy-Director of the OECD Development Centre. It has benefited from comments or inputs by a number of OECD colleagues: Catherine Anderson, Andrew Auerbach, Melissa Dejong, Sandrine Hannedouche-Leric, Julien Jarrige, Iza Lejarraga, Israel Maranon De Pablo, Claire Naval, Grace Perez-Navarro, Clémence Pougé Biyong, Elliot Smith, Ervice Tchouata, Talita Yamashiro-Fordelone. It builds on previous OECD works, notably: *Illicit Financial Flows: The economy of illicit trade in West Africa* (2018); *Illicit Trade: Converging criminal networks* (2016); and *Illicit financial flows from developing countries: measuring OECD responses* (2014).

for African governments, African regional institutions and development partners. Annex 4 goes beyond the analysis of IFFs and shows licit financial flows into Africa. It distinguishes between remittances, foreign direct investment (FDI), official development assistance (ODA) and portfolio investment, and compares these flows with tax revenues at the continental and regional levels.

#### 4.1. IFFs in Africa are Diverse and Require Tailored Responses

IFFs broadly refer to “money illegally earned, transferred or used” (ECA, 2013). They represent the revenue and proceeds generated from corruption (the proceeds of theft, bribery, graft and embezzlement of national wealth by government officials), commerce (the proceeds of tax evasion, misrepresentation, misreporting and mis-invoicing related to trade activities, and money laundering through commercial transactions), and crime (the proceeds of criminal activities, including drug trafficking, smuggling, counterfeiting, racketeering, forced labour and terrorist financing).

This section covers four specific policy areas: (4.1.1.) illicit trade, (4.1.2.) corruption, especially in the extractive sector, (4.1.3.) money laundering through implementing the recommendations of the Financial Action Task Force, and (4.1.4.) how tax policy initiatives can be leveraged to combat illicit financial flows.

##### 4.1.1. Combating Illicit Trade

**The prevalence of international illicit trade contributes to IFFs in Africa.** Illicit trade refers to the exchange in the control or possession of a good or service that a legislature deems illegal. This process usually involves criminal networks seeking high profits by procuring an illegal product at a low price and managing its transportation and storage until the product is sold at a higher price.

**Illicit trade represents a large source of IFFs.** Although the clandestine nature of such activities makes it hard to measure, the United Nations Office on Drugs and Crime (UNODC) estimates that the profits of international organized crime globally reaches USD 870 billion, or 1.5% of global GDP (UNODC, 2011a). In terms of sectors, the Organisation for Economic Co-operation and Development (OECD) estimates that the global revenue from counterfeiting is USD 460 billion, drug trafficking USD 320 billion, human trafficking USD 150 billion, and wildlife between USD 8 to 20 billion (OECD, 2016a).

**In Africa, illicit trade takes various forms.** The main forms are drug trafficking, human trafficking, illicit trade in counterfeit medicines, wildlife trafficking, illicit trade in tobacco, illicit trade in alcoholic beverages, and sports manipulation. Furthermore, as much as 60–70% of economic activity in sub-Saharan Africa is in the informal sector (OECD, 2018a). The highly informal economic structure thus blurs the boundaries between activities that are licit and illicit in Africa. Globally, illicit trade is particularly present in conflict areas, where illicit flows of about USD 30 billion a year go to organized criminal and terrorist groups (Nellemann *et al.*, 2018).

**The type of illicit trade varies across African regions and countries.** For instance, West African countries such as Mali and Guinea-Bissau are now renowned as a transit hub for narcotics such as cocaine from Latin America to European markets (OECD, 2018a). In 2009, the value of the cocaine trade in Africa was estimated at USD 1.6 billion, with about USD 600 million remaining on the continent (UNODC, 2011a). The West African coast is also increasingly serving as a transit point for illicit trade in tobacco to North Africa.

**Illicit trade can negatively affect economic stability, social welfare, public health, public safety and the environment in Africa.** Some 3.7 million people from Africa are estimated to be victims of human trafficking. Trade in counterfeit medicines is widespread across the whole continent with imports from mainly China and India (OECD, 2018a). The European Union (2014) estimates that 60% of the market value of all medicines in Africa are either fraudulently produced without active pharmaceutical ingredients, or legitimately produced without the right quantities and qualities of

ingredients. Similarly, Africa serves as the main supply point for wildlife trafficking. As many as 10 million elephants were estimated to live in Africa in 1930, which has reduced drastically over the years (WWF, 2018). As a result of increasing demand for ivory, notably in China and East Asia, poachers killed more than 100 000 elephants in Africa between 2010 and 2012, decreasing the elephant population to 500 000 by the end of 2013 (Carrington, 2014).

**A diverse set of actors, including criminal networks, the private sector (both domestic and international), and government officials are involved in illicit trade in the region (OECD, 2018).** Their methods are very dynamic, changing in response to opportunities, and to global and local market forces. For example, the main exit hubs for ivory were South Africa and Tanzania in 2008. By 2012, massive seizures along the west coast of Togo indicated a switch of the ivory trade to the West African coast.

**The complex interplay of globalization, high profits, and lack of livelihood options are the main factors that facilitate and drive illicit trade in Africa.** First, globalization has liberalized world trade, increased cross-border integration, and lowered costs of long-distance transport and communication with the rest of the world. Africa's trade has thus tripled and amounts to USD 800 billion with new trade partners such as emerging countries. This process opened new opportunities for both licit and illicit trade. Second, the demand and high profits from illicit trade serve as a strong incentive. Newer forms of illicit trade such as the rhino horn trades can fetch up to USD 60 000 per horn (OECD, 2016a). Third, a lack of livelihood options, especially for the youth, makes people vulnerable to engaging in illicit trade. An entire local community may depend on subsistence-level activities such as cross-border commodity or fuel smuggling, or illicit logging or forced labour for agriculture (e.g. in cocoa production (OECD, 2018a).

**Policies to curb illicit trade have tended to focus on each individual trade, whereas criminal networks are diversifying into multiple activities.** For instance, for most jurisdictions in the West African region, the trafficking of adults is not a crime, though child trafficking is a criminal offense. Criminal organizations have exploited this situation to traffic persons and smuggle drugs, illegal and undeclared fishing, and tobacco smuggling (OECD/SWAC, 2014). In addition, criminal penalties tend to be too weak to deter illicit trade. For example, the legal penalty of counterfeiting pharmaceuticals is comparable to counterfeiting other mass-market products, even if the former directly puts lives of people at risk. The weak criminal penalties thus encourage criminal organizations to diversify their activities to optimize their risks.

**African governments also face additional hurdles in enforcing policies.** Governments' capacity to enforce policy to prevent and tackle illicit trade relies on available resources and political will. Disputed border areas, political instability and dispersed population lead to zones without effective state presence. Extreme poverty can sometimes leave whole communities to rely on cross-border trade for livelihood, which is easily exploited for illicit trade (OECD, 2018a). By some accounts, informal trade makes up one-third of Africa's total trade. Hence, an effective approach would involve directly tackling criminal networks and simultaneously working to alleviate the development conditions that give rise to illicit trade.

**The complex drivers of illicit trade thus require a cross-cutting approach that touches multiple sectors.** First, poverty reduction strategies, especially by creating productive jobs, will be crucial to reduce the incentive of poor communities to engage and rely on illicit trade for livelihood. AUC/OECD (2018) proposes 10 policy recommendations for African governments to support structural transformation and ensure inclusive growth that creates decent jobs and reduces inequalities. Second, the complex interplay between the different sectors of illicit trade requires holistic policy responses. This process would require better inter-ministerial coordination in order to define comprehensive policies that take into account the nexus and synergies of the different sectors of illicit trade.



**National law enforcement agencies and local monitoring networks should gradually upgrade their capacity to prevent and deter illicit trade.** Specifically, actions include consistent capacity building and training of enforcement agencies like the police, military, judicial and customs officers, and civil society. This would ensure that they are equipped with the knowledge, skills, technologies and techniques to conduct monitoring services and information analysis. For example, the OECD Task Force on Charting Illicit Trade 'Information Sharing Platform' (TF-CIT ISP) proposes geo-spatial data depicting the trends in wildlife trafficking. This tool establishes a common space where experts from government, non-government organizations (NGOs), academia and even industry could tap into near real-time mobile reporting. Countries can start exploring the potential of new technology to fight the trade of counterfeit products such as using blockchain technology to tackle counterfeit medicine.

**The transnational nature of illicit trade calls for a concerted, multilateral approach to policy, involving national, regional and global actors, and industry.** A number of international instruments are available for different aspects of illicit trade (see Table 4.1). Their approaches often involve covering all the hubs of illicit trade, from source to transit point to destination. For example, to control the flows of medicines into Nigeria, the National Agency for Food and Drug Administration and Control (NAFDAC) restricted the imports of pharmaceutical products to only two airports and two seaports, each staffed by NAFDAC officials. They also worked with the Chinese and Indian government to identify and stop manufacturers exporting fake drugs to Nigeria. This policy has helped reduce the share of counterfeit drugs in the country from 41% in 2001 to 16% in 2006 (OECD, 2018b). Although this example is at the national level, it shows how concerted efforts to combat illicit trade need to happen across all the hubs along the value chain.

**Table 4.1: Summary of Selected International Instruments Governing Illicit Trade**

Sector or activity	Instrument	Year	Number of Adhering Parties
Intellectual property rights infringements (incl. infringement of trademarks and copyrights)	WOT Agreement on Trade-related Aspects of Intellectual Property (TRIPS)	1994	164
Drugs/narcotics	Single Convention on Narcotic Drugs	1961	185
	Convention on Psychotropic Substances	1971	183
	UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances	1988	189
Wildlife trafficking	Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES)	1973	183
Illicit tobacco	Framework Convention on Tobacco Control (FCTC)	2003	180
	Protocol to Eliminate Illicit Trade in Tobacco Products	2012	26
Organized crime	UN Convention on Transnational Organized Crime (UNTOC)	2000	179
Corruption	UN Convention Against Corruption (UNCAC)	2003	180
Illicit financial flows/Money laundering	UN Convention on the Suppression of the Financing of Terrorism	1999	187

Source: OECD (2018b)

**Closer regional cooperation and integration among African governments can help deter illicit trade.** This process requires coordination between law enforcement authorities in the form of mutual police assistance, extraditions and the sharing of evidence for which regional bodies are inadequately equipped to enforce and monitor. The creation and ongoing development of the African Union Mechanism for Police Cooperation (AFRIPOL) as a standalone unit within the AU can help coordinate continental and regional police work and connect with the International Criminal Police Organization (INTERPOL) to fight back criminal networks that increasingly aim to use Africa as a transit point for illicit trade.

**Development partners also play an important role in addressing illegal trade.** The global, cross-border, and organized nature of criminal networks requires development partners to serve as a critical linkage to provide international cooperation and coordinated policy responses. The G20 proposed broad principles to address illegal trade in wildlife and wildlife products. The World Bank also launched the Global Wildlife Program in 2015 to serve as a platform for knowledge exchange and on-the-ground coordination across countries in Africa and Asia. OECD countries can play a far more rigorous and active role in addressing criminal economies and IFFs outside of the region such as cutting the supply of illicit fishing or logging to the European Union market (OECD, 2018b). Such actions serve as guidelines to streamline the policies of member countries, and drive resources towards mitigating illicit trade along the global value chain.

#### **4.1.2. Fighting Corruption, Including in the Extractive Sector**

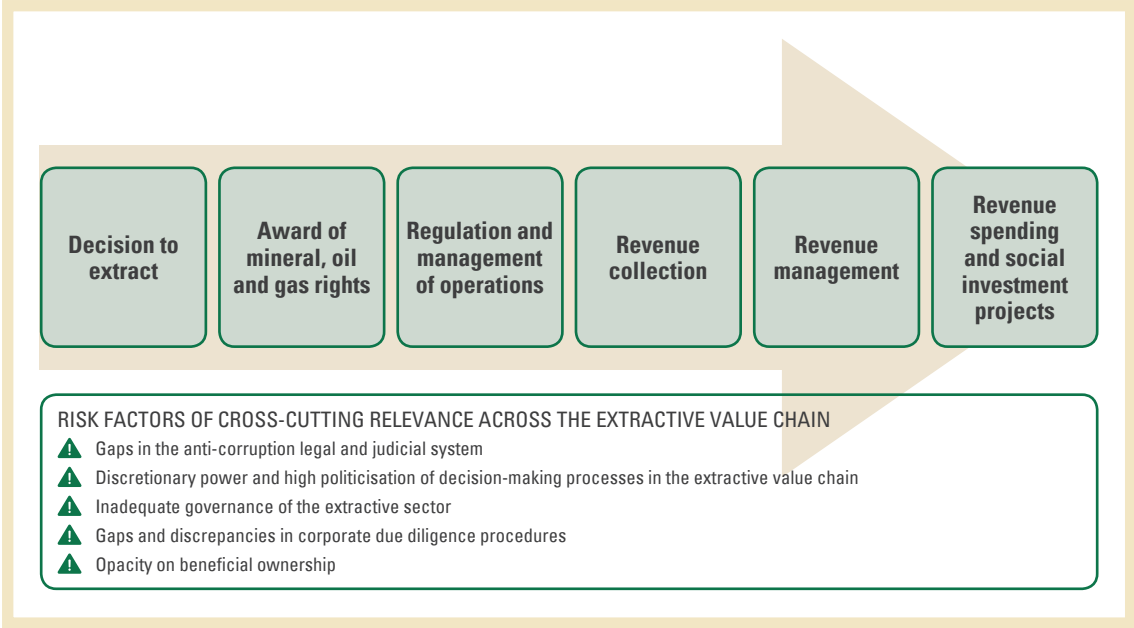
**Corruption is one of the main sources for illicit financial flows in Africa.** These IFFs include transferred money to foreign public officials as bribery and extortion, illegal commissions, gifts and entertainment. They also include deals' funds transferred offshore covered under the name of fees such as signature bonuses, cost recovery or profit sharing, local consultants' fees, penalties for the violation of labour and immigration rules or environmental regulations. Bribery in the developing world may reach an amount equivalent to 15–30% of official development assistance (ODA) flows (World Bank, 2007). Corruption can do more damage to the economy than just its monetary cost. A bribe of USD 1 million for a USD 100 million contract to provide public services can lead to large investment inefficiencies, embezzlement of public funds and undermine fiscal legitimacy.

**Trade mis-invoicing constitutes an important part of IFFs.** Such practices can include over-invoicing imports to conceal capital flight, under-invoicing exports in order to hide trade profit in tax havens; and over-invoicing exports or under-invoicing imports to clean illicit means into the domestic legal financial system. The most common offences recorded by frontline trade offices include false values, false goods, and false weight declarations. While quantitative estimation of trade mis-invoicing remains debatable (WCO, 2018), research suggests that trade mis-invoicing makes up a large proportion of IFFs (Forstater, 2018). Tackling these activities is therefore important. Fighting against trade mis-invoicing would require a sufficient mandate and resources to match for custom authorities to monitor over-invoicing, under-invoicing and irregularities in both export and import declarations.

**Fighting corruption in the extractive sector is also an important part of addressing IFFs in Africa.** Oil-rich African countries accounted for 72% of the net value of unrecorded cross border movement of capital from Africa, between 1970 and 2010 (Boyce and Ndikumana, 2012). Natural resource rents represent an important part of the economy at USD 468 billion or 7.7% of Africa's GDP. Resource rents can account for up to 49.9% of GDP in Liberia and 32.7% of GDP in the Democratic Republic of the Congo. The sector itself is also vulnerable to corruption. One out of five transnational corruption cases occurs in the extractive sector (OECD, 2014a). Tanzania recently passed three new laws in order to curb tax avoidance and evasion by extractive companies. These laws aim to double the tax contribution of the sector to 10% of GDP by 2025 and enhance transparency in the sector.

**Corruption can occur in all segments of the extractive value chain.** OECD (2016b) documents a detailed typology of different corruption risks at each stage and identifies five cross-cutting risk factors (Figure 4.1). For example, weaknesses in the anti-corruption legal and judicial system may also undermine host governments' capacity to effectively detect, prevent and sanction corruption. High politicisation and discretionary power in decision-making processes increases the risk of favouritism, clientelism, political capture and interference and other forms of corruption. Weak governance also exposes actors in the extractive sector to conflicts of interests, bribery and other corrupt practices.

**Figure 4.1: Corruption Risks of Cross-cutting Relevance across the Extractive Value Chain**



Source: OECD (2016b)

**Setting clear laws and regulations in each segment of the extractive sector reduces the risk of corruption and helps policymakers identify and close gaps.** For example, regulations related to the procurement of goods and services and to the relevant bidding process need to be distinct and clear. Similarly, rules and regulations on contract fees, fines and penalties need to be clear, standardized and where possible automatic to reduce the discretion of public officials.

**Policy can enhance transparency and help diffuse information on each segment of the extractive value chain.** Recent research identifies that addressing the transparency of the ‘first trade’ – the original transaction between the national oil companies and the oil traders – as an important area for tackling corruption in the oil sector (OECD, 2018c). First, publishing information related to all stages of bidding processes and making this information accessible to all stakeholders can help reduce the risk of opacity and discretion in the bidding process. Twenty-four African governments have implemented the Extractive Industries Transparency Initiative (EITI) Standard that requires publishing information on contracts and licenses, production, revenue collection, revenue allocation, and social and economic spending. Second, digitalizing the bidding process also helps limit the direct interaction between the review panels and bidders, which decreases the risk of corruption. Finally, the contract terms and all the relative annexes must be well stated in writing and made accessible online and in local languages if needed (EITI, 2015).

**The governance of natural resources also needs strengthening to ensure the independence of monitoring authorities and clear differentiation of roles and responsibilities.** The clear differentiation between executing government authorities and the monitoring and auditing authorities is essential for controlling IFFs produced by corruption in the extractive sector. Improving the coordination between national and local governments, state-owned enterprises and the dissemination of the decision-making process among different government institutions can alleviate corruption risks. During the bidding processes for extraction rights or procuring infrastructure services, independent monitoring authorities are essential to ensure the compliance of the rules and the transparency of bidding processes.

**State-owned enterprises (SOEs) can play a significant role in the governance of the extractive sector.** A large amount of extractive revenues can flow through SOEs, for instance during the selection of commodity buyers. The OECD Development Centre's *Thematic Dialogue on Commodity Trading Transparency* aims to improve transparency and accountability in commodity sales transactions that relate to the governments' share of production (OECD, 2018d). The OECD is also developing guidance for SOEs to reduce opportunities for corruption and public rent diversion and to minimise the role of politically exposed persons (PEPs).

**Development partners have helped fight corruption in Africa through a number of ways.** Partnerships such as the OECD/AfDB Joint Initiative to Support Business Integrity and Anti-bribery Efforts in Africa specifically aim to help countries in their fight against the bribery of public officials in business transactions, improving corporate integrity and accountability, and promoting growth through an environment conducive to attracting foreign investment. In Nigeria, for example, Department for International Development (DFID) has allocated over USD 6 million over seven years to 'Justice for All', a project to increase investigation and prosecution capability in the Nigerian justice sector, including its anti-corruption agencies. Donors have also used ODA to strengthen legal and judicial development in developing countries. Others have supported civil society and the media in recipient countries who can investigate illegal activities and advocate for reforms.

**Investing in anti-corruption efforts can have positive effects.** The experience of OECD donors shows that for each USD 1 spent on investigating the proceeds of corruption originating from the developing world and transferred to OECD countries, up to USD 20 has been tracked and frozen. A significant proportion of that sum was repatriated to the treasury of the developing country in question (OECD, 2014a).

**Donor support for combating fraud and corruption, including complex issues of economic and financial crime remains modest.** For instance, a 2017 report on the detection of foreign bribery shows that no foreign bribery case (bribery of foreign public officials) has ever been detected by a bilateral development aid agency (OECD, 2017b). Recently, the DFID has used development assistance to strengthen donor country institutions to fight corruption and money laundering in developing countries. Parties to the Convention will need to continue to prosecute foreign bribery offenders: approximately half of OECD countries (20 countries) have sanctioned a party for a foreign bribery offense (OECD, 2017c)<sup>44</sup>.

**Donors can push further in broadening their anti-corruption effort in developing countries.** At home, they can act as the liaison between recipient and donor governments to push for expanding the coverage and enforcement of anti-foreign bribery standards in OECD countries such as those included in the OECD Anti-Bribery Convention and its related instruments. In 2016 the OECD adopted a new Council Recommendation for Development Co-operation Actors (DAC) on Managing the Risk of Corruption to ensure effective measures are in place to manage risks of, and respond to, actual instances of corruption in development cooperation. The Working Group on Bribery and the DAC are monitoring the implementation of the Recommendation jointly.

**Single isolated measures cannot have significant effects over the long-term.** The interplay of measures under a comprehensive anti-corruption strategy can foster integrity and reduce corruption in a sustainable way. Effective, anti-corruption strategies are based on a corruption risk assessment. They are not only considered as policy documents but as management tools with clear objectives, measures, timelines, responsibilities, and indicators of success.

In recognition of the importance of a systemic approach to foster integrity in public administrations, the **OECD Recommendation on Public Integrity provides policy makers with the blueprint to craft their own public integrity strategies.** The recommendation asks adherents to shift the focus from

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44 It includes the 36 OECD countries and eight non-OECD countries – Argentina, Brazil, Bulgaria, Colombia, Costa Rica, Peru, Russia and South Africa – which have adopted this Convention.

*ad hoc* integrity policies to a comprehensive, risk-based approach with an emphasis on cultivating a culture of integrity across the whole of society, in particular through:

- Setting strategic objectives and priorities for the public integrity system based on a risk-based approach to violations of public integrity standards. It takes into account factors that contribute to effective public integrity policies.
- Developing benchmarks and indicators, and gathering credible and relevant data on the level of implementation, performance and overall effectiveness of the public integrity system.

**Policy makers can avoid ‘design-reality gaps’ by setting realistic objectives that match with resources available to implement the policies.** Experience underlines the importance of avoiding these ‘design-reality gaps’; that is, in establishing the objectives of an anti-corruption strategy, policy makers can match expectations with the implementation capacity, the time needed and available resources. It is better to complement a long-term strategic vision with realistic objectives that can be achieved in the short- and medium-term with clearer and simple action plans and indicators that are easy to measure. Possible criteria in setting priorities are the budget; the availability of human resources; the likelihood of quick results (low-hanging fruit); the likelihood of addressing the most harmful forms of corruption; and the possible synergies with other policy aims and efforts (e.g. administrative reforms).

#### **4.1.3. Tackling money laundering**

**Money laundering serves as a channel for individuals and organizations to hide illicit wealth out of their country to avoid scrutiny, diversify their investment portfolios, and spread risks.** The Financial Action Task Force (FATF) defines money laundering as the processing of criminal proceeds to disguise their illegal origin in order to legitimise the ill-gotten gains of crime. The phenomenon of money laundering is closely linked with criminal activities; for example, in 2009, criminal proceeds amounted to 3.6% of global GDP with 2.7% of global GDP (USD 1.6 trillion) being laundered (UNODC, 2011b).

**The money laundering process typically involves three phases: placement, layering and integration.** During the ‘placement’ phase, launderers seek to introduce criminal proceeds (cash or goods) into the financial system in their home country or abroad. ‘Layering’ seeks to conceal the criminal origins of funds and hence involves frequently transferring and splitting money between bank accounts, countries, individuals and/or corporations. During the ‘integration’ phase, the apparently clean funds enter the legitimate economy and are ‘re-invested’ in real estate, financial securities, and to support wealthy lifestyles.

**Money laundering is linked to illicit activities such as corruption, drug trafficking, illegal trade in wildlife, real estate, currency exchange and securities market industry, and many more.** The large, informal and cash-based nature of African economies facilitates the movement of funds anonymously across countries without a trail and out of the continent. The most widely known cases of money laundering is corruption related, especially involving PEPs who abuse their access to significant public funds and knowledge and ability to control budgets, public companies and contracts. Although this does not suggest that all PEPs engage in corrupt practices, exposed corruption cases have uncovered many instances of PEPs using their positions of influence to launder money.

**Terrorist groups in West and Central Africa are benefiting from money laundered within Africa to finance themselves.** The prevalence of conflicts and terrorist groups like the Boko Haram, Al-Qaeda in the Islamic Maghreb (AQIM), Ansar Dine, and various affiliates has resulted in a complex criminal network that perpetuate both legal and illegal activities to finance their operations. For example, to make their funds legitimate, Boko Haram is reported to provide micro finance to small and medium scale businesses, haulage and transportation businesses, and currency exchange

bureau (FATF/GIABA/GABAC, 2016). Across Africa, these terrorist organizations are suspected of evolving into the main channels for illicit trade in illicit trafficking, drug trafficking, trafficking of weapons, smuggling of migrants, and trafficking in persons (OECD/SWAC, 2014; OECD, 2018a). As such, anti-money laundering efforts do not only have to focus on illicit funds getting out of the continent, but also illicit funds circulating within the region.

**OECD countries are the main destinations of money laundering activities from Africa thanks to their stable and predictable financial systems (OECD, 2014b).** OECD countries thus can play a big role in preventing IFFs from Africa entering their economic and financial system. In 2003, the FATF, an inter-governmental body, developed a series of 40 recommendations recognized as international standards for combating money laundering and the financing of terrorism. The standards have been revised most recently in 2012 (Table 4.2). The recommendations encourage countries to implement various measures to prevent, detect, prosecute and sanction money-laundering crimes. In this process, FATF also promotes better international cooperation for cross-border crimes.

**Table 4.2: FATF Categories, Sub-categories and Recommendations**

Category	Sub-category	Recommendation
1 Legal systems	I. Scope of criminal offence of money laundering	1–2
	II. Provisional measures and confiscation	3
2 Measurements to be taken by financial institutions and non-financial businesses and professions to prevent money laundering and terrorist financing	III. Financial secrecy	4
	IV. Customer due diligence and record keeping	5–12
	V. Reporting of suspicious transactions and compliance	13–16
	VI. Other measures to deter money laundering and terrorist financing	1–20
	VII. Measures to be taken with respect to countries that do not or insufficiently comply with the FATF Recommendations	21–22
	VIII. Regulation and supervision	23–25
3 Institutional and other measurements necessary in systems for combating money laundering and terrorist financing	IX. Competent authorities, their powers and resources	26–32
	X. Transparency of legal persons and arrangements	33–34
4 International cooperation	XI. Conventions	35
	XII. Mutual legal assistance and extradition	36–39
	XIII. Other forms of cooperation	40

Source: Adapted from the FATF (Financial Action Task Force) (2010), *FATF 40 Recommendations 2003*, FATF/OECD, Paris, available at: [www.fatf-gafi.org/topics/fatfrecommendations/documents/the40recommendationspublishedoctober2004.html](http://www.fatf-gafi.org/topics/fatfrecommendations/documents/the40recommendationspublishedoctober2004.html)

**The performance of OECD countries on implementing these 40 Recommendations varies (OECD, 2014b).** OECD countries perform well in several areas such as giving protection to staff of financial institutions against criminal and civil liability for disclosing information if they are reporting suspicion of money laundering in good faith, such as whistleblower protection (*Recommendation 14*). Most OECD countries also score well on international cooperation (*Recommendations 35–40*). All countries are compliant with *Recommendation 36: Mutual legal assistance*, which requires countries to have clear processes to support other countries investigating money laundering.

**Many OECD countries have several areas to address to comply with the FATF Recommendations (OECD, 2014b).** Their performance trails behind on *Recommendation 6* regarding PEPs, which requires that financial institutions perform additional due diligence measures when dealing with PEPs. This low performance is problematic for combating money laundering in Africa given the relevance of PEPs in money laundering in Africa. Moreover, 27 out of 34 OECD countries store or require some beneficial ownership information for legal persons, but no country is fully compliant with the beneficial ownership requirement for legal arrangements. To address these weaknesses, OECD countries should increase efforts towards complying with the FATF Recommendations and

ensure that financial institutions and designated non-financial institutions conduct proper customer due diligence. They should also require institutions to determine beneficial owners and ensure that this information is available to the relevant authorities including those in Africa.

**African governments should also strengthen their systems and institutions to discourage IFFs abroad, as well as flows within the region that are increasingly being used for terrorist financing activities.** South Africa is the only African member of FATF. Further compliance to the 2012 FATF Recommendations by countries in Africa would also help strengthen their financial system integrity. This includes actions to improve legal systems, international cooperation, financial intelligence, and investigations and persecution of money laundering crimes. For example, Nigeria recently passed laws to make their financial intelligence unit autonomous and established a new sanction regime that stipulates fines on banks, their directors and key officials.

**A number of regional bodies have emerged in Africa to facilitate the process of adopting and implementing the FATF's 40 Recommendations.** Currently, there are four such FATF-style regional bodies: the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG), the Inter-Governmental Action Group against Money Laundering in West Africa (GIABA), the Task Force on Money Laundering in Central Africa (GABAC), and the Middle East and North Africa Financial Action Task Force (MENAFATF).

**Compliance with the FATF Recommendations and other initiatives to combat money laundering are often difficult to achieve due to several reasons.** First, as some countries are not members of the FATF-style regional bodies, countries in the same regional economic community can have different protocols and rules which criminal networks can exploit loopholes. Second, most African governments do not have the resources necessary to fully implementing the FATF Recommendations. Third, many countries lack the expertise and capacity among their financial intelligence community to be able to track the flow of funds in and outside their countries. Fourth, the cash-based economy makes it difficult to trace the flow of funds. Finally, the FATF-style regional bodies mentioned above have limited capacity. They require support to assist countries develop and enhance national control systems and legislation to be compliant with the 40 FATF Recommendations.

#### **4.1.4. Leveraging Tax Policy Tools to Combat IFFs**

IFFs are closely associated with tax evasion, and related financial crimes including money laundering, illicit trade, fraud, terrorism financing, and corruption. In this new era of 'banking without borders', criminals can exploit modern technology to move substantial sums between multiple jurisdictions with relative ease and great speed. Consequently, countries around the globe are facing a common threat posed by increasingly complex and innovative forms of tax evasion.

The IFFs that derive from tax evasion have wide-ranging negative implications as the tax burden shifts towards sources and taxpayers where it can be more easily collected. This undermines the balance in the allocation of the tax burden and erodes trust in the fairness of the national tax system and in the government more generally. In turn, it can lead to lower levels of tax compliance.

Tax avoidance by multinational enterprises (MNEs) is not illegal and therefore the associated financial flows are not considered illicit *per se*. However, tax avoidance can have similar repercussions for domestic resource mobilization as tax evasion. Exploiting gaps in international tax laws to artificially shift profits to low or no-tax jurisdictions where there is little or no economic activity, undermines the tax base and adversely affects the revenue raising efforts. While this is true in all countries, the impact of tax avoidance is particularly damaging to developing countries that continue to be behind in average tax-to-GDP ratios, and have relatively more to gain in growing their tax revenues to promote economic growth (OECD/ATAF/AUC, 2018). Developing countries also tend to rely more on corporate tax revenues than more developed countries. Tackling tax

avoidance therefore goes hand-in-hand with global efforts to fight tax evasion and other financial crimes to enhance domestic resource mobilization to support sustainable development.

The developments over the past decade to improve tax transparency, enhance inter-agency cooperation in fighting tax crime and other financial crimes, combat tax avoidance, as well as capacity building initiatives can all be leveraged by African countries to better tackle IFFs.

#### 4.1.4.1. The Africa Initiative – Maximizing Tax Transparency on the Continent

Many African countries have not been able to benefit from recent improvements in tax transparency and exchange of information (EOI) among tax administrations. Until recently, the majority of African countries did not have a wide network of EOI agreements. Additionally, a myth persists that African countries cannot obtain tax information from countries formerly known as secrecy jurisdictions or tax havens. In fact, secrecy for tax purposes has been eliminated over the past decade through the work of the Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum)<sup>45</sup>. One significant barrier to greater EOI is a lack of capacity to use EOI mechanisms effectively and access information on assets kept or business carried on abroad and collect more tax.

The Global Forum teamed up with several countries and international organizations to launch a specific program to help unlock the potential for transparency and EOI in Africa through the Africa Initiative. The Africa Initiative comprises three pillars: (i) awareness raising, (ii) political leadership, and (iii) capacity building. There were 27 African members of the Global Forum as at 2018. These countries have agreed to meet concrete targets to improve their legislation and operational aspects of EOI, build up the EOI function in their tax administrations and use it in their tax audits and investigations. Since the launch of the Africa Initiative in 2014, the Global Forum has provided more than 15 training events attended by over 800 officials from Africa on how to create functioning EOI units and how to make EOI requests. Twenty-three African countries also signed the Yaoundé Declaration that urged the AU to begin a high-level discussion on tax cooperation and IFFs, and their links to domestic resource mobilization<sup>46</sup>.

These efforts have resulted in progress in the utilization of the tax transparency tools to curb tax evasion. Already 29 African countries are participating in the work of the Global Forum and are committed to implement the international agreed standards, including automatic exchange of information on financial accounts (AEOI) held in foreign countries. Almost all of them have put in place or are establishing well-resourced EOI units in their tax administrations. The African countries' network of EOI is expanding with over 1 000 new EOI relationships created since 2014 and some countries have reported additional revenue from EOI (e.g. Uganda recovered over USD 9 million in taxes as a result of EOI in 2015/16).

However, progress remains uneven. Africa is still one of the most underrepresented regions in terms of Global Forum membership, with almost half of the continent's countries not participating in the Global Forum. Only five African countries (Ghana, Mauritius, Nigeria, Seychelles and South Africa) are doing or will soon start AEOI. AEOI is critical to stemming IFFs from Africa as the amount of African wealth held offshore is proportionately much greater than that of developed countries – 30% of Africa's financial wealth is held offshore with a corresponding USD 15 billion loss of tax revenue (Zucman, 2014). Further participation of African countries in AEOI is a key priority for the second mandate of the Africa Initiative, which was renewed in 2017 for the period 2018–2020.

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45 The Global Forum on Transparency and Exchange of Information for Tax Purposes is the multilateral framework within which work on transparency and exchange of information for tax purposes is carried out by both OECD and non-OECD countries. The Global Forum ensures the implementation of international standards on tax transparency through its monitoring and peer review activities.

46 Benin, Burkina Faso, Cameroon, Chad, Comoros, Congo, Gabon, Ghana, Guinea-Bissau, Ivory Coast, Lesotho, Liberia, Madagascar, Mali, Mauritania, Mauritius, Niger, Nigeria, Senegal, Seychelles, South Africa, Togo and Uganda.



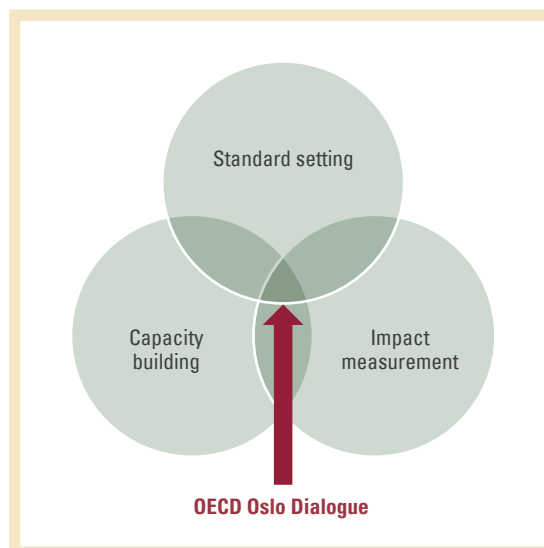
#### 4.1.4.2. Tax and Crime

Criminal activities are dynamic and adapt quickly to take advantage of new opportunities for financial gain, frequently outpacing the legislative changes designed to combat them. Preventing, detecting, prosecuting, and recovering the proceeds of these illicit activities requires greater transparency, more effective intelligence gathering and analysis, and improvements in cooperation and information sharing at the domestic and international level.

Figure 4.2: Dynamism of Crime



Figure 4.3: OECD Oslo Dialogue



Source: OECD, 2018<sup>47</sup>

All financial crimes are interlinked and the OECD works to promote a ‘whole of government’ approach to fighting these crimes through the Oslo Dialogue – an initiative launched in 2011 to promote effective cooperation between a range of financial crime agencies through standard setting, capacity building and impact measurement.

The Oslo Dialogue is focussed on breaking down silos and enhancing cooperation between the range of agencies involved in combating financial crimes, including tax administrations, financial intelligence units, police, anti-money laundering authorities, anti-corruption authorities, and prosecutors. Each of these authorities have different mandates, access to different sources of data, and different investigative powers and skills, making it critical that they can effectively collaborate in the enforcement of related financial crimes. This approach is vital for gaining the most value from the international community’s recent advances in tax transparency.

#### 4.1.4.3. Standard Setting: Enhancing Inter-agency Cooperation to Combat IFFs

The fight against financial crime starts at home and a range of practical measures exists, which African countries can take to stem IFFs. This includes implementing legal and operational frameworks to facilitate cooperation at both the domestic and international level. Recent studies on inter-agency cooperation show that while most countries either require or permit their tax administration to report and share information with authorities responsible for investigating serious financial crimes, almost all jurisdictions place restrictions on this sharing and anecdotal evidence

47 <http://www.oecd.org/ctp/crime/about-tax-and-crime.htm>

suggests that in most jurisdictions, actual levels of cooperation remain low<sup>48</sup>. This is true of all nine African countries that participated in the 2018 OECD/World Bank report on *Improving Co-operation between Tax Authorities and Anti-Corruption Authorities in Combating Tax Crime and Corruption* (Angola, Ghana, Madagascar, Nigeria, Rwanda, South Africa, Tunisia, Uganda, and Zambia)<sup>49</sup>. Even jurisdictions with well-developed legal frameworks and successful case outcomes report that inter-agency cooperation occurs on an *ad hoc* basis rather than systematically. This affects jurisdictions' ability to provide and make use of mutual legal assistance in transnational matters. To this end, the report calls on countries to make available the broadest range of information sharing gateways possible within their legal framework and to implement procedures to operationalize these. Box 4.1 presents the example of Uganda.

#### **Box 4.1: Cooperation Agreement in Uganda**

In Uganda, to enhance cooperation, different agencies have signed memorandums of understanding (MoUs) to facilitate sharing of information between different law enforcement authorities. Each of these MoUs identifies an official contact person at each participating agency who is then made responsible for ensuring that the agreements are effective and implemented in practice.

Countries can also use other enhanced cooperation mechanisms such as joint operations and taskforces, parallel investigations, coordination fora, staff secondments, and income and asset registers. African countries can benchmark themselves against the essential institutional, legal, and operational mechanisms needed to successfully combat financial crime set out in the OECD's *Ten Global Principles for Combating Tax Crime*, which involved review and data provided by a range of countries including a number of non-OECD countries<sup>50</sup>. A second edition of the guide is currently being prepared that will include inputs from a broader range of African states and thus assist in identifying both individual and regional priorities for future capacity building work.

#### **4.1.4.4. Capacity Building**

Combating IFFs relies on developing countries having the tools they need to implement the above outlined international standards. To this end, development partners have provided financial or technical assistance to help build the capacity to pursue illicit financial crimes. For example, the Africa Academy for Tax and Financial Crime Investigation supports law enforcement authorities in Africa to detect and investigate tax crimes and other financial crimes and to recover the proceeds of those crimes. The Academy runs programs on conducting and managing financial crime investigations, as well as a range of specialty courses covering topics such as VAT fraud, money laundering, and asset recovery. By November 2018, the Academy had trained over 650 investigators from over 80 (mostly developing) countries.

The OECD is also launching a new pilot Tax Inspectors Without Borders for Criminal Investigations (TIWB-CI), which addresses tax evasion and other financial crimes rather than non-criminal tax avoidance cases. TIWB-CI is bespoke, focussed on one country and aimed at addressing specific issues relating to the host administration, including resolution of complex cases of tax evasion and related financial crimes. The first pilot program started in Namibia in June 2018, with plans to expand to other developing countries based on needs and interest. One Academy for officials from developing countries is in Kenya.

48 <http://www.oecd.org/tax/crime/improving-co-operation-between-tax-authorities-and-anti-corruption-authorities-in-combating-tax-crime-and-corruption.htm>

49 <http://www.oecd.org/tax/crime/improving-co-operation-between-tax-authorities-and-anti-corruption-authorities-in-combating-tax-crime-and-corruption.htm>

50 Brazil, El Salvador, Georgia, Indonesia, Malaysia, Singapore, and South Africa.

To assist in tracking the impact that international standards and capacity building efforts have on developing countries' fight against IFFs, the OECD is currently developing a new diagnostic self-assessment approach. Based on the Ten Global Principles, the model breaks down the fundamental elements that countries need in place to effectively combat tax crime and allows countries to assess their level of maturity across five evolutionary stages: Nascent, Emerging, Adoption, Advanced and Leading Practices. The model provides structured incremental descriptions that allow relevant enforcement bodies to identify their level of maturity across a range of capabilities and suggests potential areas of focus for agencies to move to the next phase of maturity. Once finalised, the OECD will leverage the participation of African countries in its policy and capacity building work to encourage use of the new maturity model.

#### **4.1.4.5. Tackling Base Erosion and Profit Shifting**

While IFFs are generally defined as illegal activity that drains resources from developing countries, tax avoidance by MNEs is not necessarily illegal but it can have the same economic consequences, particularly given the high reliance that developing countries often have on corporate income tax revenues. The OECD/G20 Base Erosion and Profit Shifting (BEPS) Project, which was endorsed in October 2015 by OECD and G20 countries, delivers solutions for governments to close the gaps in existing international rules that allow corporate profits to 'disappear' or be artificially shifted to low or no-tax environments where companies have little or no economic activity. The Inclusive Framework on BEPS brings together 124 jurisdictions to work on an equal footing to tackle tax avoidance, in particular preventing tax treaty abuse and introducing Country-by-Country Reporting (CbCR) for the activities of MNEs.

BEPS undermines the credibility of the tax system in the eyes of all taxpayers. If the largest and most high-profile taxpayers are seen to be avoiding their tax liabilities, confidence and effectiveness of the tax system are undermined. As developing countries tend to rely more heavily on corporate income tax than developed countries do, the impact of BEPS on developing countries can be expected to be higher.

Transparency is a crucial element in tackling BEPS, since it aims at breaking through information asymmetries that hinder countries from taxing MNEs based on their actual international activities. Strong, coherent and widely adopted international tax standards in the areas of exchange of tax rulings and CbCR make it significantly harder for MNEs to engage in aggressive international tax planning.

The OECD, together with African Tax Administration Forum (ATAF), the EU Commission and the World Bank Group (WBG) have raised awareness of the BEPS measures (and related transparency initiatives) and the benefits of the BEPS Inclusive Framework, and have supported countries with their BEPS implementation plans. Currently, 90% of the recipient countries or jurisdictions are in the process of or have followed recommendations on legislative changes. These recommendations have led to the approval of legislation, as well as the issuance of guidance for taxpayers and tax administrations in some cases. Countries such as Tunisia and Zambia joined the Inclusive Framework in the second half of 2017.

#### **4.1.4.6. BEPS Inclusive Framework Induction Program**

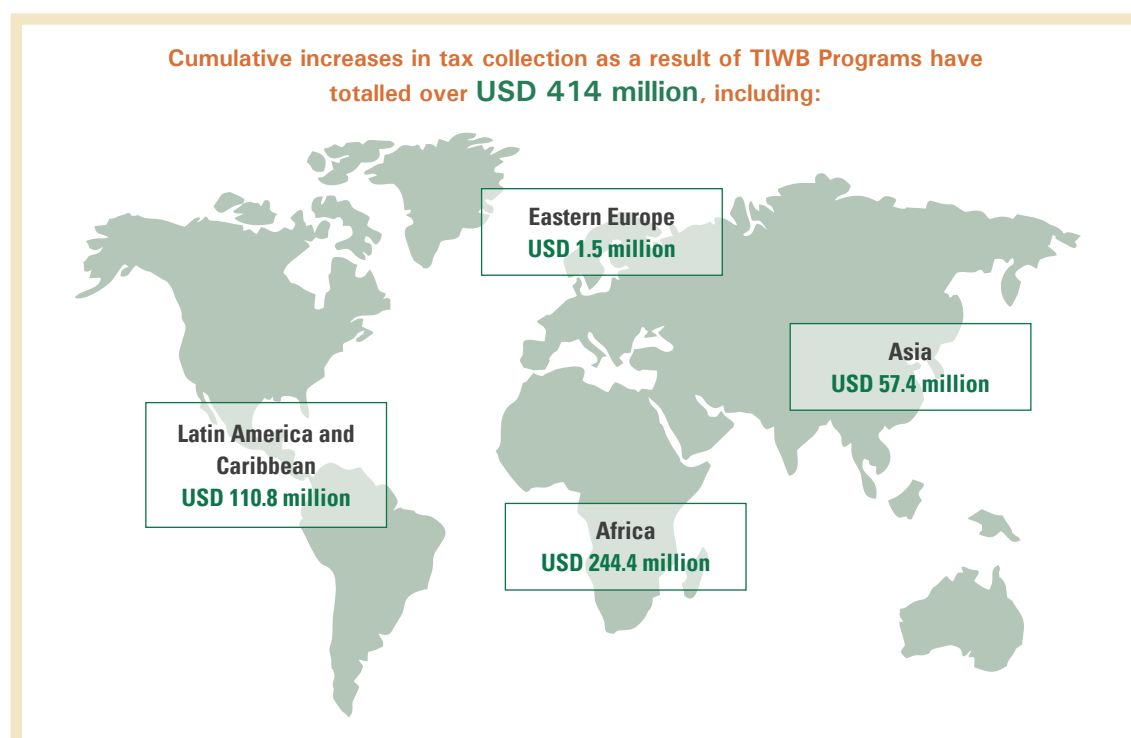
Induction Programs were introduced in 2017 to provide assistance to developing countries through tailor-made programs for the implementation of the BEPS package. After an initial request, Induction Programs begin with a meeting with the Minister of Finance (or minister otherwise responsible for taxation), fostering political buy-in for legislative changes, particularly the four BEPS minimum standards. This ensures key decision makers are informed of the advantages of policy change, international developments and can monitor progress. Induction Programs are provided based on demand from countries/jurisdictions and their specific priorities. They can be tailored to include wider stakeholder engagement such as with parliamentarians or the judiciary.

Based on these initial meetings, as well as a technical-level workshop with tax policy and revenue administration staff, a roadmap for BEPS implementation is developed. This document also identifies the responsibilities of different stakeholders supporting the country (including, for example, the WBG, IMF and regional organizations), thereby acting as an important tool to strengthen coordination and avoid duplication. Wherever possible, country visits are carried out jointly by the Secretariats of the Inclusive Framework and the Global Forum on Transparency and Exchange of Information for Tax Purposes, given the strong linkages between the two agendas (this is particularly the case on confidentiality assessments). To date, 23 induction programs have been carried out, including nine in Africa: Botswana, Burkina Faso, Cameroon, Egypt, Liberia, Mauritius, Nigeria, Tunisia and Zambia.

#### 4.1.4.7. Tax Inspectors Without Borders

The OECD/United Nations Development Programme (UNDP) Tax Inspectors Without Borders (TIWB) initiative provides hands-on audit support to tax administrations in developing countries, engaging tax audit experts to transfer skills to strengthen capacity in auditing MNEs and engaging a 'learning by doing' approach. Following the successful 'South-South' experience of the Kenya-Botswana TIWB program in 2017, South Africa launched a new program with Zambia in June 2018. Since 2012, TIWB has completed nine projects; 33 are currently running, and there are 23 to come in Africa, Asia Pacific, Latin America and Caribbean, and Eastern Europe. TIWB is now branching out from general audit support to more specific sector audits mainly in mining, financial sector, commodities and telecommunications, as well as tax avoidance issues, and tax evasion issues supporting investigations for tax and crime. The target is 100 deployments by 2020. To date, USD 414 million of additional revenues have been raised with costs of less than USD 4 million, including USD 244.2 million in Africa (OECD/UNDP, 2018). TIWB represents good value for money with over USD 100 in additional revenues recovered for every USD 1 spent on operating costs.

**Figure 4.4: Cumulative Increases in Tax Collection across the World**



Source: OECD/UNDP 2018 Tax Inspectors without Borders Report

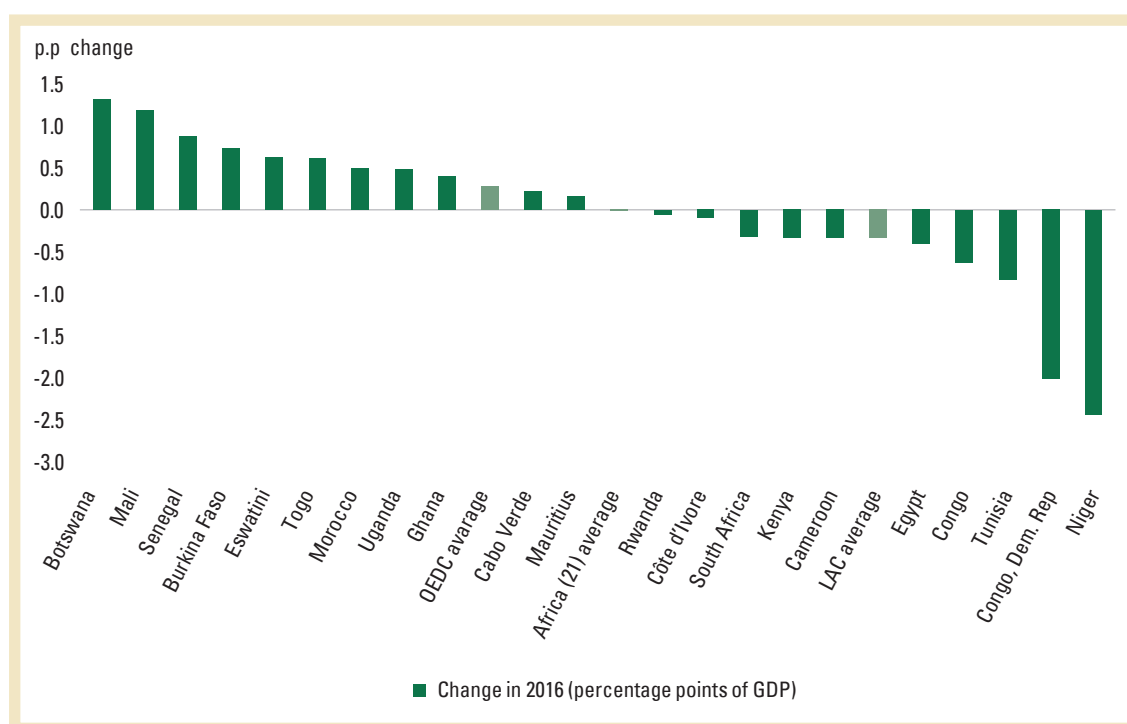
As noted above, the OECD is now launching a new pilot TIWB-CI as an extension of the current TIWB program, but for addressing tax evasion and other financial crimes (rather than non-criminal tax avoidance cases).

#### 4.1.4.8. Collecting Comparable, High-quality Revenue Data to Support Tax Policy Design

Achieving the United Nations' Sustainable Development Goals (SDGs) and implementing the Addis Ababa Action Agenda (AAAA) requires mobilizing additional finance, in particular domestic resources, to fund public goods and services. *Revenue Statistics in Africa* provides internationally comparable indicators on tax and non-tax revenues, which can be used to track progress on domestic resource mobilization and to inform tax policy and reforms. It is a joint initiative between the African Tax Administration Forum (ATAF), the African Union Commission (AUC) and the OECD and its Development Centre, with the support of the EU. The 21 African countries participating in the initiative have significantly increased domestic resource mobilization since 2000 (AUC/ATAF/OECD, 2018).

Between 2015 and 2016, the tax-to-GDP ratios of 11 African countries increased, while those of 10 countries in the *Revenue Statistics in Africa* sample decreased. Botswana registered the highest increase (1.3 percentage points) followed by Mali (1.2 percentage points). The largest decreases (of over 2.0 percentage points) occurred in the Democratic Republic of the Congo and Niger. The changes in tax-to-GDP ratios were primarily due to economic factors. Declines in oil prices coupled with lower activity among mining and oil companies contributed to the decreases in the Democratic Republic of the Congo and Niger, while a significant increase in the sale of diamonds in Botswana has increased revenues. In contrast, the increased tax-to-GDP ratio in Mali is partly explained by improvements to tax administration.

**Figure 4.5: Change in Tax-to-GDP Ratios between 2015 and 2016 (Percentage Points of GDP)**

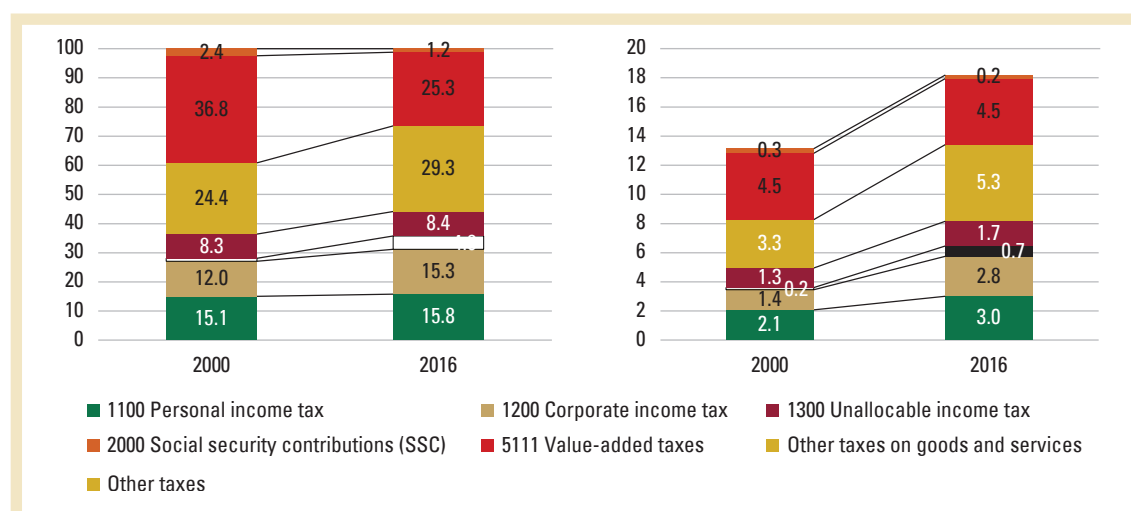


Source: OECD 2018, Revenue Statistics in Africa 1990–2016

African economies continue to rely heavily on taxes on goods and services, which accounted for 25.3% of total tax revenues in the Africa (21) average. Value-added taxes (VAT) alone accounted for 29.3% of revenues. However, the contribution of income taxes is increasing: taxes on income and profits accounted for 34.3% of total revenues across the Africa (21) average in 2016 and have contributed

the most to growth in tax revenues since 2000, increasing by 2.6% of GDP to reach 6.2% of GDP in 2016. Corporate income tax revenue increased by 1.4 percentage points over this period to 2.8% of GDP, while revenue from personal income tax rose from 2.1% to 3.0% of GDP in 2016, a historic high.

**Figure 4.6: Tax Structure, Africa (21) Average as Percentage of Total Tax Revenue and Percentage of GDP, 2000 and 2016**



Source: OECD 2018, Revenue Statistics in Africa 1990–2016

*Revenue Statistics in Africa* is an important part of the AU's Strategy for the Harmonization of Statistics in Africa (SHaSA) and is aligned with the AU's Agenda 2063 and SDG 17.1. The 2018 edition contains a special chapter on SHaSA, outlining its approach to establishing an efficient statistical system that covers the political, economic, social, environmental and cultural development and integration of Africa, as well as the role of *Revenue Statistics in Africa* in this strategy.

## 4.2. Policy implications for African Governments, Regional Institutions and Development Partners

The diversity and complexity of IFFs call for a cross-cutting strategy encompassing various actors at national, regional and international levels and addressing the root causes as well as the lack of livelihood options that create the demand for IFF activities. This section proposes policy implications for different actors: African governments, African regional institutions and development partners.

### 4.2.1. Policy Implications for African Governments

Tackling IFFs requires first and foremost strong political commitment. African leaders have shown top-level commitment to fighting IFFs, exemplified by the target of halving IFFs by 2023 in Agenda 2063's First Ten-year Implementation Plan (2014–2023). Translating these multilateral declarations into actions at national level remains a challenge due to a lack of follow-up, weak institutional capacity and the complexity of the issue. Gradually building the evidence-base regarding the type of IFFs, their magnitudes and the threat they pose to sustainable and inclusive development could help maintain the awareness and commitment to policy against IFFs. Engaging in exercises such as the African Peer Review Mechanism (APRM) can also help highlight policy challenges, identify good practices and publicise government's progress in this domain.

**The cross-cutting nature of IFFs requires policymakers to adopt a strategic overview of IFFs.** Burkina Faso, Kenya, Liberia, Mauritius, Niger, Senegal and Sierra Leone recently established national action plans on policies to combat IFFs (Miyandazi and Ronceray, 2018). Others have set out or updated sectoral policy and institutional frameworks to combat IFFs. The strategy should

include not only public authorities but also non-state actors such as financial sectors, regulated professions (e.g. lawyers and accountants) and private companies.

**The approach in addressing IFFs will tailor to the local context.** The experience of criminal economies in West Africa show that different types of IFFs pose varying degree of harm on local development (OECD, 2018a). The prevalence of informality and cash-based transactions and the lack of livelihood options also pose additional challenges for African governments. Furthermore, the success of measures against IFFs depends on the drivers and organizations of such flows, the strength and capacity of governments and institutions and other contextual factors. In particular, post-conflict and fragile states face specific challenges related to their lack of capacity and resources, aid dependency, missing institutions, incomplete legal frameworks and insecurity. Taking stock of their capacity constraints, governments will thus evaluate actions against IFFs based on their harmfulness, the risks involved and the difficulties to curb them.

**Clear responsibilities, coordination and collaboration among the different agencies are crucial during the process of policy design and implementation.** Dedicated authorities against IFFs require a clear and appropriate mandate with the financial and functional resources to match. This is particularly pertinent as several African countries such as Kenya, South Africa, Uganda, Tanzania, Nigeria, Senegal, Tunisia and Angola are establishing separate transfer pricing units within their revenue collection agencies to audit and investigate taxes paid by multinationals. The OECD’s *Oslo Dialogue* and its ‘whole of government’ approach to tackling tax crimes and other financial crimes, including its emphasis on inter-agency cooperation, can be a key vehicle for African countries to foster progress in this area.

**Strategies to tackle IFFs can exploit synergies and factor in potential trade-offs.** OECD (2016c) proposed a methodology to map out potential frictions and incompatibilities, and exemplified potential trade-offs and synergies in 12 different policy areas (Table 4.3).

**Table 4.3: Trade-offs and Synergies in Relation to IFFs**

<b>Trade-offs</b>	
Taxation	Balance economically efficient taxation with considerations about which taxes are more prone to entail IFFs. Balance revenue recovery and administrative resource constraints with the need to deter further tax evasions and maintain public support and compliance.
Business regulation	Balance the need for transparency and regulation of the establishment of companies with the consideration of creating a business-friendly environment and minimizing compliance costs.
Export promotion	Prohibit bribing of foreign officials while maintaining competitiveness with other companies abroad.
Financial markets and financial stability	IFFs can cause real estate bubbles, exchange rate volatility, and general financial instability. They could also destabilize systemically relevant institutions.
Financial inclusion	Balance the need for stringent reporting rules with concerns for access to financial services of poor people with insufficient identity documentation. Increased regulation and administrative oversight of financial institutions without shutting down the informal financial sector.
Migrant remittances	Crackdown on IFFs while not discouraging migrant remittances.
De-risking	De-risk without negatively affecting financial inclusion and remittance flows.
NGOs and CSOs	Maintain access to finance for civil society organizations (CSOs) while preventing the misuse of NGS for IFFs.
Data protection	Balance the need to combat IFFs with diplomatic concerns about tensions between countries/government about high-profile cases.
<b>Synergies</b>	
Government and Public Administration	IFFs can erode the authority’s capacities and perceived legitimacy, while sound institutions are more likely to succeed in combating IFF.
ODA	Improving institutional arrangements and administrative capacities in developing countries could help combat IFF, increase domestic resource mobilization and contribute to achieving other (developmental) targets.

Source: OECD (2016c)

**African governments can take advantage of regional and international initiatives to increase their capacity to fight IFFs.** First, they can engage further with international norms and standards such as implementing the FATF's Recommendations against money laundering or joining the Extractive Industries Transparency Initiative and the OECD Thematic Dialogue on Commodity Trading Transparency. They can continue to implement international standards on exchange of information and enact automatic exchange of information agreements through initiatives such as the Global Forum on Transparency and Exchange of Information for Tax Purposes, particularly in the context of the Global Forum's Africa Initiative. They can utilize development assistance to build their capacity to fight IFFs. For example, 15 African countries have been participating in the Tax Inspectors Without Borders initiative to build tax audit capacity by having experienced tax auditors work on current tax audits and international tax issues alongside local tax officials. This can create significant gains for the countries involved, with over USD 240 million in additional tax revenues generated in Africa so far, and more countries can join this initiative.

#### **4.2.2. Policy Implications for African Regional Institutions**

**Africa's regional institutions play a very important role in keeping political commitment.** The High Level Panel on Illicit Financial Flows has been instrumental in championing interest in the topic. Its 2015 report has helped mobilize the political momentum towards tackling the issues of beneficial ownership and exchange of information for tax purposes. More recently, AUC's designation of anti-corruption as the theme of 2018 shows interest from top-level African leaders in the topic. Overall progress in implementing the report's recommendations remain partial (Miyandazi and Ronceray, 2018). Regional institutions play an important role in maintaining the political commitment to fight IFFs.

**African institutions can take a stronger role in guiding national responses against IFFs.** The IFF Working Group can help monitor the progress of implementing the recommendations of the High Level Panel report across the different African countries. Regional Economic Communities (RECs) can play an important role in setting standards that are more adapted to their local contexts. For example, the RECs have been active in establishing FATF-style regional bodies to combat money laundering and terrorism financing. These bodies extend the membership to more African countries and provide technical assistance for national authorities.

**The regional institutions can also help facilitate collaboration and dialogue among African governments, and between African countries and their development partners.** They can organize training at a larger scale to build up specific technical capacity of national authorities such as fostering transfer pricing capacity. The regional institutions can also coordinate Africa's position on IFFs to include necessary measures to combat IFFs in their partnership agreements with other international players. Moreover, they can create the link between African countries and development partners for more proactive use of repatriation mechanisms.

**Regional institutions are important in advancing the knowledge base on IFFs in Africa.** They have been working with development partners in building new statistics and producing research on the drivers, magnitude and impacts of IFFs in Africa. In 2018, the New Partnership for Africa's Development (NEPAD) and African Development Bank (AfDB) collaborated with the OECD and the World Bank on a report on the economy of illicit trade in West Africa (OECD, 2018a). Since 2015, the African Union Commission and the African Tax Administration Forum have been working with the OECD to collect comparable and high-quality revenue statistics in Africa. Now in its third edition, the *Revenue Statistics in Africa* (OECD/ATAF/AUC, 2018) provide detailed, internationally comparable revenue data for 21 African countries. Similarly, the United Nations Economic Commission for Africa (UNECA), the United Nations Conference on Trade and Development (UNCTAD) and the United Nations Office on Drugs and Crime (UNODC) are working together on the methodology for SDG indicator 14.6.1.



### 4.2.3. Policy Implications for Partner Countries

**Africa's trade, investment and development partners have a key role to play on tackling IFF from the continent.** On one hand, they can take measures to reduce the lack of economic opportunities that foster 'demand' for IFF activities. On the other hand, they can work with African governments, civil society and the private sector to share good practices in tackling IFFs and strengthen capacities. In 2016, G20 Leaders recognized the detrimental effects of corruption and IFFs on equitable allocation of public resources, sustainable economic growth, the integrity of the global financial system, and the rule of law. They committed to reinforce the G20's efforts to enhance international cooperation against corruption and reaffirmed their commitment to addressing IFFs that have a detrimental effect on domestic resources mobilization.

**All countries can ratify and fully adhere to standards and conventions set to ensure responsible business conduct and tackle corruption and foreign bribery.** This includes implementing all the elements of the United Nations Convention against Corruption and the standards set by the Financial Action Task Force (FATF). It enjoins signatory countries (particularly financial centres) to conduct due diligence of politically exposed persons and to establish the real ownership of companies and trusts. Countries can also put in place systems that sanction overseas bribery payments more actively and effectively. This includes providing better protection for whistleblowers. In addition, countries can double efforts to end safe havens for corrupt funds by facilitating more systematic and timely return of stolen assets (OECD, 2014b).

**Promoting the integration of African countries in the discussions on global taxation would help better tackle global tax evasion.** For instance, better inclusion of developing countries in the design phase of the system for automatic exchange of tax information would enable them to better provide reciprocal information by better aligning with the African context. As a result, these countries would benefit more from such systems (UNGA, 2015). The problem of tax evasion requires a coordinated effort from all actors.

**Development partners need to continue to build capacity and promote good governance in tackling IFFs in Africa.** Development partners should continue to build relevant capacities, such as administrative and investigative capacities, in developing countries. For example, the Norwegian Agency for Development Cooperation (NORAD) launched the Taxation for Development Program, which uses Norway's own experiences with governing natural resources to help improve tax collection in resource-rich developing countries such as Tanzania and Zambia. Partners can also help developing countries develop their exchange of tax information agreements and build capacity on transfer pricing through initiatives such as TIWB and the Global Forum on Transparency and Exchange of Information for Tax Purposes.

**Donors should continue to support civil society efforts in developing knowledge and advocating to curb corruption and financial crimes.** International CSOs such as Global Financial Integrity (GFI), Transparency International (TI), Global Witness and local CSOs such as the Civil Society Advocacy and Legislative Centre (CISLAC) in Nigeria and Maka Angola are allies in bringing issues to global and domestic policy agendas.

**Development agencies remain important liaisons between developing countries and donor countries.** Their field presence fosters political commitment to combat economic and financial crimes in Africa, and in developed countries for Africa. Within African countries, development agencies support committed institutions and actors and raise relevant issues in dialogues with policy actors. In their home countries, they engage in internal policy dialogues to maintain the political momentum for tackling IFFs in Africa. For example, development agencies could work with universities, think tanks, other ministries, or the OECD to provide country-specific assessment of their risk profile as recipients of illicit flows.

**The scale of donor support is relatively modest and development agencies are not exploring the full range of options for supporting this complex agenda.** Developing agencies could play a greater role in signalling asset recovery as a political priority, and encouraging OECD countries to dedicate more resources to it and to adopt legal best practices (OECD, 2014b). For instance, USD 423 million in stolen assets were returned from just four OECD countries (Switzerland, the United States, Australia, and the United Kingdom) to developing countries between 2006 and 2012. In addition, development agencies could lead efforts in research by providing support to academic institutions. This would inject additional methodological rigour into the research process which has until now been dominated by civil service organizations.

**Development partners can play an important role in supporting fragile states combat IFFs.** OECD (2018e) identified 18 African countries as chronically fragile since 2018. Fragile states lose more revenues to IFFs than they get from aid and foreign investment. They often have scarce resources, weak technical and institutional capacity and low state legitimacy, which prevents them from tackling illicit economic and financial crimes. Developing partners could help build their capacities on the ground and ensure coherent global action to block illicit funds from flowing to OECD countries.

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## Annex 4: Licit Financial Flows to Africa

Table A4.1: Foreign and Domestic Financial Flows and Tax Revenues to Africa (Current USD, billion), 2010–2016

		2010	2011	2012	2013	2014	2015	2016	
Foreign	Private	Inward foreign direct investment	46	45	55	62	64	49	59
		Portfolio investments	28	26	42	32	31	20	13
		Remittances	53	60	64	64	68	65	62
	Public	Official development assistance (net total, all donors)	47	52	52	57	54	51	50
	<b>Total foreign flows</b>		<b>175</b>	<b>182</b>	<b>214</b>	<b>215</b>	<b>217</b>	<b>185</b>	<b>185</b>
<b>Domestic tax revenues</b>		<b>332</b>	<b>407</b>	<b>421</b>	<b>418</b>	<b>412</b>	<b>343</b>	<b>312</b>	

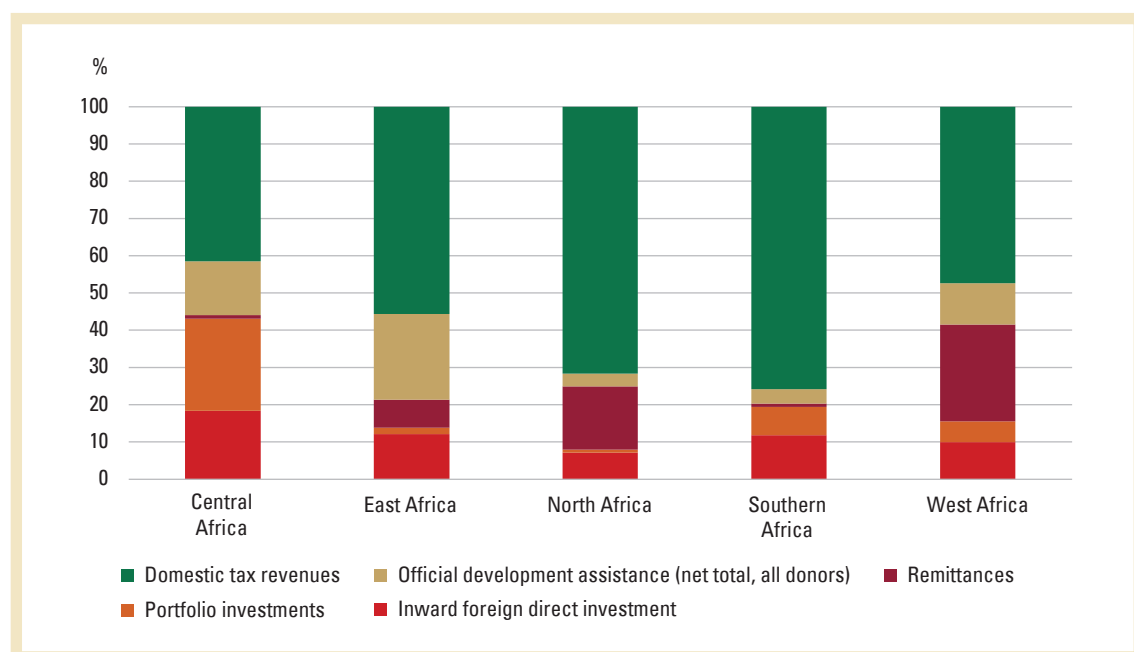
Source: AUC/OECD, 2018

Table A4.2: Financial Flows and Tax Revenues to African Regions, 2014–2016

	Inward Foreign Direct Investment	Portfolio Investments	Remittances	Official Development Assistance (Net Total, All Donors)	Domestic Tax Revenues	Total
Central Africa	6.3	8.5	0.3	5.0	14.3	34.4
East Africa	8.5	1.2	5.3	16.1	39.0	70.2
North Africa	12.3	1.4	29.5	5.9	124.2	173.3
Southern Africa	19.6	12.7	1.5	6.5	126.5	166.8
West Africa	10.8	6.1	28.4	12.1	51.7	109.2

Source: Authors calculations with data from WEO and UNCTAD

Figure A3.1: Breakdown of Shares of Regional Financial Flows to Africa, 2014–2016



Source: Authors calculations with data from WEO and UNCTAD

# CHAPTER V.

## Stemming Illicit Financial Flows in Africa: Lessons Learned from Asia

United Nations Office for South-South Cooperation<sup>51</sup>



### 5.1. Introduction

#### 5.1.1. What is Meant by Illicit Financial Flows?

The World Bank Group defines illicit financial flows (IFFs) as “money illegally earned, transferred, or used that crosses borders”<sup>52</sup>. In the international development community, the concept of IFFs is emerging as a powerful and constructive umbrella to bring together previously disconnected issues<sup>53</sup>. The term emerged in the 1990s and was initially associated with capital flight. If the capital movement breaks laws, regulations, or global standards anywhere along the path of the international transaction, then it is classified as an IFF<sup>54</sup>. Corruption, tax evasion and money laundering are the fuel in the engine of illicit flows. IFFs drive resources from where they are needed into the hands of a corrupt few.

Regardless of how IFFs are precisely defined, it’s clear that the flows are an impediment to development. What’s most important is to understand how and why money flows out of countries and to devise strategies and policies to curb these flows. While it’s difficult to quantify IFFs, there is widespread agreement that significant amounts are involved and are growing and that they pose deep problems, particularly in resource-rich countries and fragile and conflict-affected states.

#### 5.1.2. Scope and Scale of IFFs”

A key challenge is that IFFs are difficult to identify and track. Global Financial Integrity (GFI) estimates that the IFF outflows and inflows from the developing world ranged between USD 620–970 billion and USD 1.4–2.5 trillion, respectively, in 2014<sup>55</sup>. The 10 countries with the largest transfer of illicit capital are spread across the globe. Based on the World Bank Residual Model, Asia has the largest share of IFFs and six of the top 15 exporters of illicit capital. These are China, Malaysia, India, Indonesia, Thailand and Philippines<sup>56</sup>.

51 This submission to the African Union is a collaboration between the UNOSSC Regional Offices in Asia and Africa. Our gratitude goes to Dr. Banashri Sinha, Dr. Denis Nkala and Dr. Francois Ekoko for their valuable contribution to this African Publication, and Ivania Mondlane for the review of the final details. The views expressed in this publication do not necessarily reflect those of the United Nations, the United Nations Office for South-South Cooperation or governments. The designations employed do not imply the expression of any opinion whatsoever concerning the legal status of any country, territory or area, or its frontiers or boundaries.

52 World Bank. (2017). Brief: Illicit Financial Flows (IFFs). 7 July. <http://www.worldbank.org/en/topic/financialsector/brief/illicit-financial-flows-iffs>. (Accessed 7 July, 2017).

53 Ibid.

54 UNDP and UNODC. (2015). *Coming to grips with Illicit Financial Flows in Asia-Pacific*. UNDP, UNODC and Global Financing Integrity.

55 Global Financial Integrity. (2017). *Illicit Financial Flows to and from developing countries: 2005-2014*. Washington: Global Financial Integrity.

56 Kar, Dev, and Brian LeBlanc. (2013). *Illicit Financial Flows from Developing Countries: 2002-2011*. Washington, DC: Global Financial Integrity.

Capital flight from Asia and the Pacific has increased over the years. The accumulation of IFFs in Asia is still the highest at 38 percent of the global total. According to the GFI report, developing countries have suffered from financial losses of up to USD 7.85 trillion over the period of 2004–2013. Outflows in Asia are estimated to have grown between 9–9.8 percent per year from 2004–2014, reaching USD 272–388 billion in 2014.

These IFFs are often bigger than the official development assistance (ODA). For instance, net ODA flows from countries of the OECD Development Assistance Committee stood at USD 137.2 billion in 2014 compared to the USD 620–970 billion lost<sup>57</sup>. Furthermore, the outflow of finances threatens sustainable development and inclusive growth. The inflow of illicit resources, on the other hand, is a damaging act that undermines governance, rule of law and security. A usual knock-on effect is that governments have to borrow to fill in the gaps, thus increasing indebtedness.

### 5.1.3. How do IFFs Impact Development Agendas?

The negative impacts of IFFs have been recognized in the 2030 Agenda for Sustainable Development, especially in target 16.4 of the Sustainable Development Goals (SDGs), which states that the aim “...by 2030, [is to] significantly reduce illicit financial flows and arms flows, strengthen the recovery and return of stolen assets and combat all forms of organized crime”<sup>58</sup>. Understanding IFFs and finding ways to curb them is complicated. There is no universally accepted methodology to monitor IFFs. In fact, currently categorised as a Tier III indicator, the SDG indicator 16.4.1, “total value of inward and outward illicit financial flows”, still requires a methodology to be developed and agreed upon. The United Nations Conference on Trade and Development (UNCTAD) and the United Nations Office on Drugs and Crime (UNODC) are joint custodians of this indicator. Despite the available data, in some cases it is insufficient to measure how large these flows are, where they originate from and what consequences they have on institutions and economic activity. In the case of Africa, the Mbeki Report estimated that Africa is losing on average USD 50 billion each year due to IFFs; this is higher than the annual ODA that the continent receives<sup>59</sup>. In other words, the continent needs to develop strategies and mobilize the international community to fight IFFs more than it needs to develop strategies for external resource mobilization.

At the Third International Conference on Financing for Development in Addis Ababa, UN Secretary General Ban Ki Moon spoke of a world “in which both the global population and resource constraints are growing” and consequently one in which “development finance needs a reboot”<sup>60</sup>. A vital component of that reboot is helping developing countries generate and retain domestic resources to fund programs and infrastructure. This ‘retaining’ can’t happen without concerted efforts to reduce IFFs<sup>61</sup>.

The Addis Ababa Action Agenda (AAAA) on financing for development also calls for a redoubling of efforts to substantially reduce IFFs by 2030. In addition, the Action Agenda invites the “appropriate international institutions and regional organizations to publish estimates of the

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57 OECD. (2015). *Final Official Development Assistance Figures in 2014*. <http://www.oecd.org/dac/stats/final-oda-2014.htm>. (Accessed 2018).

58 SDSN. (2012). *16.4 by 2030 significantly reduce illicit financial and arms flows, strengthen recovery and return of stolen assets, and combat all forms of organized crime*. Accessed February 22, 2019. <http://indicators.report/targets/16-4/>.

59 AU/ECA. 2018. “Illicit Financial Flow Report of the High Level Panel on Illicit Financial Flows from Africa.” *AU/ECA Conference of Ministers of Finance, Planning and Economic Development*. Addis Ababa: AU/ECA.

60 UN. (2015). *UN conference opens with call for “reboot” of development finance*. 13 July. Accessed 2018. <https://www.un.org/sustainabledevelopment/blog/2015/07/un-conference-opens-with-call-for-reboot-of-development-finance/>.

61 Badre, B.. (2015). *How the world can put a stop to illicit financial flows*. 24 July. Accessed 2018. <https://blogs.worldbank.org/voices/how-the-world-can-put-a-stop-to-illicit-financial-flows>.

volume and composition of illicit financial flows”<sup>62</sup>. The Inter-Agency Task Force on Financing for Development is mandated to follow-up on these commitments and is further mandated by General Assembly Resolution A/RES/71/213 to analyse the issue<sup>63</sup>. The Financing for Development strategies stress the importance of improving national tax systems and enhancing revenue. The Monterrey Consensus and Doha Declaration both address the question of returning stolen assets. The Doha Declaration also notes that “it is vital to address the problem of illicit financial flows, especially money laundering”<sup>64</sup>.

#### 5.1.4. How can Principles of South-South Cooperation Help Us to Deal with IFFs?

South-South and triangular cooperation have become an integral part of development cooperation and have emerged as important vehicles in contributing to the achievement of the SDGs. Their roles are increasingly critical to bolstering the capacities of developing countries towards positive impacts on development performance and prospects in poverty eradication, trade and financial flows, technological capabilities and enhancement of knowledge on strategies and policies.

The Nairobi Outcome Document of the UN High-level Conference on South-South Cooperation of 2009, noted in item 17: “We recognize that developing countries tend to share common views on national development strategies and priorities when faced with similar development challenges. The proximity of experience is therefore a key catalyst in promoting capacity development in developing countries and, in this regard, accentuates the principles of South-South Cooperation. It is important to enhance South-South Cooperation in order to fulfil its full development potential”<sup>65</sup>.

The use of the South-South Cooperation modality can help address the issue of IFFs through the intensification of cooperation of developing countries on this common problem and based on the principle of solidarity.

This cooperation can take different forms. These include sharing of intelligence on IFF (outflows or inflows) activities that can affect other countries; sharing of information and best practices on addressing IFFs in terms of policy and strategies; signing of different agreements among themselves and committing to harmonize their legislation or policy frameworks in the areas of IFFs; lending of resources to countries that lack capacity or have limited capacity to IFFs; and restitution of proceeds from illegal or criminal financial activities to affected countries.

The Second UN High Level Conference on South-South Cooperation (BAPA+40) provided the South with the golden opportunity to discuss and develop a very progressive position and set up a mechanism for such technical cooperation on IFFs and eventually engage its partners from the North. However, the opportunity has been missed.

The current work therefore aims to share some of the success stories and case studies from the Asia-Pacific region to enhance the understanding of strategies that can help curb the problems associated with IFFs. It is hoped that the lessons learnt in Asia may help African countries to develop their own policies and strategies in tune with their unique contexts and national realities.

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62 UNCTAD, UNECA and UNODC. (2018). *Expert meeting on statistical methodologies for measuring illicit financial flows*. Concept Note, UNCTAD. [https://unctad.org/meetings/en/SessionalDocuments/stat2018\\_em\\_iff0620\\_cn\\_en.pdf](https://unctad.org/meetings/en/SessionalDocuments/stat2018_em_iff0620_cn_en.pdf).

63 —. n.d. *UN Inter-Agency Task Force on Financing for Development*. Accessed 2018. <https://www.un.org/esa/ffd/ffd-follow-up/inter-agency-task-force.html>.

64 Ibid.

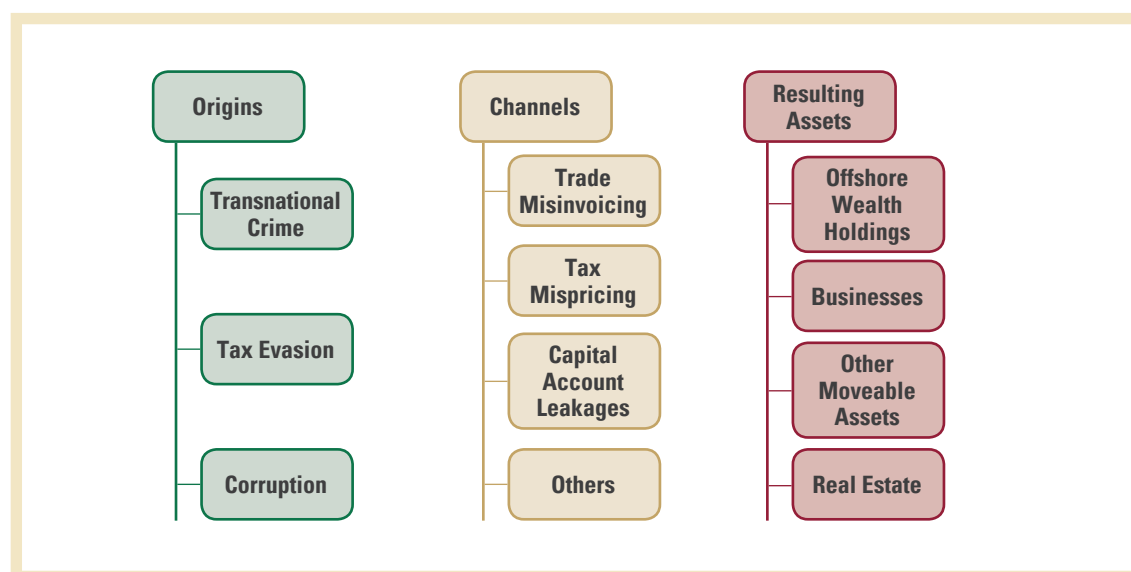
65 UNOSSC. (2009). *The UN General Assembly adopted on 21 December 2009 the Nairobi Outcome Document*. Accessed 2018. <http://southsouthconference.org/wp-content/uploads/2010/01/GA-resolution-endorsed-Nairobi-Outcome-21-Dec-09.pdf>.

### 5.1.5. What are the Main Channels through which IFFs Operate?

Globally, IFFs can be divided into three main components (see Figure 5.1):

- Proceeds from commercial tax evasion mainly through trade mis-invoicing, transfer pricing and laundered commercial transactions by multinational corporations;
- Corruption, proceeds from theft and bribery mainly by government officials or individuals; and
- Proceeds from criminal activities, including drug trading, counterfeit currency and trade in contraband goods.

Figure 5.1: Channels of Illicit Financial Flows



IFFs occur mainly through the following three channels or means:

**Cross-border trade** – GFI has estimated that 87 percent of IFFs were due to trade mispricing<sup>66</sup>. Hence, the first line of defense has to be at the borders. Customs authorities have an important role to play in combating IFFs while facilitating legitimate trade<sup>67</sup>. The misuse of trade for the movement of illicit funds, as well as the physical cross-border movement of money and natural resources, are areas that relate directly to customs’ competence and expertise, and need to be subject to strong enforcement measures. Banking systems are also used as a channel for cross-border IFFs related to mis-invoicing.

**Banking systems** – The reality is that the large sums of money involved in IFFs are often moved through the financial system. Therefore, a growing need for an era of financial transparency is imperative, as issues of beneficial ownership come to the fore. Banks have a greater legal responsibility in detecting and reporting suspicious transactions than they would have previously considered. This includes identifying the source and purpose of fund transfers and establishing the beneficial ownership of recipients. This channel is mainly for the purpose of commercial tax evasion through transfer pricing and trade mispricing or mis-invoicing. The main preventive mechanisms include appropriate regulation of the financial systems.

66 GFI, ‘Illicit Financial Flows to and from developing countries: 2005-2014.

67 World Customs Organization, “Customs and the Fight Against Illicit Financial Flows: World Customs Organization Plan”, <http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/enforcement-and-compliance/activities-and-programmes/iff/wco-iff-action-plan.pdf?la=en> (2017).



**Disruptive technologies** – New non-financial digital tools for money transfers, such as online and mobile banking, electronic payments, cryptocurrencies, e-commerce providers, and online gambling services, especially if they are combined, provide a countless number of opportunities to distance money from illegal sources of profit, or to illegally transfer money from legal sources. New forms of doing business online, and the digital economy as a whole, facilitate the transfer of illegal profits and the aggregation of illicit funds in offshore accounts, and their placement in fake e-commerce companies and offshore online businesses. These may be curtailed by stringent regulations, attractive incentives and formalizing the informal transfer. Currently, the regulations for these tools are not in place in many countries. Furthermore, developing countries will likely be further disadvantaged as they have no tools to tax the digital economy.

## 5.2. Case Studies from the Region

### 5.2.1. Bangladesh

The International Monetary Fund (IMF) estimates that a country has to contribute at least 15% of GDP in taxes to provide services for development. Bangladesh had a low tax-to-GDP ratio of around 9.6 percent in 2015<sup>68</sup>. More than 80 percent of the country's revenue comes from taxation; 30 percent of these taxes are collected by way of direct taxes. The country has also faced a steadily growing problem of revenue loss to IFFs over the years. Since 1976, the country has lost USD 24.7 billion to illicit financial flows<sup>69</sup>. The 'Swiss bank account' deposits for Bangladesh nearly doubled between 2012 and 2014<sup>70</sup>. Among least developed countries, Bangladesh is estimated to be the largest contributor to IFFs with an average annual outflow of USD 5.6 billion in the decade between 2004 and 2013, mainly attributed to trade mispricing, which represents 88 percent of these flows<sup>71</sup>.

Bangladesh's total trade equals approximately 50 percent of its GDP; however trade taxes generate only 35 percent of overall government revenue<sup>72</sup>. Bangladesh's cumulative illicit flows from 2002–2011 were USD 17.1 billion, which represented 2.1 percent of GDP, 5.8 percent of total trade and 122.9 percent of ODA during the same period<sup>73</sup>.

A brief outline of the issues along with the steps that are being taken to curb IFFs is provided below:

- i) **Adopt international regulations to curb IFFs** – In an attempt to tackle the illicit flows associated with trade mis-invoicing, Bangladesh's customs undertook a comprehensive reform to follow 'international best practice' throughout their operations. This included the introduction of the Automated System for Customs Data World (ASYCUDA)<sup>74</sup> computerized system, which has been available since the mid-1990s. Over the years, many reforms and changes have taken place, and more are underway to make the customs formalities correct,

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68 Seraul Quadir, "World Bank says bureaucracy a major weakness of Bangladesh economy", <https://www.reuters.com/article/economy-bangladesh-worldbank-idUSL3N1444QM20151215> (December 15, 2015).

69 The Daily Star, "Illicit Money Flies of Bangladesh", <https://www.thedailystar.net/money-flies-away-from-bangladesh-30220> (2015).

70 Rejaul Karim Byron and Md Fazlur Rahman, "Swiss Banks: Deposits of Bangladeshis Tk 4,423cr". Asia News Network. <https://www.thedailystar.net/frontpage/deposits-bangladeshis-tk-4423cr-1248571> (2015).

71 Kar D. and Joseph Spanjers (2015). Illicit Financial Flows from Developing Countries: 2004–2013. Global Financial Integrity.

72 Biplob Kumar Nandi and Bazlul Haque Khondker, "Cost-Benefit Analysis: Strengthening the Tax Base in Bangladesh" [https://www.copenhagenconsensus.com/sites/default/files/khondker\\_vat.pdf](https://www.copenhagenconsensus.com/sites/default/files/khondker_vat.pdf) (2016).

73 UNDP, UNODC and Global Financing Integrity. "Coming to grips with Illicit Financial Flows in Asia-Pacific" (2015).

74 ASYCUDA is a computerised customs management system which covers most foreign trade procedures. This software is developed by UNCTAD, Geneva. <https://asycuda.org/about/>.

simple and easier. However, the system has only recently been deployed throughout Bangladesh. The National Board of Revenue (NBR) is currently strengthening the customs clearance process by adding new functionalities and establishing linkages and interfaces.

#### **Box 5.1: ASYCUDA**

**Automated System for Customs Data known as ASYCUDA** is an innovative, efficient and effective method for customs procedures that can be adopted by any modern custom authority world-wide. In 1981, UNCTAD had a request from the secretariat of the Economic Community of Western African States (ECOWAS) to assist in the compilation of foreign trade statistics in their Member States. While conducting the job, they observed that without the expertise and involvement of customs administration, as well as the automation and modernization of the customs procedures, it would not be feasible to acquire data or compile foreign trade statistics in an appropriate manner. As such, the system has been introduced, and over the years, the ASYCUDA technical development unit has designed and developed the most sophisticated automation system and tools that ensure faster processing of documents, automatic verification and accounting of customs declarations.

*Source:* ASYCUDA World Operations – Bangladesh Perspective by M.A.Jabbar, 2017

ASYCUDA acts as a single window covering government agencies, different ministries, the Central Bank, commercial banks and other financial institutions; as well as stakeholders such as insurance, agriculture, and others. Also, Bangladesh Bank's existing online reporting system of import and export data has created an avenue for adopting and implementing the automated customs data in an appropriate manner. This allows for the reporting of all the import and export data through the online monitoring system; and customs formalities for the clearance of imported goods in a transparent, faster, easier and economic way. Technological capacity development and modernization of border control mechanisms is needed to make the best of ASYCUDA.

- ii) **International cooperation for the repatriation of stolen assets** – Transparency International Bangladesh (TIB) has expressed deep concern over the growing illicit flight of money out of the country, and has called upon the government to take advantage of the relevant national and international legal instruments, including the United Nations Convention against Corruption (UNCAC)<sup>75</sup>, to repatriate stolen assets and bring to justice those involved in this crime. In this regard, the Government of Bangladesh can arrange for a mutual legal assistance with the Swiss and other Governments of host countries harboring corrupt money, to arrange for the return of stolen assets. As a State Party to UNCAC, Bangladesh can secure legal and technical cooperation, and support from other State Parties of the Convention. The repatriation by Singapore to Bangladesh in February 2013 of approximately USD 1.6 million, in addition to confiscation of other assets of the convicted, is an example in point.

Similarly, Bangladesh is working towards the repatriation by the Bangladesh Bank of a total of USD 81 million. In early February 2016, this money was illegally transferred to four fictitious accounts at a branch of the Rizal Commercial Banking Corporation (RCBC) in the Philippines, from the foreign reserve account of the Bangladeshi central bank at the Federal Reserve Bank of New York. Both countries are working harmoniously to return the money. Some countries, like Switzerland and Singapore, have recently become more proactive than before in facilitating repatriation of stolen money to the countries of origin, which may be helpful for Bangladesh. For example, Singapore can provide a full account of resources held by nationals of a partner country in Singapore.

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75 UNCAC is a multilateral treaty negotiated by Member States of the United Nations and promoted by the UN Office on Drugs and Crime.

- iii) **National Strategies to stem IFFs** – Bangladesh is working on its anti-money laundering regime in a stringent way, following the Review of the Implementation of the UNCAC in 2012. The main issue is that there is no legal obligation for companies to hold information on their beneficial owners. The compliance with the regulatory mechanisms that do exist has been extremely low. It is most likely that the anonymous companies are the default way to do business. This represents a major vulnerability for the country's economy.

As a result, the country's NBR is establishing a separate cell to gather information on siphoned funds, and to scrutinize the income of dual citizens. There is a need for greater coordination between NBR and the Anti-Corruption Commission (ACC) to limit cross-border tax evasion and to address trade-based money laundering by multinational corporations (MNCs). A separate wing in the ACC may be helpful in keeping up with domestic tax dodging in real estate transactions, gold smuggling and illegal capital flows.

- iv) **Understanding disruptive technologies to curb IFFs** – Capital transfer for Bangladesh is often practised through the Hundi system to buy property, invest in business and capital markets, or to simply deposit in a bank account likely in an offshore centre, to hide it away from the prying eyes of the tax authorities and other parties. The lion's share of foreign exchange, which gets into the Hundi market comes from about eight million overseas Bangladeshi workers and the diaspora. The use of Hundi money for the financing of smuggled goods into Bangladesh is arguably the main source of foreign exchange leakages. Additionally, the remittance inflow has seen negative growth in Bangladesh for the past several years, although the number of expatriates has increased. The inward remittance has decreased by USD 1.96 billion or 16.02 percent in the financial year 2016–2017, compared to the corresponding period of 2015–2016. In 2015–2016, it was estimated that the size of the funds flowing away from the country through Hundi by under-invoicing was over USD 5.0 billion, even at a very conservative estimate<sup>76</sup>.

To deal with such user-friendly, yet disruptive technologies<sup>77</sup>, the government can choose a policy under which it will give banks the remittance handling fees comparable to Hundi rates. The government can also offer some attractive investment opportunities for the money remitted through legal channels. These steps will certainly encourage expatriates to send money home through banking channels and thereby help enhance the remittance figure.

- v) **South-South and Triangular Cooperation** – Financial transparency is still weak in this country, making it easier for traders to abuse the system. The government has a few tax treaties with other states in South Asia in effect; however, they have their flaws. For example, Bangladesh signed one of the first multilateral tax information exchange arrangements in 2005 with the South Asian Association for Regional Cooperation (SAARC) Members. This has not been useful because the information exchange only happens on request. As a consequence, Bangladesh needs to work more on its policies at a regional level to boost government's access to information. Bangladesh and other countries could use the mutual benefits principle of South-South Cooperation to curb IFFs. The example of Singapore, if replicated with other countries, could be effective. To secure more support along this line, Bangladesh and other developing countries may sign the OECD Automatic Exchange of Information, or become a member of the OECD's Global Forum on Transparency and Exchange of Information (AEOI) for Tax Purposes to gain access to information and thereafter formulate strategies to deal with illegally siphoned money.

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76 Syed Ashraf Ali, "Capital flight: An enduring conundrum" <https://thefinancialexpress.com.bd/views/capital-flight-an-enduring-conundrum> (June 9, 2016).

77 See glossary of terms section.

## 5.2.2. India

In India, IFFs or 'black money' in local terminology, are systematic and systemic. The most common ways in which IFFs occur in the country include out-of-the-book transactions, manipulating books of accounts, mis-invoicing trade receipts, transfer mispricing and round tripping. IFFs in India are most often found in land and real estate deals, bullion, counterfeit currency, financial market transactions and public procurement. There have been several estimates to determine the size of India's black economy with respect to the country's GDP – ranging from Nicholas Kaldor's estimate of 4–5 percent in 1956, India's National Institute of Public Finance and Policy at 18–21 percent in 1985, and Arun Kumar's 62 percent in 2015<sup>78</sup>.

Capital flight was valued at USD 28.6 billion between 1971–1986. India is estimated to have lost USD 510 billion in IFFs between 2004–2013. The average trade mis-invoicing outflows to total trade in the same period were 10.3 percent and India was ranked 4<sup>th</sup> in Asia. Illicit outflows averaged USD 473 million in 2010 and 2011. However, the methodologies employed couldn't accurately calculate trade manipulation in services, proceeds from crime, *hawala* and *round tripping*.

For instance, 'round tripping', or rerouting illicit capital held offshore as foreign direct investment (FDI) is a big challenge in India. The Department of Industrial Policy and Promotion has shown that between April 2000 and March 2011, FDI from Mauritius (widely considered a tax haven) stood at 41.8 percent of the entire FDI received in that decade. FDI from Mauritius in 2016–2017 stood at USD 15.72 billion, and from Singapore at USD 8.71 billion<sup>79</sup>. Comparing the size of the country and its share in the total FDI in India, it is very difficult to employ methodology to accurately calculate the 'round tripping' value in this total value.

India has adopted and supported a few transparency reforms, as discussed below:

- i) **Adoption of international regulations to curb IFFs:** India joined the standard of OECD's Automatic Exchange of Information (AEOI) in 2015, and began exchanging information in 2017. By this measure, Indian tax authorities are able to receive tax information regarding Indian citizens from other countries. Thus, if an Indian citizen has an account in a Swiss bank, and has a balance over a certain threshold, their information will be sent to the Indian tax authorities automatically. This will not only deter tax dodging and crime, but also enable investigations by tax authorities. Since 2011, India has been vocal in its support for the establishment of a global, democratic, inter-governmental tax body under the auspices of the UN, maintaining that it would be "crucial for the effective implementation of the 2030 agenda".

Country-by-Country Reporting (CbCR) of MNCs Operation and Tax Data: Information about the operations of MNCs tends to be unclear and obscure. Currently, MNCs are able to exploit loopholes in domestic and international tax laws to shift their profits from one country to another (often through tax havens), and avoid paying their fair share of taxes in the countries where MNCs have a business presence. As a result, India announced the adoption of the CbCR requirements for MNCs in the Union Budget 2016–2017, to ensure that large corporations operating in India have to report their data to Indian authorities. The new documentation regime was applicable from 1 April, 2016 with the first filing by 30 November, 2017.

Furthermore, source-based taxation as a policy allows a country to tax MNCs creating real economic activity or value within their jurisdiction, without permanent establishment in the country. A primary concern for state authorities has been taxing companies providing services

78 Arun Kumar, "Estimation of the Size of the Black Economy in India, 1996–2012" <https://www.epw.in/journal/2016/48/estimation-size-black-economy-india-1996-2012.html> (November 26, 2016).

79 Live Mint, "Mauritius dislodges Singapore to top India's FDI charts in 2016–17" <https://www.livemint.com/Money/ljiFTvs8yPPqA5LI6GqM9O/Mauritius-dislodges-Singapore-to-top-Indias-FDI-charts-in-2.html> (May 28, 2017).

with 'virtual presence' in the source country. Therefore, an 'equalisation levy' at 6 percent was introduced in 2016 by the Ministry of Finance to tax such companies. Keeping in line with the source-based taxation policy, the agreement has also focused on expanding the scope of 'permanent establishment' provisions. Additionally, timely exchange of information across countries will enhance such efforts in combating IFFs through tax evasion by MNCs.

- ii) **National Strategies:** A mixed strategy for curbing the generation of 'black money' from legal and legislative activities consists of different pillars, such as:
- Reducing disincentives against voluntary compliance (such as reducing transaction costs of compliance and administration, further economic liberalization);
  - Effective implementation of the tax laws can arrest tax evasion. Relaxation in tax laws, simplification of tax laws, removal of drawbacks in the tax system, and proper processing of information available can be the best tool for the betterment of Indian tax compliance;
  - Reforms in vulnerable sectors of the economy (such as in the financial sector, real estate, bullion and jeweller sector, cash economy, mining and allocation of property rights over natural resources, equity trading, misuse of corporate structures for the generation of black money, non-profit organizations and the corporate sector);
  - Creating effective credible deterrence (such as integration of databases leading to action by monitoring agencies, enhanced exchange of information, income-tax overseas units, efforts to be undertaken at international forums, international taxation and transfer pricing, effective curbing of structuring through tax havens, supporting indirect tax administration, Financial Intelligence Unit, Central Economic Intelligence Bureau, the Directorate of Revenue Intelligence and Enforcement Directorate, Joint Task Force); and
  - Supportive measures (such as creating public awareness and public support, enhancing the accountability of auditors, protection of witnesses and whistleblowers, the need to join international efforts and use platforms, requires the fine tuning of relevant laws and regulations).

Some examples are detailed below:

- Anonymously owned companies facilitate embezzlement and secrecy. India has implemented a law for creating a registry of beneficial owners of companies registered in India, in the Companies (Amendment) Act, 2017. This policy measure will ensure that the Registrar of Companies, under the Ministry of Corporate Affairs, will have information about the owners (specifically persons) of each company set up in India – which will help track down the people responsible for any crime or tax abuse. In addition, in the Budget 2016–2017, a new scheme was unveiled under which those with undisclosed income and assets located in India could come clean by paying a tax of 45 percent. As an outcome, the tax department reported recovery of INR 65 billion (approximately USD 1 billion) from 64 275 declarations.
- Demonetisation policy – The formal announcement of demonetisation of high currency denomination notes of INR 500 and INR 1000 worth nearly INR 15.4 trillion (USD 0.23 trillion) constituting about 87 percent of the currency in circulation, took place on 8 November, 2016. The Reserve Bank of India (RBI) under its annual report ending June 2017 announced that 99.3 percent of the demonetised notes came back to the Central Bank, only 1 percent did not come back<sup>80</sup>.

This move was aimed at curbing corruption, eliminating counterfeit currency and terrorism funding. Academics concurred that demonetisation helped the government

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80 Indian Institute of Public Administration, "The 63<sup>rd</sup> Annual Report 2016–2017" (New Delhi: Indian Institute of Public Administration).

to get a sound grasp on the monitoring of tax evasion and corruption ('black money') while increasing oversight of citizens' activities. The fiscal and monetary goals were meant to generate higher revenue and force more economic activity in the banking system. Demonetisation has helped in reducing cash in the hands of people and improved the deposits base in the banking sector to maintain capital requirements amid the new accord of Basel III.

#### **Box 5.2: Basel III on Banking Supervision**

Basel III is a comprehensive set of reform measures developed by the Basel Committee on banking supervision, to strengthen the regulation, supervision and risk of the banking sector.

The Basel Committee is the primary global standard-setter for the prudential regulation of banks and provides a forum for cooperation on banking supervisory matters. Its mandate is to strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability.

The Basel III reforms in 2017 seek to restore credibility in the calculation of risk-weighted assets (RWAs) and improve the comparability of bank's capital ratios. RWAs are an estimate of risk that determines the minimum level of regulatory capital a bank must maintain to deal with unexpected losses.

Source: <https://www.bis.org/bcbs/basel3.htm>

- iii) **South-South and Triangular Cooperation:** India needs to make concerted efforts towards adequately staffing and enhancing the capacity of its taxation and customs departments. The fight against this systemic issue requires coordination among countries at regional and global levels; and countries should join forces on an equal footing to address the generational and corrosive impacts of IFFs.

For example, in an attempt to deal with transfer mispricing, India has revised its Double Taxation Avoidance Agreement (DTAA) with countries like Mauritius, Cyprus, Singapore and others.

### **5.2.3. Indonesia**

Indonesia's total illicit flows from 2002–2011 were USD 495.66 billion; the average annual IFF figure from trade mis-invoicing was USD 49.57 billion, which represents 13.2 percent of GDP, 27.6 percent of total trade, and 8 208.3 percent of ODA<sup>81</sup>. Based on a study by an Indonesian research team<sup>82</sup>, *Calculating Illicit Financial Flows to and from Indonesia: a Trade Data Analysis, 2001–2014*, the following key findings are summarised:

- The value of illicit financial inflows are always bigger than illicit financial outflows. The total accumulated funds inflow is USD 628.9 billion while the total accumulated outflow is USD 217.3 billion.
- Based on the annual analysis from 2001–2014, the largest illicit financial outflow from Indonesia took place in 2012 with an estimated value of USD 24.5 billion.
- The top three countries with the largest financial inflow values were Singapore, China, and Japan. For example, the annual average of illicit financial inflows to Indonesia from Singapore was USD 15.6 billion. Illicit financial inflows do not always have positive impacts on the receiving country. Consumption might increase due to influx of funds into a country, but in most cases, this flow of funds can be used to the finance criminal activities, such

81 GFI, "Illicit Financial Flows from Developing Countries: 2002–2011".

82 Perkumpulan Prakarsa, "Calculating Illicit Financial Flows to and from Indonesia: a Trade Data Analysis, 2001–2014" (2016).

as terrorism, drug investment, and trade in exotic animals. Also, many rich Indonesians have companies and properties in Singapore. Trading activities between their companies and production activities in Indonesia could possibly drive the fund inflows to Indonesia.

- Furthermore, as the saying goes, “bad money drives out good money”. The illicit financial inflows could affect confidence in the Indonesia economy and discourage FDI.
- Illicit financial outflow is clearly harmful for a country’s economy, as it means large amounts of money going out of a country and a loss of potential tax revenues. The top three countries with the largest financial outflow values were Saudi Arabia, China, and Singapore. Illicit financial outflows from Indonesia to Saudi Arabia were USD 2.1 billion on average, followed by China at USD 1.55 billion, and Singapore at USD 1.4 billion per year for the period 2001–2014.

A brief summary of the issues along with the steps that are being taken, is provided below:

- i) **National Strategies:** The Directorate-General of Customs and Excise, under the Ministry of Finance, implemented a proprietary single administrative document and single-window reporting system which standardizes the information and interface of what trading parties and customs inspectors see and use. However, the administration needs to share this information with relevant stakeholders to further curtail trade mis-invoicing.

Indonesia also has a substantial number of export restrictions in place. In an effort to improve the transparency, consistency, and efficiency of export and/or import process of international trade activities, the government has issued Regulation 44/2018. This regulation relates to the management and organization of the Indonesia National Single Window (INSW) system, the national single window agency, the single window service unit, and the steering committee. However, achieving meaningful results in establishing single window systems depends principally on building genuine collaboration between stakeholders which is yet to be achieved.

- ii) **Adopt international regulations to curb IFFs:** The Financial Action Task Force (FATF) Mutual Evaluation Report (MER) in July 2008 reported that the government does have a corporate registry, but the utility of this registry is undermined by the lack of a requirement to include beneficial ownership transparency information. Therefore, it is recommended that the Government create supportive policies in this regard. The 2012 Global Shell Games report<sup>83</sup> ranked Indonesia at 20% of compliance enforcement of company formation agents. The GFI 2010 reports that worldwide, 60–65% of the total illicit funds came from internationally based companies. That being said, non-compliance of regulations may be a key factor of illicit funds. Other positive fundamentals of financial transparency for Indonesia include having a financial intelligence unit (FIU) and the existence of customer due diligence (CDD) laws, both of which are critical for effective anti-money laundering. Since 2010, Indonesia has been a candidate for the Extractive Industries Transparency Initiative (EITI), to implement the OECD’s automatic exchange standard for account information for tax purposes. Indonesia being a country rich with natural resources, requires near complete compliance to EITI to promote government revenue and accountability in extractive sectors.
- iii) **Programs to repatriate offshore assets:** The Government of Indonesia finally launched its ambitious tax amnesty program on 18 July 2016. Funds that were repatriated in 2016 through the tax amnesty program were required to remain in Indonesia for at least three years. The government selected 18 financial institutions, 18 investment managers and 19 stockbrokers to handle these funds.

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83 <https://www.gfintegrity.org/wp-content/uploads/2014/05/Global-Shell-Games-2012.pdf>.

### Box 5.3: Tax Amnesty Program of Indonesia, 2016

The program mainly aims to improve tax compliance in Indonesia, boost the government's tax revenue and encourage the repatriation of offshore assets. The Indonesian government estimated that some IDR 4000 trillion (approx. USD 303 billion) worth of "Indonesian money" is secretly stashed abroad in tax havens. By offering tax incentives and immunity from prosecution (although a small penalty needs to be paid), the Indonesian government tried to make it attractive for (former) tax evaders to declare their offshore funds to Indonesia's tax authorities and – if desired – repatriate these funds into Indonesia. If an Indonesian taxpayer decides to move assets into Indonesia, then it needs to be moved to specific investment instruments that were prepared by the Indonesian government and the financial authorities (Bank Indonesia and the Financial Services Authority, or OJK). These investment instruments were prepared in an effort to absorb the potential excess liquidity that could be caused by the huge inflow of assets into Indonesia's financial system.

"Indonesia's 2016/17 tax amnesty initiative was a success by global standards," said Hans Anand Beck, senior country economist for the World Bank in Indonesia. "Total declared assets reached 122.1 percent of the government's Rp 4000 trillion (USD 302 billion) target; however, the share of declared offshore assets that were repatriated only reached 14.7 percent of the government's Rp 1000 trillion (USD 75.4 billion) target," he added.

Legal reforms also received a boost in May 2017 when the government introduced a new regulation granting tax authorities greater access to information on accounts in domestic financial institutions, such as bank accounts. The legal reforms are aimed at improving monitoring and enforcement, thus further demonstrating Indonesia's commitment to joining the OECD's Automatic Exchange of Information (AEOI) initiative.

- iv) **Regional Cooperation:** Association of Southeast Asian Nations (ASEAN) governments have made commitments to implement the ASEAN Single Window (ASW) via the National Single Windows (NSWs) to address businesses' concerns regarding administrative issues at the borders. ASEAN countries have several commitments<sup>84</sup> for facilitating trade in the region, such as the establishment of ASEAN e-custom, enhancement of customs efficiency and effectiveness, and the setting up of an ASEAN Trade Facilitation Repository and a regional cooperation mechanism. In the AEC 2025 Blueprint and subsequent Action Plan, trade facilitation encompasses several commitments, such as the elimination of non-tariff barriers, customs integration, ASEAN Single Window, and others. In 2018, ASEAN Economic Ministers announced their target to reduce transaction costs for ASEAN trade by 10 percent by 2020. Along with other trade facilitation initiatives such as the creation of the ASEAN Trade Repository, the ASEAN Tariff Finder, and the ASEAN Solutions for Investments, Services and Trade (ASSIST), the implementation of the e-ATIGA Form D seeks to increase the ease of doing business within the region, a welcome step toward an integrated single ASEAN market. Implementation of such programs will curb IFFs, by reducing burdensome customs procedures within ASEAN and advance the principles of South-South Cooperation.

#### 5.2.4. Malaysia

IFFs from Malaysia have been growing rapidly for over a decade. By encouraging Malaysian corporations to invest abroad, 'legitimate outflows' have also been growing rapidly with financial liberalization. Many international financial centres are involved in intense competition to attract customers by offering lower tax rates and banking secrecy. As per the GFI report, Malaysia lost up to USD 431 billion in illicit outflows between 2005 and 2014. Malaysia was ranked fifth among all

84 These include customs modernization, adoption of international best practices for uniform tariff classification, customs valuation and origin determination.



countries for illicit capital flight but took first spot on a per capita basis and accounted for around 6 percent of total illicit flows of all developing countries. In 2014, Malaysia's illicit financial outflows were between 6–10 percent of its total trade while inflows were 8–13 percent of the country's total trade of USD 443 210 million. About 87 percent of illicit financial outflows from 2005–2014 were attributed to fraudulent 'trade mis-invoicing'.

Jomo KS and Raisa Muhtar, Malaysian researchers reported that Malaysia is experiencing 'premature deindustrialisation' while counting on growth of services<sup>85</sup>. They also pointed out the official ambition for Malaysia to become another global financial centre in the face of premature deindustrialisation. As a result, authorities have been promoting financial liberalization at the expense of exposing the country to greater macro-financial risk. As a recipient of capital inflows, Malaysia has benefited significantly in terms of lowering financing costs, increased technological transfers, and higher investment and economic growth<sup>86</sup>.

**Table 5.1: Malaysia – Total Illicit IFFs, 2005–2014**

Illicit Financial Flows (%)				Trade Mis-invoicing (%)				BoP Leakages (%)		Total trade (USDm)
Outflows		Inflows		Outflows		Inflows		Outflows	Inflows	
Low	High	Low	High	Low	High	Low	High			
8	12	8	13	6	10	8	13	2	0	3 587 978

**Table 5.2: Annual Illicit Financial Flows, 2005–2013**

2005	2006	2007	2008	2009	2010	2011	2012	2013
35 255	36 554	36 525	40 779	34 416	62 154	50 211	47 804	48 251

The Malaysian Anti-Corruption Commission works closely with national bodies like Bank Negara Malaysia, the Inland Revenue Board, Royal Malaysian Customs and the Royal Malaysian Police to enhance tax collection, increase government transparency, improve natural resource control by the government and enable public scrutiny of revenues and other national budgets. A further recommendation would be for Malaysia to become a member of the Extractive Industries Transparency Initiative, which is a very productive program for improving transparency. Malaysia is largely compliant with FATF recommendations in financial transparency and anti-money laundering. Yet, the electronic filing systems are outdated, and need to be upgraded and hence the accuracy of the system may be questionable.

### 5.3. Role of Financial Institutions

In many of the case studies, integrity of the financial institutions is a key question for the general public, owing to their perceived corruption and engagement in the shadow economy. A 2017 report by the Royal United Services Institute<sup>87</sup> suggests that greater independence between power structures and financial institutions is required to enhance public trust of formal banking.

Effective know your customer (KYC) regimes or customer due diligence (CDD) to identify, verify, and monitor financial service providers' (FSP) customers, represent the hallmark of national anti-money laundering (AML)/combating the financing of terrorism (CFT) policy frameworks and help preserve the integrity of financial markets. Nevertheless, policy responses at the national level

85 Jomo KS and Raisa Muhtar, "Malaysia's Illicit Financial Flows" <https://www.freemalaysiatoday.com/category/opinion/2017/10/19/malaysias-illicit-financial-outflows/> (October 19, 2017).

86 Ooi Sang Kuang, "Capital flows and financial assets in emerging markets: determinants, consequences and challenges for central banks: the Malaysian experience" <https://core.ac.uk/download/pdf/7354085.pdf> (December 31, 2007).

87 Iain, *et al.*, "illicit financial flows and corruption in asia", (royal united services institute, 2017).

stemming from global standards setting bodies – such as the FATF and the Basel Committee on Banking Supervision (BCBS) – can sometimes exclude segments of the population, such as women, who are less likely to fulfill documentation requirements during the customer identification and verification stage of the CDD process. Thus, policymakers and remittance service providers need to strike the right balance between preserving financial stability and improving financial inclusion. Stringent AML/CFT has equally had unintended consequences for financial inclusion, resulting in people using informal money transfers in unregulated markets. Some steps are being taken in this direction by international agencies as illustrated below.

#### 5.4. Efforts by International Organizations and Donors

- The Stolen Asset Recovery Initiative (StAR) is a partnership between the World Bank Group and the United Nations Office on Drugs and Crime (UNODC), which supports international efforts to end safe havens for corrupt funds. StAR works with developing countries (mainly in South and Southeast Asia) and financial centers to prevent the laundering of the proceeds of corruption and to facilitate more systematic and timely return of stolen assets<sup>88</sup>.
- Asset Recovery Interagency Network-Asia Pacific (ARIN-AP) is an informal network of experts/practitioners in the field of asset tracing, freezing and confiscation, which intends to serve as a cooperative group in all aspects of tackling the proceeds of crime in the Asia-Pacific region<sup>89</sup>.
- A framework such as the UNODC's Central Asia Regional Information and Coordination Centre<sup>90</sup> offers the legal framework and mechanism for information-sharing on drug trafficking.
- The Framework Agreement on Facilitation of Cross-border Paperless Trade in Asia and the Pacific adopted on 19 May 2016 by the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP), is dedicated to the digitalization of trade processes. It also encourages seamless electronic exchange and legal recognition of trade-related data and documents across borders, rather than only between stakeholders located in the same country. This agreement is also expected to reduce trade mis-invoicing.
- The United Nations Development Programme (UNDP) in Nepal launched an Enhancing Access to Financial Services project from 2008–2012, which sought to increase banking access in rural areas, strengthening the micro-finance institutions in the Central African Republic, Democratic Republic of Congo, Georgia, India, Mongolia, Myanmar, Nepal and Timor-Leste<sup>91</sup>.
- As of 2015, ASEAN Finance Ministers and central bank governors met yearly to address opportunities and challenges to enhance regional integration as part of the ASEAN Economic Community. The IMF, World Bank and the Asian Development Bank (ADB) take part in these meetings. Due to the combination of insufficient political will in South Asia to function regionally through the South Asian Association for Regional Cooperation (SAARC), and illicit flows that run through Southeast Asia, linking China with Central and South Asia, the above-mentioned organizations are planning to come together and strategize on policies to integrate ASEAN member countries into a solution to tackle illicit regional flows.

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88 World Bank and UNODC, "Stolen Asset Recovery Initiative", <<http://star.worldbank.org/star/>>, (2017).

89 ARIN-AP, "Asset Recovery Interagency Network – Asia Pacific" <http://www.arin-ap.org/main.do> (2013).

90 CARICC, "Central Asian Regional Information and Coordination Centre" <http://www.caricc.org/index.php/en/> (2017).

91 UNDP, "UNDP Microfinance and Financial Services Projects", [http://www.us.undp.org/content/dam/washington/docs/CountryPapers/NEW\\_Papers/Microfinance%20and%20Financial%20Services.pdf?download](http://www.us.undp.org/content/dam/washington/docs/CountryPapers/NEW_Papers/Microfinance%20and%20Financial%20Services.pdf?download) (December 2014).

- The UNCDF’s Mekong Remittance report (2017)<sup>92</sup> demonstrated the prevalence of unregulated channels for remittance flows, whereby 54 percent of the 4.3 million remittance recipients across Cambodia, Laos, Myanmar and Vietnam received money through informal channels, with over 60 percent of remittance recipients being women, with many residing in rural areas (75 percent). As such, it reports that “transitioning migrants from using informal to formal remittance products can potentially add an additional USD 6–17 billion to the formal Cambodia, Myanmar, Laos, Vietnam (CMLV) remittance market, which in turn, strengthens the resilience of central bank systems through improved balance of payments and monetary reserves”.
- UNCDF, in partnership with MAS, implemented a challenge fund window launched at the Singapore FinTech festival (2017) on digital remittances and financial services aimed at improving women’s financial inclusion and empowerment. These Fintech solutions and pilots include cross-border mobile wallets, the strengthening of distribution networks and service delivery, and the implementation of remittance hubs in some least developing nations in the ASEAN region. Moreover, the UNCDF is actively contributing to policy dialogue at the ASEAN and African-Indian Ocean (AFI) regional level and with various central banks in both sending (Singapore, Malaysia, Thailand) and receiving nations (CMLV), including the ASEAN working committee on financial inclusion.
- The United Nations Capital Development Fund (UNCDF) has further collaborated within the UN network as part of the Global Compact on Migration. This includes working with the International Labour Organization (ILO) and International Organization for Migration (IOM), which have completed a triangle study on labour migration and remittances in the Mekong region. UNCDF has also collaborated with the UNHCR in Africa in tailoring remittance services to migrants and refugees who generally lack formal identification. Finally, UNCDF has joined forces with the AFI Global Standards and Proportionality Working Group (GSPWG) to explore policy responses to International AML/CFT standards that advance women’s financial inclusion, whilst limiting AML/CFT risks.

## 5.5. Conclusion and Recommendations

Measuring IFFs remains a key challenge, and methodologies are still being revised to get closer to actual figures. However, it is to be noted that many of the countries, both from the South and the North, are coming together to deal with the issues of IFFs. South-South Cooperation can play the role of a key catalyst in dealing with this universal problem by promoting capacity development, knowledge sharing and joint research.

Principles of South-South Cooperation, including shared responsibility of countries as well as solidarity and mutual benefit should spur countries towards actions such as repatriation of stolen assets from off-shore (StAR) and unconditional but compulsory sharing of information in relation to trade (EITI; ARIN-AP). If each of the countries from the South work together, many of the problems can be addressed. The following table summarises some of the action that can be taken by the countries:

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92 UNCDF, “Remittances as a Driver of Women’s Financial Inclusion in the Mekong Region”, (UNCDF, Bangkok, 2017).

**Table 5.3: Summary of Issues and Remedies from Case Studies**

Issue	Remedial action	Additional action recommended
Cross-border trade (Trade mis-invoicing)	<ul style="list-style-type: none"> <li>Adopt international regulations such as ASYCUDA</li> <li>Regional cooperation as exemplified by ASEAN trade-related mechanisms</li> </ul>	Technological capacity development and modernization of border control mechanisms
Illicit flight of money by corrupt officials	<ul style="list-style-type: none"> <li>Repatriation of stolen assets with the help of relevant national and international legal instruments (like UNCAC)</li> <li>Tax amnesty programs</li> <li>Demonetisation policy</li> </ul>	<ul style="list-style-type: none"> <li>Seek legal and technical cooperation</li> <li>Able to handle sensitivity in exchanging secure data</li> <li>Provide a secure information exchange platform</li> <li>Strengthening the AML laws and Financial Intelligence Unit of the country</li> </ul>
Illicit use of natural resources	Implement EITI and FATF	Regional cooperation Advance National Single Window and integrate with regional NSW
Corruption at corporate level (MNCs)	<ul style="list-style-type: none"> <li>Country-by-Country Reporting of MNC Operation and Tax data</li> <li>Member of G20-OECD Base Erosion and Profit Sharing project</li> <li>Revise the Registrar of Companies Act to include all necessary information</li> </ul>	<ul style="list-style-type: none"> <li>Timely exchange of information across countries</li> <li>Source-based taxation policy</li> <li>Enhance policies like Double Taxation Avoidance Agreement with countries</li> </ul>
Disruptive technologies like Hundi	Formalize informal transfers by supportive fiscal policies	<ul style="list-style-type: none"> <li>Attractive investment opportunities for money remitted through legal channels</li> <li>Remittance handling fees as per the need</li> <li>Strict KYC and CDD regulations</li> </ul>

Based on a World Bank Group study the following additional recommendations can be suggested<sup>93</sup>:

- **Global Development Agendas** such as the Addis Ababa Action Agenda (AAAA) and the 2030 Agenda for Sustainable Development contain specific commitments to reduce the flows and increase the return of stolen assets. Therefore, all countries should consider these critical aspects while formulating strategies and policies for the implementation of the Development Agendas.
- **Developing and developed countries** need to work towards a common goal to tackle IFFs, which will require collaborating on management and regulation of finances, governance and transparency, natural resources, trade, and proactive international cooperation on proceeds of crime and tax. Developed countries (financial centres) need to take the lead on preventing inflows of illicit money, while developing countries must address weaknesses in their legal and regulatory regimes that make them susceptible to the activities that lead to IFFs. This is particularly critical for African countries as most stolen assets and proceeds of IFFs are deposited or hidden in developed countries.
- While **private sector** firms expect a business environment with fair, clear and transparent tax and trade policies, they must do their part by ensuring their tax and trade practices comply with local laws. Initiatives like Publish What You Pay<sup>94</sup> are beginning to develop mechanisms to increase transparency around financial arrangements between governments and firms, which is essential for constructive engagement. African countries should possibly agree on the Pan African Code of Investment, which would help them avoid competing against one another, and granting unreasonable advantages to foreign companies.
- **Firms and governments** have gained experience in implementing ‘transparency pacts’ and other forms of collective action to support ethical conduct around particular transactions.

93 World Bank. “Illicit Financial Flows (IFFs)”.

94 Publish What You Pay, “Proud past, bright future”, [http://www.publishwhatyoupay.org/wp-content/uploads/2016/02/pwyp\\_ar2016.pdf](http://www.publishwhatyoupay.org/wp-content/uploads/2016/02/pwyp_ar2016.pdf) (February, 2016).

Increased legal and market risks connected to being associated with corruption have spurred firms to establish ethics and compliance programs, and have generated a growing market in compliance management certification. These examples of private sector efforts, done in collaboration with government, are likely to be an essential element of a coordinated effort to address IFFs.

- **Civil society organizations** have a role to play as advocates to increase transparency around revenues and expenditures, as well as to monitor the behaviour of public and private officials. In the case of Africa, governments should learn to use the advocacy capacity of international non-government organizations (NGOs) to oblige governments of countries of the North as well as multinational companies to return to African government stolen assets or proceeds of IFFs.
- **The international community** needs to address countries and firms seeking to profit from illegal behaviour that undercuts national efforts to implement effective and transparent tax and trade policies.

### ***Glossary of terms***

**ASYCUDA:** Automated System for Customs Data is a computerized system designed by the United Nations Conference on Trade and Development (UNCTAD).

**Automatic Exchange of Information:** The Organisation for Economic Co-operation and Development (OECD) and the G20 have devised the standard for tax authorities to be able to exchange citizens' tax information with each other automatically. This measure is termed Automatic Exchange of Information, and it allows for information such as names, addresses, tax identification numbers and account balances to be exchanged at regular intervals with the account holder's country's government.

**Base Erosion and Profit Shifting (BEPS):** The G20-OECD project requires MNCs with an annual consolidated revenue of over € 750 million to report information regarding revenue accrued, profits earned, taxes paid, number of employees, and assets in a disaggregated, country-by-country basis. This greatly enables governments across the world to ensure that MNCs operating in their jurisdictions pay their fair share of taxes, and spot irregular information and activity that needs further investigation.

**Beneficial ownership:** Beneficial ownership outlines the identity of persons, enabling a Financial Institution (FI) to understand the ultimate recipient of a financial transaction. Anonymous companies are entities that are used to disguise the identity of their true owner – the person (or people) who ultimately control or profit from the company, known as the 'beneficial owners'. Understanding beneficial ownership and those with a controlling stake in the organization is an essential part of a financial institution's anti-money laundering (AML) program. This is in accordance with the guidance from the Financial Action Task Force (FATF) on money laundering.

**Capital flight:** This occurs when assets or money rapidly flow out of a country due to an event of economic consequence.

**Capital transfer:** This involves the transfer of money abroad, mostly through disruptive technologies for the acquisition of property, investment in the business and capital markets, or simply for depositing (likely in an offshore centre, to avoid inquisition from tax authorities and other authorities).

**Customer Due Diligence (CDD):** CDD information comprises customer data that should enable an organization to assess the extent to which the customer exposes it to a range of risks. These risks include money laundering and terrorist financing.

**Direct taxes:** A direct tax is paid directly by an individual or organization to the imposing entity. A taxpayer, for example, pays direct taxes to the government for different purposes including property tax, income tax or taxes on assets.

**Global Shell Games:** This is an invaluable resource for scholars of international relations, and a read for anyone interested in learning about worldwide criminal practice in corporate finance. Every year a staggering number of unidentified shell corporations succeed in hiding perpetrators of terrorist financing, corruption and illegal arms trades. Adopting a unique, experimental methodology, Global Shell Games attempts to unveil the sordid world of anonymous shell corporations.

**Hawala:** An informal value transfer system facilitated by a trusted network of money brokers in India.

**Hundi:** This is an informal money-transfer system in which an expat transfers an amount of money to an agent wherever they are based, and an equivalent payment is made in local currency back in the country. Hundi is cheaper, faster and thought to handle at least as much in remittances as banks, without foreign currency ever crossing the borders (mainly practiced in Bangladesh). The Hundi market needs three things: A demand from a Bangladeshi for foreign exchange that cannot be made according to the foreign exchange regulations; a source of dollars that is outside the control of the Bangladesh central bank; and trustworthy representatives to organize the market.

**Illicit inflows:** In illicit inflows, export values would be greater than corresponding import values, hence relatively more capital would flow to the exporting country. This is possible when the invoice presented at export overvalues the consignment relative to the true market value of the goods being traded, or when the invoice presented at import undervalues the goods relative to their true value<sup>95</sup>.

**Illicit outflows:** Illicit outflows understate export values or overstate import values. It is the sum of over-invoicing of import and under-invoicing of export.

**Indirect taxes:** Indirect taxes can be defined as taxation on an individual or entity, which is ultimately paid for by another person. The body that collects the tax will then remit it to the government. Customs duties levied on imports, excise duties on production, sales tax or value-added tax (VAT) at some stage in the production-distribution process, are examples of indirect taxes because they are not levied directly on the income of the consumer or earner.

**National Single Window (NSW):** This is a nationwide integrated system which is used in processing documents for customs, quarantine, licensing, seaports/airports, and other documents which are related to export and/or import. Through the NSW portal, applicants can submit their applications to the relevant ministry/institution.

**Offshore assets:** Assets secretly kept in 'so-called' tax havens – using shell companies – where investors can enjoy low tax rates.

**Profit shifting:** This is an abusive tax practice that severely impacts the tax base of developing countries. MNCs report on their profits, revenue, taxes paid and number of employees in an aggregate global manner, which does not clarify a corporation's operations in a specific country. This implies that MNCs may be making profits in India, for instance, but could easily shift their profits to a low tax jurisdiction like Hong Kong and justify that transaction as a payment for the use of a patent.

**Round tripping:** Illicit capital held in offshore centres is rerouted to a country in the garb of foreign capital to take advantage of tax incentives offered to foreign investments.

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95 Kravchenko, Alexey (2018). Where and how to dodge taxes and shift money abroad using trade mis-invoicing: A beginner's guide. TIID Working Paper No. 01/18, ESCAP Trade, Investment and Innovation Division, Bangkok.

**Shell banks/companies:** A bank/company which is established without any real clients for money laundering purposes.

**Trade mis-invoicing:** A form of trade-based money laundering, which involves distorting trade receipts by reporting either over or under-invoicing of transactions on intermediaries in a country to avoid taxes. When trade declarations are manipulated such that the stated value of imports exceeds their actual value (**over-invoicing**) and/or the stated value of exports is below their actual value (**under-invoicing**), financial resources are implicitly transferred abroad.

**Transfer pricing:** Approximately 70 percent of all world trade carried out by MNCs occurs between related companies or subsidiaries. The cost related to such transactions between related entities is known as the transfer price. These costs associated with the product or service provided by one subsidiary to another, may vary from the real market price of the transaction between two independent entities.

**Transfer mispricing:** Transfer mispricing allows corporations to shift profits accrued from regions where they operate to a low tax jurisdiction, thereby avoiding taxes across jurisdictions.

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# CHAPTER VI.

## The Role of South-South Cooperation in Combating Illicit Financial Flows

### The South Centre<sup>96</sup>



#### 6.1. Key Dimensions of Illicit Financial Flows

In 2015, illicit financial flows (IFFs) officially became a matter of tax policy and international tax cooperation.

In July 2015, in Addis Ababa, the Member States of the United Nations (UN) agreed to “redouble efforts to substantially reduce illicit financial flows by 2030, with a view to eventually eliminating them, including by combating tax evasion and corruption through strengthened national regulation and increased international cooperation” (UN, 2015a).

UN Member States in Africa led the way in breaking ground on the issue with the commissioning of a High Level Panel on Illicit Financial Flows from Africa in 2011 (led by former South African President Thabo Mbeki) by the Conference of Ministers of Finance, Planning and Economic Development of the African Union and the United Nations Economic Commission for Africa.

The Mbeki Panel Report (2015) took a decidedly different approach<sup>97</sup> to the question of the problem of the unwelcome transfer of capital from developing countries by recognizing that these losses could occur in non-crisis times, not just through the category of ‘capital flight’; these losses could be inflicted through economic transactions and through the tax system. Capital needed for development could be diverted even during boom times, including when foreign capital is gushing inward or external debt is being accumulated. The report recognized this issue as not specific to Africa and applicable to all other developing regions.

In applying the term, ‘illicit’, the Mbeki Panel Report (2015) insisted on the multi-jurisdictional nature of the category of ‘money illegally earned, transferred or used’. As it is now a matter of contention whether IFF applies only to violations of the law, it is important from the outset to reiterate that IFF applies even to legal acts in one location “when the intent... is to hide money even if legitimately earned” through facilities in other locations (Mbeki Panel Report, 2015).

The report classified the types of IFFs into three categories: (i) commercial activities, (ii) criminal activities, and (iii) corruption.

Combating IFFs has become an indispensable element of the new UN development agreement, Agenda 2030 (UN, 2015b), organized around 17 Sustainable Development Goals (SDGs) among which Target 16.4 seeks to significantly reduce IFFs by 2030.

96 Manuel F Montes, Senior Advisor on Finance and Development, The South Centre. I am solely responsible for all errors, opinions and analyses. Email: montes@southcentre.org.

97 See also Montes, Danish, and Uribe (2018).

In a discussion on combating IFFs through South-South Cooperation (SSC), it is important to note at the outset the South Centre, for whom the author works, is itself an instrument of SSC. It is an inter-governmental body of developing countries, set up in 1995 under the leadership of President Julius Nyerere of Tanzania as an offshoot of the South Commission. There are now 54 Member States.

In the area of tax policy and tax cooperation, the South Centre launched a project in November 2016 to build a network of tax officials and experts from the South to advance the role of developing countries in the current global effort at tax reform and combating IFFs. The current chairperson of the South Centre board is former South African President Thabo Mbeki. The tax policy and cooperation program of the South Centre has convened two global Fora, attended by over 60 tax officials from developing countries. The network building project for which the South Centre provides the secretariat, has publications and peer exchange programs. Many of the analyses in this paper are drawn from this network building work, and many of the suggestions for action are part of the agenda of the South Centre's tax project.

## 6.2. South-South Cooperation

As an early practice of SSC, in 1987, the South Commission was established to implement a decision from the 1986 Harare Non-Aligned Summit. The Commission identified 10 major areas of SSC which involved finance, trade, industry and business, services, transport and infrastructure, food security, science and technology, environment, information and communications, and people-to-people contact (Chaturvedi, 2008). In this report, more than a quarter century ago, the South Commission (1990) listed tax reform as a critical policy challenge for the developing countries. The concept of SSC has been elaborated on a series of official meetings in the UN and among developing countries. The principles that have been elaborated on SSC provide fertile ground for work on curbing IFFs.

Like IFFs, the category of SSC is an innovation from the community of developing nations. Like IFFs, there are new controversies surrounding this concept and its practice, particularly when it has the potential to upend norms and practices preferred by Northern countries.

In the UN, the Buenos Aires Plan of Action (BAPA) of 19 December 1978 articulated the basic principles of interaction and collaboration among developing countries, including respect for national sovereignty, non-interference in domestic affairs and equal rights (UN, 1998a; UN, 1998b).

During the meeting held on 10–13 June 2008 in Yamoussoukro, Côte d'Ivoire, governments of the developing countries, formally agreed on the **Yammasoukro Principles** of SSC. These were adopted in the Ministerial Declaration of the 32<sup>nd</sup> Annual Meeting of the Ministers of Foreign Affairs of the Member States of the Group of 77 and China on 26 September 2008 in New York, USA (see G77) and China (2008).

It is important to highlight *selected* key principles as agreed among the developing countries themselves:

- i) SSC is a **common endeavour of peoples and countries of the South** and must be pursued as an expression of South-South solidarity and a strategy for economic independence and self-reliance of the South based on their common objectives and solidarity;
- ii) **SSC and its agenda must be driven by the countries of the South;**
- iii) SSC must not be seen as a replacement for North-South cooperation. Strengthening SSC must not be a measure of coping with the receding interest of the developed world in assisting developing countries;
- iv) **Cooperation between countries of the South must not be analyzed and evaluated using the same standards as those used for North-South relations;**

- v) **Financial contributions from other developing countries should not be seen as official development assistance (ODA) from these countries to other countries of the South.** These are merely expressions of solidarity and cooperation borne out of shared experiences and sympathies;
- vi) **SSC is a development agenda based on premises, conditions and objectives, which are specific to the historic and political context of developing countries and to their needs and expectations.** SSC deserves its own separate and independent promotion;
- vii) SSC is based on a strong, genuine, broad-based partnership and solidarity;
- viii) SSC is based on complete equality, mutual respect and mutual benefit;
- ix) SSC respects national sovereignty in the context of shared responsibility;
- x) **SSC strives for strengthened multilateralism in the promotion of an action-oriented approach to development challenges;**
- xi) SSC promotes the exchange of best practices and support among developing countries in the common pursuit of their broad development objectives (**encompassing all aspects of international relations and not just in the traditional economic and technical areas**);
- xii) SSC is based on the **collective self-reliance** of developing countries;
- xiii) **SSC seeks to enable developing countries to play a more active role in international policy and decision-making processes,** in support of their efforts to achieve sustainable development;
- xiv) The modalities and mechanisms for promoting SSC are based on bilateral, sub-regional, regional and inter-regional cooperation and integration as well as multilateral cooperation.

The list expresses a set of ideals. SSC is in an evolving mode, with partners shaping their offerings according to their existing capabilities both in terms of budgetary and bureaucratic resources. It is the case, ODA norms evolved out of practice and critique before being systematized in the Organisation for Economic Co-operation and Development (OECD)-Development Co-operation Actors (DAC) practice. Even here there have been many transgressions by individual country practices of OECD standards; for example, the writedowns of least-developed country debts under the Multilateral Debt Relief Initiative were supposed not to be counted as part of ODA, but some countries have done that.

Some of the key elements of the Principles are worth noting. The Yammasoukro Principles, which seeks to promote a “development agenda based on premises, conditions and objectives that are specific to the historic and political context of developing countries” is a basis for the fact that the deployment of enterprises, including private companies, are part of SSC. As part of their development effort, productivity has to be bred into the enterprise sector.

The Principles include an explicit decision that activities should not be evaluated in the same way as ODA. Financial flows from developing countries should not be counted and aggregated along with financial contributions from developed countries. SSC recognizes all aspects of international relations, not just traditional economic and technical ones. SSC is an exercise in collective self-reliance. SSC incorporates not just support for multilateralism but seeks to enable developing countries in playing a more decisive role in international policy and decision-making processes.

The subsequent discussion will explore the application of these principles in combating IFFs.

### 6.3. Reforming the Global Tax System

IFFs arise from the exploitation by international companies operating in multiple tax jurisdictions of facilities to manipulate prices of economic transactions and transfer their profits to low or no-tax locations.

The current system evolved out of the system prevailing during the heyday of colonial trade and investment regimes. During the colonial era, economic transactions took place to a great extent within imperial trading blocs. Corporations from the home countries dominated the external economic transactions of the colonies. With the demise of colonial blocs, corporations have taken advantage of loopholes created by uncoordinated policies among tax jurisdictions, paying taxes in the lowest tax localities, if not to escape taxation altogether.

There is a global consensus that the international tax regime is broken and is in need of thoroughgoing reform. It does not mobilize sufficient revenues required to achieve sustainable development and poverty elimination objectives, such as those agreed among by UN Member States under the Agenda 2030 Development Framework. It increasingly relies on stakeholders with limited incomes and wealth for its revenues. It is increasingly unable to depend on the rich and on large international corporations for its source of revenues. The rules and standards, which prevail in this system do not meet common notions of good governance, such as transparency, non-discrimination, equity, and the rule of law.

Developed and developing countries share a common cause, to reform the system. In the developed countries, the inability of public revenues to keep pace with the expansion of their economies is disassembling the foundations of their social programs and welfare states. The pressures toward greater financialization are driven to a large extent by the withdrawal of responsibility by states in advanced economies to guarantee pension support to their retiring workers. Workers' pension funds must find ways to earn high returns in riskier, short-term, investments.

In the developing countries, states have been reducing their reliance on traditional taxes, such as tariffs on trade, in an effort to attract foreign investors. However, strategies to attract foreign investors introduce their own trade-offs. Developing countries are twice as dependent on corporate income taxes compared to developed countries (IMF, 2014) and must contend with a race to the bottom of statutory corporate income tax rates (IMF, 2014) that started in 1980 as both developing and developed country governments competed for investment. Thus, rules on the sharing of the corporate income taxes between developed and developing countries is a matter of special concern to developing countries. Restoring faster growth in most developing countries will require states more capable of leading the development effort through its own investments in infrastructure. Most developing country governments are unable to do this with severely restricted tax revenues.

In this global reform effort to reform tax systems, however, there is a distinct danger that the resulting global choices and mechanisms will turn against the less powerful stakeholders. The reason is that there is a fundamental difference in interest between developed and developing countries in regard to the treatment of enterprises that operate in more than one tax jurisdiction. This kind of enterprise is precisely the type that can engage in IFFs.

Foreign investors are overwhelmingly headquartered in developed countries. They have enormous advantages in the scale of their capital, in technology, and in the variety of their products. Developed countries choose tax rules that guarantee that their tax systems are based on the total earnings of these enterprises. These rules are called 'residence-based' taxation. These rules are codified in the OECD's double taxation model – the OECD being the inter-governmental organization of developed countries.

Developing countries that host foreign investors, seek to obtain revenues from their operations in their territory. They are adversely affected by rules that facilitate the transfer of income earned in their borders to other jurisdictions. These rules are 'source-based' taxation, obtaining taxes where economic activity takes place.

If the consequence of the global tax reform is to strengthen 'residence-based' taxation, then developing countries will be bearing the cost of the collective interest to reform tax rules.

In May 2014, the IMF (2014) published an analysis of the international tax system, using the word ‘spillovers’ to explain the impact of tax policies of individual countries on other countries. This study finds that “the network of bilateral double taxation treaties based on the OECD model significantly constrain the source country’s rights” (IMF, 2014), the source country being where the actual economic activities occur.

In the study, IMF staff state that the international tax system requires thorough reform. The fact that the estimated spillover impacting on non-OECD countries is twice as large as that on OECD countries speaks to the urgency of this reform. The IMF (2014) suggests that “limiting adverse spillovers on developing countries requires not just capacity building, but also addressing weaknesses in domestic law and international arrangements”.

When they found themselves desperately seeking taxpayer resources to bail out their financial sectors in the wake of the 2007–2008 financial crisis, North Atlantic authorities (all responsible for the world’s leading economies) asked the G20 and OECD to launch the Base Erosion and Profit Shifting Project (BEPS). The outcomes of BEPS, launched in September 2015, confirm the existence of a need, or a set of needs, for a thoroughgoing reform of international tax cooperation.

The BEPS outcome did not respond to the most critical needs of developing countries in tax cooperation, even though the cooperation and participation of developing countries would be required to make the BEPS proposals effective in meeting the needs even of developed countries.

BEPS explicitly avoided dealing with the split between residence and source taxation, despite the fact that the global community had reached agreement earlier that “all companies, including multinationals, pay taxes to the Governments of countries where economic activity occurs and value is created, in accordance with national and international laws and policies” (AAAA).

There is no place in the BEPS project structure for two of the most important tax issues confronting developing country officials in generating revenue from activities of foreign companies in their jurisdiction: (i) taxation of technical services and (ii) the treatment of enterprises in extractive industries.

Change in the ‘right direction’ for the global tax system will require that those parties with the greatest interest in seeing it happen, have sufficient capability and force to participate actively in the international processes of change. Developing countries have the greatest interest in the matter of international tax cooperation but they are hampered by the following weaknesses:

- Weaker technical capabilities compared to developed countries
- More sources of disunity among developing countries because of the great variety in levels of income, geography, history, and political systems
- Significantly smaller resources for coordination, research, and joint action in the international arena.

The SSC Principles enunciated in Yammasoukro provide guideposts to a path for developing countries to overcome these weaknesses and participate actively in a reform process that is in their interest. Change can be more feasible and accessible with strategies that help overcome weaknesses of developing countries.

The change being sought is in two arenas: (i) changes in international norms and rules on tax cooperation and (ii) changes in national policies and administrative practices. In the case of (ii), other development organizations, such as the IMF, play an important role, but it would still be important for developing country authorities to form their own judgement and make decisions consistent with the interests of their nation and their poorer citizens.

The principles of SSC can be applied in three specific areas:

- 1) Drawing on Yammasoukro Principles a, b, k, and l, SSC must be directed at upgrading the capacity of country authorities in researching the design of effective tax policies for their own countries drawing on lessons and experiences **from the developing country context**;
- 2) Drawing on Yammasoukro Principles j, k, l, and m, SSC should seek to strengthen and better coordinate developing country engagement with and negotiations in international tax cooperation activities such as in the OECD-G20 processes, the UN tax cooperation work, and regional cooperation activities; and
- 3) Drawing on Yammasoukro Principles f, g, h, and i, SSC can establish international tax cooperation mechanisms among developing country authorities, for arriving at agreed norms and mutual action at the regional and global levels.

## 6.4. Stemming IFFs through SSC

The effort of combating IFFs must be embedded in and understood within the broader context of global tax reform and the reforms that are required to meet Agenda 2030. This section will present some specific areas where SSC can be applied to reduce IFFs.

### 6.4.1. Exchange of Information

First, there are clear possibilities for establishing a more robust exchange of information modalities to reduce IFFs. Even BEPS recognized the importance of greater exchange of information among tax authorities by promulgating what is called country-by-country reporting (CbCR). The problem is that the BEPS process only requires the disclosure of information (of sales, profits, etc.) to tax authorities and these can only be disclosed to other tax authorities if they qualify with regard to privacy protection standards of developed countries.

The current practice has always put developing countries at a disadvantage in respect to obtaining information from developed country tax authorities. Before BEPS, countless requests for information from developed country authorities did not elicit timely responses or were not responded to at all. Under the BEPS process, developing countries have to install a computerized database running an OECD program, which have significant start-up costs (including the digitization of the original data from taxpayer statements).

As a matter of SSC, developing country authorities can establish their own mechanisms of information exchange, beginning with joint work among tax intelligence units at the regional level. The objective is to increase the information flow, independent of the often unduly elaborate standards required by OECD countries. The African Tax Administration Forum (ATAF) has introduced the ATAF Mutual Assistance in Tax Matters (AMATM) process, which has pioneered the joint audit of companies operating in tax jurisdictions. An expansion and normalization of this practice could be an important next step.

In its paper on Accelerating the IFF Agenda for African countries, GFI *et al.* (2017) call on African governments to joint African tax information sharing networks and to require CbCR by multinationals. As elaborated in the same paper, there are other informational innovations that developing countries can undertake as a matter of South-South Cooperation. Countries can require the disclosure of beneficial ownership, especially from government contract bidders.

### 6.4.2. Manage Tax Competition at least at the Regional Level

Developing countries compete for foreign investment. It is a sovereign right for every country to offer investment incentives to foreign investors as part of its development program. A major portion of these incentives take the form of tax incentives even though the evidence does not

support the proposition that offering tax advantages promote inward investment. However, since competitors offer tax incentives, every country feels the need to offer these incentives.

As a matter of SSC, developing countries, particularly at the regional level where tax competition is most intense, can coordinate their incentives structure to avoid ruinous competition. There are some policies that can be considered in this regard:

1. Developing countries can jointly decide not to give tax incentives on profits but to give incentives on actual business activities – such as number of employees, or size of the payroll, or introduction of new technologies, and so on.
2. Developing countries can agree on a minimum tax rate on profits, below which no country will offer an incentive. Because each country has different methodologies of what can be deducted from earnings to arrive at profits, cooperating developing countries can agree on a list of which deductions can be included in a profit calculation that will be subject to a minimum tax, without requiring each jurisdiction to change its method of calculating profits.
3. At the domestic level, developing countries can work together to disclose the cost of their investment incentives to domestic legislature and to civil society, as some countries are doing (a method that includes concealing the actual company receiving the incentive). By making this a common endeavor, foreign investors will not feel disadvantaged when they invest in jurisdictions that apply this methodology.

#### **6.4.3. Concertedly Strengthen Transfer Pricing Disciplines and Prohibit Trade Mis-invoicing**

Developing country authorities can also strengthen one another's transfer pricing practices and consider passing legislation to prohibit transfer pricing.

In recognition that the largest channel of IFFs is through trade mis-invoicing, all countries are under pressure to strengthen their transfer pricing audit capabilities. The tussle that many developing country authorities and experts have with the BEPS outcome is that it protects a strong version of the separate entity principle, instead of moving towards a tax treatment that treats transactions differently among related companies.

As a matter of SSC, tax authorities among developing countries can strengthen their transfer pricing capabilities. An OECD-UNDP project, Tax Inspectors Without Borders (TIWB) aims to train developing country officials on transfer pricing procedures. However, the problem is that many developing country officials find that, while many of the procedures are interesting in an ideal world, they are not practical for developing countries. For example, the OECD methodology requires that an audit should be based on 'comparable prices' of similar transactions. Developing countries do not have the diversity of companies and transactions to find truly comparable prices.

There are more practical approaches such as the Brazilian 'fixed margin' method and the Argentine 'Sixth' method, which is more practical for developing country authorities. As a matter of SSC, developing countries can strengthen technical cooperation in the application of more practical transfer pricing audit methods.

As a matter of SSC, developing countries can jointly legislate prohibitions against trade mis-invoicing, a practice that now lives within the gray world of ambiguous norms and practices under the preferred OECD methodologies. This effort can begin by agreeing on a model law which defines the kinds of transactions subject to prohibition.

#### **6.4.4. Coordinated Participation in International Standard Setting in Tax Standards and Practices**

Developing country authorities are active participants in international fora that debate and set standards for tax policy and tax cooperation. Developing country officials attend these various fora, most often at the expense of their own government. It is important for developing countries to attend these events in pursuit of their own interests, to make sure that standards being agreed, protect their taxing rights and are practical for their situation.

The OECD (well resourced and staffed) is the major player among these fora. The OECD secretariat is accountable to the 34 Member States of the OECD. Under the BEPS Agenda, the OECD secretariat has been pursuing the Inclusive Framework where developing country officials attend, theoretically, on an equal footing. It is still the case that the secretariat for the Inclusive Framework is the OECD.

In participating in this fora and in the other OECD forum called the Global Forum on Transparency and Exchange of Information for Tax Purposes, developing countries should consider, as a matter of SSC and in line with the Yammassoukro Principles, to begin by consulting among themselves to better advocate the developing country interest. The prospective developing country participants can begin to form caucuses around different issues (recognizing that the variety of development levels and economic structures are much larger than those for developed countries).

There is also the 25-member UN Committee of Experts on Cooperation in International Tax Matters which is composed of nominee UN Member Countries, selected for balanced regional representation. The members act in their personal capacity, because UN Member States have not mandated the Committee to have an inter-governmental character, though its work is in the tradition of a similar committee set up during the era of the League of Nations between the two 20<sup>th</sup>-century world wars. It is important for greater coordination among the developing country members of the Committee; this is an activity that the South Centre has been supporting.

Member States of the UN should also support the work of the Committee. The Government of India has contributed to the trust fund of the UN Committee to support the participation of developing countries in the sub-committee meetings of the UN body.

Developing countries are Member States of the IMF and the World Bank. Their representatives to these bodies must begin working more explicitly toward identifying the developing country view to tax and IFFs matters and seek the recognition of these positions in the operations of these institutions. The G24, which is the caucus of developing country executive directors at the Bretton Woods institutions, inaugurated a project on key issues of international tax cooperation.

#### **6.5. Conclusion and Recommendations**

Developing countries bear the brunt of costs from IFFs. These losses are the result of the facilities that the global system provides transnational companies, operating in multiple tax jurisdictions, to move their profits to favorable locations. International cooperation has been seen to be a key ingredient in restricting IFFs. However, a difference in interests in the treatment of many types of transactions between developed and developing countries is an obstacle to a fast solution of the problem. For example, developing countries seek to obtain tax revenues where economic activities take place, while developed countries prefer to be able to tax income and profits as remitted to their territory. Recent international efforts at reforming the tax system have been dominated by developed country officials through the OECD and these efforts raise much skepticism about whether developing country interests will be addressed.

Developing countries must seek to seize the initiative to restrict their losses from IFFs. They can deploy various joint and concerted actions (as discussed in this chapter), within the umbrella of the principles of South-South Cooperation for this purpose.



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# CHAPTER VII.

## Experience of Selected African Peer Review Mechanism: Reviewed Countries in Fighting Corruption and Illicit Financial Flows

### APRM



#### 7.1. Introduction

Corruption and illicit financial flows (IFFs) are major hindrances to governance, sustainable development and democracy, as they break down opportunities for transparency, transformation and the growth of good democratic policies, practices and institutions.

Over the past 50 years, the continent of Africa has lost an average of USD 1 trillion due to IFFs (Kar and Cartwright-Smith, 2010). This consideration when compared with the high levels of poverty, and unenthusiastic and challenging economic growth, depressed public services, reflects the multi-layered system that sustains IFFs. Corruption, fraud, money laundering, manipulation of stock prices and taxation processes, forgery, irregular and duplicitous relationships between governments and businesses, illegal land allocation and illegal flows of funds are some illicit activities conducive to the proliferation of IFFs.

While the concept and definition of corruption are more or less clear and agreed upon among international organizations and countries, there is yet no firm agreement on conceptual and definitional issues related to IFFs.

For the Organisation for Economic Co-operation and Development (OECD) IFFs are all cross-border financial transfers which contravene national or international laws. This is a wide category which encompasses several different types of financial transfers, made for different reasons which can include:

- Funds with criminal origin, such as the proceeds of crime (including corruption);
- Funds with a criminal destination, such as bribery, terrorist financing or conflict financing;
- Funds associated with tax evasion;
- Transfers to, by or for entities subject to financial sanctions; and
- Transfers which seek to evade anti-money laundering /counter-terrorist financing measures or other legal requirements (such as transparency or capital controls). (OECD, 2015)

For the World Bank, the concept of IFFs refers to cross-border movement of capital associated with illegal activity or more explicitly, money that is illegally earned, transferred or used that crosses borders. IFFs fall under three main areas:

- The acts themselves are illegal (e.g., corruption, tax evasion); or
- The funds are the results of illegal acts (e.g., smuggling and trafficking in minerals, wildlife, drugs, and people); or
- The funds are used for illegal purposes (e.g., financing of organized crime). (WB, 2016).

In each of the definition, it transpires that IFFs are the subset of illicit finance that crosses borders, and which contravenes national or international laws. But what are the methodologies, instruments and indicators to monitor and assess IFFs effectively and to be able to better fight against this phenomenon? Even though there is substantial work on the subject, the inability to reach a consensus on the concept and definition as well as the multidimension of the phenomenon have made it difficult to develop methodologies for monitoring and assessing the progress made in fighting against IFFs.

The African Peer Review Mechanism (APRM) methodology tackles the root causes of IFFs through illegal activities which create this phenomenon. Through its country governance self-assessment reports, APRM has, throughout the years, highlighted some aspects of this phenomenon.

The APRM is a self-monitoring mechanism of governance that is intended to foster the adoption of policies, standards and practices that lead to political stability, high economic growth, sustainable development and accelerated sub-regional and continental economic integration through sharing of experiences and reinforcement of successful and best practices, including identifying deficiencies and assessing capacity-building needs.

Of the 55 African Union (AU) Member States, APRM has used its methodology, instruments and indicators since its establishment in 2003, to assess 23 countries out of the 38 countries currently participating in the Mechanism. The objective of this document is to give insight to the findings of the country review reports (CRR) regarding the experiences of countries in fighting corruption and IFFs. For this publication, only the experiences of a few APRM reviewed countries will be presented. The document is divided into three parts. The first part of the document presents the link between the APRM questionnaire, corruption and IFFs; the second part is a short overview of the findings of the APRM review reports; and the third part provides selected country cases in fighting corruption and IFFs.

## 7.2. Link Between the APRM Questionnaire, Corruption and IFFs

The APRM questionnaire facilitates and guides the process of country reviews by serving as a checklist to determine whether the various stakeholders participating in the process have responded to their concerns and as a convenient summary to provide an overview of universal standards and procedures across four thematic areas, namely: Democracy and Good Political Governance, Economic Governance and Management, Corporate Governance and Socio-Economic Development.

- 7.2.1. The **Democracy and Good Political Governance** thematic area addresses one of the main goals of the APRM, which is the promotion of democracy and good political governance as a basis for the reduction of poverty and the attainment of sustainable development. This thematic area measures some of the key requirements for the promotion of a democratic and well governed society. The objective in this thematic area, which refers to corruption and illicit flow of funds is **Objective 5: Ensuring Accountable, Efficient and Effective Public Service Delivery at the National and Decentralized levels**. This objective touches on procedures that are designed to ensure the continuous accountability of officials, elected as well as non-elected, to the public. The questions on this issue seek to ensure that public office holders and civil servants are accountable, efficient and effective. The related questions on corruption and IFFs in this thematic area are as follows:

*Question 1: What measures have been taken in the country to strengthen institutions for an efficient and an effective public service?*

*Question 2: What is the state of corruption in the public sector?*

*Question 3: What efforts, if any, have been made to empower local or rural communities through the devolution or decentralization of political power, judicial authority or financial resources?*

7.2.2. The **Economic Governance and Management** thematic area addresses the broad national economic policy framework, the institutions, processes and practices in place that are aimed at facilitating, supporting or otherwise promoting an economic climate that encourages growth, poverty reduction and the general welfare of the citizens. The objective referring to corruption and illicit flow of funds in this thematic area is **Objective 4: Fight corruption and money laundering**. This thematic area should be understood as multi-pronged and focuses on the actions, policies and programs that the relevant economic authorities (in particular, the state, regulatory agencies, and to a lesser extent businesses and business organizations) are adopting and implementing to manage the economy. This is done with an understanding that a dynamic economy is not enough in itself but must be complemented by appropriate systems and institutions that ensure the smooth-functioning of markets, the combating of corruption, the regulation of capital flows and the equitable distribution of wealth to meet the needs of the people. The questions relating to corruption and IFFs in this thematic area are as follows:

*Question 1: What measures have been taken by your country to fight corruption in public procurement and with what results?*

*Question 2: What are the main forms of money laundering prevalent in your country? What measures have been taken by your country to fight money laundering? With what success?*

7.2.3. The **Corporate Governance** thematic area assesses sustainable production and creation of wealth through well-governed and competitive organizations whether they are in the private, public or not-for-profit sectors. It includes a section on corruption and illicit flow of funds under **Objective 3: Ensuring Ethical Conduct Within Organizations** where issues on corruption and IFFs are dealt with, although not mentioned directly but through ethical aspects of business, as follows:

*Question 1: What is the overall assessment of ethics within organizations in your country?*

7.2.4. The fourth thematic area relating to **Socio-economic Development** does not have any specific objective on corruption and IFFs but does allude to corruption in certain areas as a measure of implementation. This thematic area provides insight on the progress that African countries are making in terms of reducing inequalities, poverty and hunger through improvement in agricultural production, food security, environmental protection and affordable access to natural resources and basic services as sustainable development is about the well-being of present people without compromising the life of future generation. In its questionnaire, APRM has defined some indicators for tracking and assessing the root cause of IFFs.

Regarding 7.2.1., the **Democracy and Good Political Governance** thematic area, the assessment focuses on whether or not there is an independent body or authority responsible for sanctioning key public servants in key public sector institutions in the case of perpetration of illegal activities in relation to IFFs; the existence of effective mechanisms for sanctions which have been applied leading to dismissals; the demand-side accountability mechanism for civil servants; the existence of an anti-corruption tool such as asset declaration regime and anti-corruption institutions; the effectiveness of these anti-corruption tools and institutions; the number of legal and political penalties for public office holders, both elected and appointed who abuse their positions or conflict of interest rules resulting to IFFs; cases of sanction for abuse of office for pecuniary gain over the past five years leading to IFFs; and the effectiveness of the devolution of power to local and traditional authorities.

In 7.2.2., the **Economic Governance and Management** thematic area, the assessment focuses on the description of policy and regulatory measures as well as institutional establishment in place to improve transparency and integrity in government procurement. It also highlights the case of corruption in public procurement; the number of public and private actors investigated, prosecuted and convicted of corruption; the case of stolen assets recovered; the existence of public procurement laws; the existence of preventive measures against money laundering (including tax evasion, heist money, organized crime money, fraud and embezzlement) as well as anti-money laundering legislation and institutions. The assessment also examines the capacity and expertise of agencies to counter money laundering and the existence of regional cooperation on anti-money laundering. The statistics on the cases of money laundering reported, the total value of money laundering transactions reported as well as the cases investigated, prosecuted and convicted, are also assessed.

For 7.2.3., the **Corporate Governance** thematic area, the assessment focuses on the ethical behaviour of the organization, both internally and externally. The indicators include the existence or not of the code of ethics and practices to promote ethical behaviour such as whistleblowing regulations; existence of mechanisms, including legal framework within organizations for whistleblowing and protection of whistle-blowers; existence of regulations surrounding organizations making political donations; cases of market abuse including insider trading/state capture; the quality of investigative financial journalism in reporting on corporate governance practices; impact and influence of multinationals on ethics within organizations; effectiveness of measures taken by organizations to promote adoption of good ethics in combating corruption, smuggling, fraud, and money laundering; and success stories in bringing these cases to court.

### 7.3. Overview of APRM Country Review Report Findings

A quick analysis of the APRM country review reports shows that illegal activities that generate IFFs (fraudulent personal and corporate enrichment, money laundering and abuse of institutional funds by different actors within each individual state) and corruption are all issues that exist as cross-cutting phenomena in almost all the APRM CRRs.

Corruption is endemic and is widely acknowledged as a national vice in many countries. Financial corruption is linked to political challenges of establishing unwavering practices of good governance and promoting durable democratic institutions. Corrupt activities indict even top government officials in many countries. The Transparency International Survey on Corruption regularly ranks African countries among the most corrupt in the world. Corruption is still the main obstacle to foreign direct investments. Corruption thrives in both the private and public sectors and imposes an additional cost on doing business. The public procurement system is the hardest hit by corruption. A high percentage of the value of public procurement is lost through corrupt practices. Corruption is also rising in drug distribution in the health sector, where several not-for-sale medicines distributed to health centres are leaked to the market through corrupt practices. In some countries, corruption is also reported to be a serious problem at district level and some stakeholders pointed out that decentralization of procurement to local authorities simply extended corruption to all levels of local government.

Some of the root causes of corruption include the following:

- Breakdown in the rule of law;
- Lack of clear understanding of existing codes of conduct;
- Poor procurement systems;
- Inadequate legal machinery;
- Lack or unclear inter-institutional linkages;
- Inadequate systems, logistics and capacities in public offices; and
- Lack of competition and business ethics.

## 7.4. Selected APRM Reviewed Country Experiences in Fighting Corruption and IFFs

### 7.4.1. Republic of Kenya

#### 7.4.1.1. Overview

Kenya has had and continues to have a significant and debilitating problem of corruption. Decades of endemic corruption have fundamentally perverted cultural values, with looters being admired as 'tycoons' and honest public servants derided as failures. The country has consistently been ranked in the bottom 10% of Transparency International's (TI) Corruption Perception Index. The evidence is corroborated by internal assessments conducted by Transparency International Kenya, the annual Kenya Bribery Index, and that of other groups such as the Centre for Law and Research International (CLARION), the Kenya Anti-Corruption Commission and most recently, the reports of the task forces and commissions set up by the North African Regional Capability (NARC) administration.

The President is taking anti-corruption measures. The actions of the President are also complemented by strong advocacy on the part of the Kenyan civil society movement, which has also managed to keep the anti-corruption drive permanently on top of the political agenda. The results are now perceptible. The important point to note is the need for the government to consolidate current gains and broaden the support base for the current initiatives by promoting the ascendancy of a public that shows zero tolerance to official malfeasance and by eradicating the culture of impunity.

#### 7.4.1.2. Policies in Place and Institutions Fighting against Corruption and IFFs

Government has instituted several measures to fight corruption and made important strategic linkages. The National Anti-Corruption Steering Committee and Governance, Justice, Law and Order Sector (GJLOS) have incorporated the civil society, including the media, into their coordination and implementation framework. The Kenya Anti-Corruption Commission and Advisory Board comprises religious associations, professional associations, private sector associations and labour organizations.

Kenya has established key institutions including the Kenya Anti-Corruption Commission (KACC) and the Kenya Anti-Corruption Police Unit.

In the legal area, the CRR mentions the Anti-Corruption and Economic Crimes Act, 2003, which led to the establishment of the KACC; the Public Officers' Ethics Act, 2003, the Public Audit Act, and the Public Procurement and Disposal of Assets Bill. Among bodies set up, apart from the KACC, the Country Self-Assessment Report (CSAR) mentions the Kenya Anti-Corruption Advisory Board (KACAB) and the Permanent National Anti-Corruption Campaign Steering Committee (PNACCSC). The KACAB, with membership from professional and business associations, and labour and religious organizations, advises the KACC, which is controlled only by Parliament. The President of Kenya created the PNACCSC, in an attempt "to coordinate the entire nationwide anti-corruption campaign". Also in the fight against corruption are: (i) the Ministry of Justice and Constitution Affairs, set up by the current government "with the mandate to spearhead the anti-graft war and especially to spearhead the enactment of requisite laws to facilitate the execution of the anti-corruption campaign"; (ii) a Permanent Secretary in the Office of the President that is in charge of governance and ethics; (iii) the Controller and Auditor General; and (iv) the Public Investment Committee (PIC) and Public Accounts Committee (PAC) of Parliament, whose reports have pointed out the enormity of public financial mismanagement, and have made recommendations to improve financial probity and accountability.

The CRR highlighted that the Anti-Money Laundering (AML) and the Proceeds of Crime Bill, 2005 had been passed by Parliament. The measures taken to combat white-collar crime are as follows:

- Setting up of the KACC, and the Efficiency Monitoring Unit (EMU);
- Monitoring and investigation mechanisms developed by the Central Bank of Kenya (CBK), based on the Anti-Fraud Unit to track irregular movements of cash;
- Enforcement of best practices among the banks by CBK's Bank Inspection Unit, including anti-money laundering initiatives, such as the 'Know Your Customer (KYC) Guidelines';
- Strengthening of internal audit by the government;
- Ratification of East and Southern African Anti-Money Laundering Group (ESAAMLG) Memorandum of Understanding and its implementation; and
- Establishment of a special prosecution section in the Department of Public Prosecutions in the Office of the Attorney General, to specially prosecute terrorism, money laundering and organized crime.

### **7.4.1.3. Challenges**

The existence of corruption in government ministries and departments, parastatals, the judiciary and local authorities poses a daunting challenge for government. The old and largely corrupt civil service bureaucracy is still very much in place, which carries significant implications for the effective implementation of new anti-corruption measures.

The CRR asserts that a sound legal basis now exists for the fight against corruption, and that the administrative and organizational structures are also there in principle. But, with respect to the laws, there are weaknesses in implementation and follow-up. In addition, some capacity problems exist in the bodies that have been set up, and some re-organization of the structure would be useful; it appears that too many bodies have been set up to fight corruption and they sometimes seem to have conflicting roles.

## **7.4.2. Republic of Uganda**

### **7.4.2.1. Overview**

The incidence of corruption is endemic and widespread in Uganda. Defining corruption as "the misuse of public power for private gain", the main causes are societal attitudes, political greed, weak institutions, weak and faulty accounting systems, low remuneration and poor employment benefits in the public sector. Corruption manifests itself in various ways, including the abuse of office, bribery, extortion, nepotism, favouritism, fraud, embezzlement, misappropriation of public funds and assets, and use of public resources or assets for personal gains.

Appreciation of the government's efforts to fight corruption was expressed by way of delivering on commitments and enforcing and upholding the law the non-implementation of which was widely featured as a serious weakness in the legal framework.

### **7.4.2.2. Policies in Place and Institutions Fighting against Corruption and IFFs**

Legislative measures aimed at eradicating corruption include the Penal Code Act (Cap. 120), Prevention of Corruption Act of 1970, Police Act (Cap. 303), Leadership Code Act, Inspectorate of Government Act of 2002, Public Procurement and Disposal of Public Assets Act of 2003, Local Government Act (Cap. 243), Local Government Act (Public Procurement and Disposal of Public Assets Regulations) of 2006, Local Government Financial and Accounting Regulations of 1998 and Public Finance and Accounting Act of 2003.

The Inspector-General of Government (IGG) is the principal institution tasked with a clear and specific mandate to eradicate corruption by:

- Promoting and fostering strict adherence to the rule of law and principles of natural justice in administration;
- Fostering the elimination of corruption and abuse of authority and public office;
- Enforcing the Leadership Code of Conduct; and
- Investigating the conduct of any public officer who may be directly or indirectly involved in corruption or abuse of office.

Other state institutions mandated to eradicate corruption include the Public Accounts Committee of Parliament, the Office of the Auditor-General, the Directorate of Ethics and Integrity, the Criminal Investigation Department of Police, the Public Procurement and Disposal Authority, the Internal Audit Department in the Ministry of Finance, Planning and Economic Development (MoFPED) and the Uganda Human Rights Commission (UHRC).

The civil society has also embarked on initiatives aimed at combating corruption in the public and private spheres. Two such initiatives are the Anti-Corruption Coalition of Uganda (ACCU) and the Centre for Corporate Governance (CCG).

Since 2002, the government has put in place various laws and regulatory frameworks aimed at reducing corruption. The following are some of the key measures:

- Institutionalization of the IGG, established in 1986, through the Inspectorate of Government Act of 2002, which is aimed at eliminating corruption and abuse of public office;
- The IGG also conducts periodic public awareness education programs, as well as regular national integrity surveys;
- The Leadership Code Act of 2002, which provides for a minimum standard of behaviour and conduct for leaders, as well as the declaration of their assets and liabilities;
- The Public Procurement and Disposal of Public Assets Act of 2003;
- The Whistleblower Act of 2006, which stipulates the protection of persons who report acts of corruption;
- Participation in the process of drawing up the Draft African Convention on Preventing and Combating Corruption; and
- Intended enactment of the Prevention of Corruption Law, aimed at recovering embezzled public funds.

#### **7.4.2.3. Challenges**

The main challenges encountered in fighting against corruption and IFFs in public office include:

- A lack of commitment on the part of the government to implement recommendations of various anti-corruption agencies and commissions of enquiries;
- An inadequate financial, human, technological and logistical capacities in various agencies charged with the responsibility of fighting corruption;
- An inherent weaknesses in the public procurement system;
- Weak information management systems without a coordinated tracking and information-sharing mechanism; and
- Public attitudes that tolerate and elevate corruption.



### 7.4.3. Republic of Mozambique

#### 7.4.3.1. Overview

Corruption is rife in the country. TI's 2008 Corruption Perception Index ranked Mozambique 126<sup>th</sup> out of 180 countries surveyed, which is a downgrade in both relative and absolute terms. It ranked 111<sup>th</sup> out of 180 countries in 2006 and 2007.

As indicated in the CRR, corruption continues to thrive in Mozambique, not only at the highest levels, through rent-seeking practices and the manipulation of procurement, but also in the shape of so-called 'petty corruption', through small bribes demanded, for example, by traffic police and hospital staff. Despite the government's commitment to solving these problems, a lot remains to be done.

The Ant-Corruption Plan is reinforced by Anti-Corruption Law No. 14/2012, by the Organic Law of the Public Prosecutor's Office No. 4/2017 and by the Law on Protection of Witnesses. This seeks to mitigate the spread of corruption.

In addition, the country has taken concrete actions to promote business ethics among stakeholders. It has raised awareness on corruption among the Institute of Board of Directors of Mozambique (IODMz). The IODMz has partnered with the Ethics Institute to promote regular business ethics events. These awareness campaigns are meant to create values and ethics against corruption.

#### 7.4.3.2. Policies in Place and Institutions Fighting against Corruption and IFFs

The government has put in place a comprehensive ant-corruption strategy and instruments which, if applied vigorously, could drastically curb the levels of corruption. Under the 2006–2010 Anti-Corruption Strategy, the government's policies to combat corruption will focus on the following:

- Rationalization and simplification of administrative procedures;
- Reduction in the discretionary power of civil servants in the exercise of their duties;
- Development in the public administration of a management culture oriented towards delivering concrete results;
- Strengthening of accountability procedures and mechanisms in public financial, asset and procurement management;
- Establishment of mechanisms for the participation of civil society and the private sector in government action;
- Prosecution of a greater number of corruption cases as a way of discouraging the development of a culture of impunity; and
- Decentralization of government action to bring government decisions closer to the citizens.

Action has been taken on preventing and combating corruption, which was followed by the ratification of the UN Convention Against Corruption in December 2006.

An anti-corruption unit, the Unidade Anti-Corrupção (UAC), was established within the Public Prosecution Service Office in 2002 but was replaced by the Central Office for Combating Corruption (GCCC) when the Cabinet adopted the Anti-Corruption Strategy.

Among the legal instruments available to fight corruption are the Anti-Corruption Law No. 6/2004, which together with Decree No. 22/2005, provides sufficient legal teeth for fighting corruption; Decree No. 30/2001, which prescribes norms or operational values for the public service; Law No. 4/90 and No. 21/92, which make it mandatory for the President and other high-ranking government officials to declare their assets to the Constitutional Council no later than 30 days after assuming office; Law No. 9/98, which defines a code of conduct for public officials; Law No. 9/2002 on Treasury management, as amplified by Decree No. 23/2004; Decree No. 19/2005 on tax inspection; Law No. 7/2002 and No. 14/2007 on money laundering; and Decree No. 54/2005 on public procurement. In addition, Mozambique ratified the SADC Protocol.

In April 2006, the government approved the Anti-Corruption Strategy, including the respective action plans for combating corruption. These focus on five critical sectors, namely the ministries of Health, Finance, Education and Culture, Home Affairs, and Justice. The strategy is under implementation in the five sectors and has made considerable progress.

There is a need to strengthen the dissemination of laws and regulations coordinating illicit practices and corruption. The government has a global strategy for combating corruption involving all institutions.

#### **7.4.3.3. Challenges**

The Anti-Corruption Act, established in 2004, does not give full prosecution powers to the GCCC. While the introduction of the Anti-Corruption Act was regarded as a milestone in the anti-corruption movement in Mozambique, increasing concern remains over the lack of investigative authority of the GCCC, its limited authority and the ineffective nature of whistleblowing mechanisms. This raises doubt over the applicability and efficiency of the Act. A significant number of policies and legislative measures were introduced but the lack of action by government weakens these law and policies thereby significantly reducing their effectiveness.

### **7.4.4. Democratic Republic of Algeria**

#### **7.4.4.1. Overview**

Since the beginning of this third millennium, Algeria has been aware of the negative impact of corruption on building the State and achieving development and ranked this issue among the priority threats to be addressed. The issue of corruption has therefore been emphasized as a major concern in the governance program conducted in Algeria.

To this effect, Algeria actively participated, from 2000 to 2003, in the negotiations conducted as part of the United Nations Convention against Corruption and of the United Nations Convention against Transnational Organized Crime, which also addresses the issue of corruption. Algeria was among the first Arab and African countries to ratify the United Nations Convention against Corruption, as well as other international and regional instruments such as the African Convention on Preventing and Combating Corruption among others. Algeria's determination to fight corruption is also reflected by the daily submission to the justice system of many cases of corruption involving executive officers from various sectors.

#### **7.4.4.2. Policies in Place and Institutions Fighting against Corruption and IFFs**

Algeria instituted various measures to combat corruption, including the following:

- Reforming the judiciary aimed at improving performance;
- Concluding 57 bilateral agreements; and
- Passing legislation against corruption as part of a global process designed to promote good governance.

This legislation – inspired by the provisions laid down in the United Nations Convention against Corruption – covers four major thrusts, namely:

- Prevention of corruption in the public and private sectors;
- Numbering the counts of indictment attached to the various corruption offences at 22;
- International cooperation and the recovery of products and assets gained through corruption; and
- The related restitution of products and assets to their country of origin.

The anti-corruption mechanisms have strengthened their capacity through:

- Creating a financial information processing unit (Executive Decree 02-127 of 7 April 2002);
- Lifting bank secrecy in respect of the unit (sections 104 to 110 of the Budget Act of 2003);
- Incriminating money laundering through an amendment of the Criminal Code in 2004; and
- Promulgating the Framework Law on the Prevention of and Fight against Money Laundering and the Funding of Terrorism (Act 05-01 of 6 February 2005).

Algeria also approved recommendations of the Financial Action Task Force (FATF) on Money Laundering and the Funding of Terrorism and the Framework Law on the Prevention of and Fight against Money Laundering and the Funding of Terrorism (Act 05-01 of February 2005).

In addition to the anti-corruption and anti-money laundering efforts that are being deployed, the government of Algeria is conducting other actions to improve the effectiveness of the measures undertaken, such as:

- Improving coordination among services, some advisory institutions, employer associations and trade unions;
- Bringing the administration's performance up to standard; and
- Promoting business ethics through training seminars, one-day conferences and training sessions organized to encourage integrity, transparency and responsibility in business transactions and management.

The two main actions undertaken by the government in terms of money-laundering and smuggling are the following:

- Creation of a financial information processing unit in 2006 under the joint supervision of the Ministries of Finances and Internal Affairs; and
- Computerization of all customs services.

However, steps have been taken to promote good commercial ethics, including two legislative measures in force, covering:

- Competition – Ordinance 03-03 of 19 July 2003 on competition; and
- Commercial practices – Act 04-02 of 23 June 2004 setting out the rules for commercial practices.

#### **7.4.4.3. Challenges**

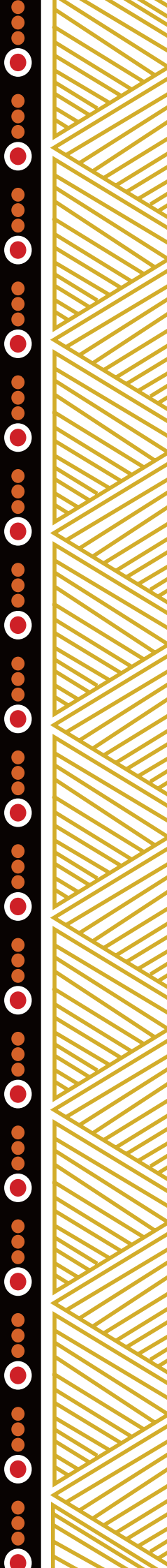
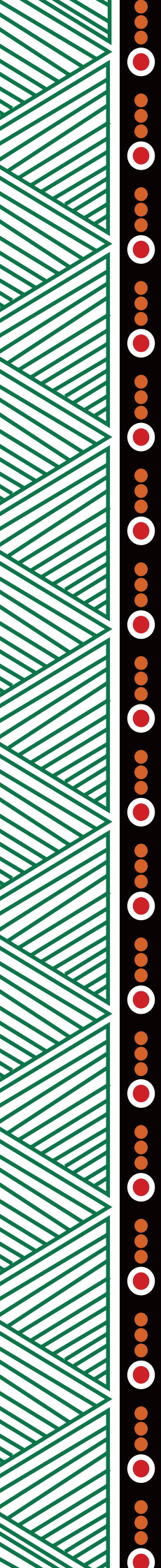
Despite numerous political, economic and social advances made, Algeria still faces several challenges in fighting against corruption and IFFs.

## **7.5. Conclusion and Recommendations**

IFFs and activities that create them, notably corruption, are major scourges in Africa. In order to eradicate these ills that impede sustainable development in Africa and, especially the implementation of Agenda 2063 and attainment of the Sustainable Development Goals (SDGs), a common African strategy with efficient monitoring and evaluation mechanisms is necessary. In implementing its methodology, the APRM has, since it was established in 2003, reviewed 23 African Union member countries participating in the Mechanism. These evaluations indicate that a lack of governance is the root cause of these IFFs and the illegal activities that spawn them. Despite the establishment of institutions and the implementation of policies in various African countries to fight against these plagues, much remains to be done. To put an end to these IFFs, it is necessary to develop a comprehensive response involving all States, international and regional organizations, as well as technical and financial partners working in the area.

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Experiences from Member  
States in Mobilizing Domestic  
Resources: Fighting Corruption  
and Illicit Financial Flows

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# CHAPTER VIII.

## The Case of Mauritius

Prepared by the Republic of Mauritius



### 8.1. Background

Illicit financial flows (IFFs) generally refer to all cross-border financial transfers which contravene national or international laws. Global Financial Integrity (GFI) classifies such movements as illicit flows when the funds are illegally earned, transferred, and/or utilized. IFFs reportedly can take the following forms:

- Money laundering, drug trafficking, racketeering, counterfeiting, dealing in contraband goods and terrorist financing;
- Commercial transactions by multinationals not at arm's length, tax evasion, laundered commercial transactions, aggressive tax avoidance through harmful tax holidays, duty waivers and mis-invoicing; and
- Corruption (theft, bribery and other forms).

The issue of IFFs is at the forefront of the international agenda. Governments worldwide are joining forces to combat money laundering, tax evasion and international bribery, which make up the bulk of IFFs. Mauritius has also come up with various measures aimed at combating illicit flows.

### 8.2. Measures Adopted by Mauritius to Combat Corruption, Money Laundering and the Financing of Terrorism

#### 8.2.1. Legal Framework

A robust Anti-money Laundering/Combating Financing of Terrorism (AML/CFT) legal and institutional framework to deal with corruption, fraud, financial crime, money laundering and the financing of terrorism activities is in place and is being strengthened in light of evolving international standards. Our AML/CFT framework is based on international standards contained in the Financial Action Task Force (FATF) Recommendations, United Nations (UN) Conventions against Corruption, the Vienna Convention, Palermo Convention and other relevant conventions.

The framework is provided in the following legislations:

- The Dangerous Drugs Act (Mauritius took its first anti-money laundering [AML] measure in 1995 with the adoption of the Dangerous Drugs Act which criminalizes money laundering where the predicate offence relates to drugs);
- The Financial Intelligence and Anti Money Laundering Act, 2002 (FIAMLA);
- The Prevention of Terrorism Act, 2002 (PoTA);
- The Prevention of Corruption Act, 2002 (PoCA);
- The Convention for the Suppression of the Financing of Terrorism Act, 2003;
- The Asset Recovery Act, 2011 which enables the State to recover assets which are proceeds or instrumentalities of crime or terrorist property, where a person has been convicted of

an offence, or where there has been no prosecution but it can be proved on a balance of probabilities that property represents proceeds or instrumentalities of an unlawful activity;

- The Good Governance and Integrity Reporting Act, 2015, which aims at investigating any form of unexplained wealth by individuals in Mauritius. The law was enacted with a view to:
  - Address the deficiencies in the current legislative framework and stimulating performance in the public and private sector organizations through effective reporting and other processes;
  - Encourage and foster a culture of integrity and good governance in the Republic of Mauritius, through encouraging positive reports of acts of good governance, disclose and deter malpractices and recover unexplained wealth, and protect and reward persons making genuine disclosures and reports of malpractice; and
  - Stimulate a culture of good governance and righteousness among all Mauritians.
- The Banking Act which vests the Bank of Mauritius with AML/CFT supervisory and regulatory powers with respect to financial institutions falling under its purview.
- The Guidance Notes on AML/CFT issued to financial institutions under the purview of the Bank of Mauritius by virtue of statutory powers vested to it in terms of S50 of the Bank of Mauritius Act and S100 of the Banking Act. The Guidance Notes set out the parameters within which those financial institutions should operate in order to ward off money laundering and terrorist financing. Those requirements of the Guidance Notes are enforceable.
- Amendments were brought to the FIAMLA in the Finance (Miscellaneous Provisions) Act 2018 to provide a legal framework to conduct the National Risk Assessment of money laundering and terrorism financing risks in Mauritius.
- New regulations were promulgated under the FIAMLA, revoking the previous regulations under the FIAMLA. The new regulation is titled Financial Intelligence and Anti-Money Laundering Regulations which came into effect on 1 October 2018. The aim is to complement the FIAMLA and address the deficiencies which have been flagged in the East and southern African Anti-Money Laundering Group (ESAAMLG) Mutual Evaluation Report Mauritius 2018.

## **8.2.2. Institutional Framework**

The institutional framework comprises the following:

### **8.2.2.1. Independent Commission Against Corruption**

The Independent Commission Against Corruption (ICAC) was set up under the Prevention of Corruption Act, 2002. Its role is to investigate acts of corruption and money laundering; conduct corruption prevention reviews in public bodies; and educate the population of the dangers of corruption.

To fulfill its mandate, the ICAC initiated the following:

#### **i) Investigation/Law Enforcement**

- Facilitating reporting of allegations of corruption by providing appropriate reporting channels;
- Investigating of allegations of corruption and money laundering cases; and
- Prosecuting of corruption and money laundering cases in court.

#### **ii) Prevention of Corruption through Systems Enhancement**

- Conducting of Corruption Prevention Reviews (CPRs) in public bodies and follow up on implementation of recommendations. CPRs are either investigation led or as an ICAC initiative or follow a request from public bodies;

- Implementing a Public Sector Anti-Corruption Framework in public bodies, which consist of the setting of anti-corruption committees for the elimination of corruption risks in the public bodies;
- Developing of best practices to address corruption risk areas; and
- Developing codes of conduct for different sectors in the public service.

### iii) Education against Corruption

- Several mass awareness campaigns and anti-corruption education campaigns; workshops seminars; face-to-face sessions; and conferences on topics such as on corruption reporting channels, dangers of corruption, corruption offences and integrity enhancement. These activities targeted the public sector, private sector and the civil society comprising the general population, including the youth and students, the media, the judiciary and others;
- Appointing integrity officers in each public body; and
- Developing of codes of conduct for specific sectors, for example, a code of conduct for parliamentarians.

### iv) Research Work on Corruption and Related Issues

- A research unit was set up in May 2017 at the ICAC and embarked on the conduct of three research studies. These studies are aimed at:
  - Understanding indicators of effectiveness in the fight against corruption;
  - Political funding as a source of corruption; and
  - Barriers to youth engagement in the fight against corruption in the Republic of Mauritius (in collaboration with the University of Technology Mauritius).

#### 8.2.2.2. Financial Intelligence Unit

The Financial Intelligence Unit (FIU) was set up in 2002 under the Financial Intelligence and Anti-Money Laundering Act, 2002. The FIU is the central agency in Mauritius responsible for receiving, requesting, analysing and disseminating to the investigatory and supervisory authorities, disclosures of financial information concerning suspected proceeds of crime and alleged money laundering offences and the financing of any activities or transactions related to terrorism.

#### 8.2.2.3. National Committee for Anti-Money Laundering and Combating the Financing of Terrorism

A national committee for AML/CFT was set up, under the chairmanship of the Ministry of Finance and Economic Development, to advise government on matters relating to AML and the combating of the financing of terrorism.

#### 8.2.2.4. Other Institutions

Other institutions involved in the fight against money laundering are the Police; the Bank of Mauritius, which is the supervisory body in relation to AML/CFT for banks; non-bank deposit taking institutions and cash dealers; the Financial Services Commission; the Attorney-General's Office; the Asset Recovery Investigation Division (ARID); the Director of Public Prosecutions' Office; the Gambling Regulatory Authority; and the Mauritius Revenue Authority.

Mauritius is an active member of the ESAAMLG, which is a FATF-style regional body. Mauritius is also a member of the Group of International Finance Supervisors, which participates in initiatives with the FATF, Basel Committee, Financial Stability Board and the International Organization of Securities Commissions (IOSCO).



### 8.3. Measures to Ensure Transparency

Greater transparency in financial systems – in both national and cross-border dealings – is one of the major recommendations in the Global Financial Integrity (GFI) report. In this regard, it is worth noting the following:

- Mauritius has put in place the necessary mechanism to ensure that **information on ownership, accounting information and banking information are always maintained, can be accessed** by the Government authorities and **can be shared** with foreign authorities.
- The OECD recognizes that Mauritius has an Exchange of Information system that is effective and efficient and is compliant with international standards.
- As such, following the in-depth Peer Review process conducted by the Global Forum in 2017, **Mauritius has been rated as compliant with the international standards on transparency and exchange of information. This rating is the most favourable rating allocated, bringing Mauritius to the same rating as Ireland and Norway and moving a step ahead of countries like Australia, Bermuda, Canada, Cayman Islands, Germany and Qatar which were rated largely compliant.**

The Bank of Mauritius also applies strict licensing procedures in order to ensure that financial institutions are owned and managed by only fit and proper persons, comprising, *inter alia*, the shareholders, beneficial owners, directors and senior officers. In addition, only reputable foreign banks having operated for at least five years in the jurisdiction of its head office and subject to consolidated supervision by competent foreign regulatory authorities, may obtain a license to operate as a branch in Mauritius.

#### 8.3.1. Maintaining Information

All entities operating in Mauritius, under their respective Act, have an obligation to maintain proper accounting records, records of ownership and banking information for at least seven years.

As part of the peer review process, the Global Forum has assessed whether there were any gaps in our legal framework and whether access and exchange of information was effective and efficient and compliant with international standards. The review concluded that Mauritius has all the essential elements in place for an effective and efficient implementation of the international standards on transparency and exchange of information for tax purposes.

#### 8.3.2. Access to Information

##### 8.3.2.1. Access to Information Regarding Beneficial Ownership

The Financial Services Commission (FSC) has access to information on beneficial ownership prior to the incorporation of global business companies – additional information can also be obtained from management companies (MCs) at any time under powers provided by section 42 of the Financial Services Act, 2007 (FSA, 2007). At the time of application, applicants for global business licences need to submit complete and satisfactory customer due diligence (CDD) documents. In this respect, the ultimate beneficial owners and the source of funds are ascertained before a licence is issued.

The Financial Intelligence and Anti-Money Laundering Regulations, 2018 (The Regulations 2018) stipulate the kind of information required before and during a business relationship for the purposes of CDD measures; see Regulations 2, 6, 7, 8, 9, 10, 12. In relation to Politically Exposed Persons (PEPs), see Regulation 15 where on-going CDD measures have to be performed in terms of risk assessment and management.

### 8.3.2.2. Access to Information Regarding Operations of Entities (Accounts)

Domestic companies are required under the Mauritius Companies Act to maintain proper accounting records and to file with the Registrar of Companies audited financial statements annually (except small companies).

Under the Financial Services Act, 2007 (FSA) Global Business Companies are required to file annual audited accounts with the Financial Services Commission (FSC).

As part of an audit exercise, auditors verify and report compliance with regulatory requirements, including whether accounts are prepared in accordance with the applicable accounting standards.

### 8.3.2.3. Access to Bank Information

The banking laws provide the necessary mechanisms for the Central Bank to access and share banking information with public sector agencies, law enforcement agencies and foreign regulatory agencies, under conditions of confidentiality.

The Banking Act, 2004 allows the Director-General of the Independent Commission against Corruption, the Chief Executive of the FSC, the Commissioner of Police, the Director-General of the Mauritius Revenue Authority (MRA), or any other competent authority in Mauritius or outside Mauritius who requires any information from a financial institution relating to the transactions and accounts of any person, to apply to a Judge in Chambers for an order of disclosure of such transactions and accounts or such part thereof as may be necessary (s.64(g)).

Furthermore, the Banking Act allows banks to share information with other institutions, without a Judge's order, where:

- The Bank has been summoned by the Commissioner, under section 45(4) of the Dangerous Drugs Act, to give evidence or produce any record, book, document or other article or to make any disclosure relating to the possession of a convicted person or his family as specified in that section;
- A financial institution, other than a cash dealer, is required to provide information and particulars, and to do any other act, under the Income Tax Act; and
- The bank is required to make a report or provide additional information on a suspicious transaction to the FIAMLA.

The Bank of Mauritius remains committed to enhancing its network of cooperation with other counterpart institutions which have regulatory functions in different parts of the Mauritian economy.

On the domestic front, the Bank has entered into seven Memorandums of Understanding (MoUs) with, namely, the Financial Services Commission, the Statistics Mauritius, the Financial Intelligence Unit, the Mauritius Revenue Authority, the Competition Commission of Mauritius, the Registrar of Cooperative Societies and the Independent Commission Against Corruption. The Bank ensures coordination and sharing of information with its counterparts under these MoUs.

The Bank has entered into MoUs on cross-border supervision and information sharing with 16 of its foreign counterparts. The MoU sets forth a statement of intent between the Bank of Mauritius and its counterparts to establish a framework for mutual assistance, cooperation and the exchange of information in the fulfilment of the institutions' respective supervisory responsibilities.

### 8.3.2.4. Sharing of Information

#### 8.3.2.4.1. Tax Information

The framework for exchange of information is provided by the Mauritius Income Tax Act and Double Taxation Avoidance Treaties and Tax Information Exchange Agreements, which Mauritius

has signed with other countries. Whereas the Double Taxation Avoidance Treaties and the Tax Information Exchange Agreements contain relevant provisions for the exchange of information with our treaty partners, the Income Tax Act on its part empowers the Director General of the MRA to obtain information from taxpayers for exchange, whether or not Mauritius has a domestic interest in the information.

Double taxation treaties signed by Mauritius include an article, which is based on the OECD Model article 26, that provides for exchange of information with the treaty partner.

Mauritius has signed a Tax Information Exchange Agreement (TIEA) as well as an Inter-Governmental Agreement with the United States of America (USA) in the context of becoming Foreign Account Tax Compliance Act (FATCA)-compliant. This also provides for automatic exchange of information between the two countries. Mauritius is the first African country that has signed an inter-governmental agreement with the USA to implement the FATCA.

Mauritius has joined a large network of tax information sharing by signing the Multilateral Convention on Mutual Administrative Assistance in Tax matters. This provides for extensive forms of administrative cooperation between states in the assessment and collection of taxes with a view to combating tax avoidance and evasion. The Convention provides a legal basis for multi-country cooperation as compared to bilateral cooperation with Double Taxation Avoidance Agreements (DTAAs) and TIEAs. It covers exchange of information on request as well as automatic exchange of information.

Mauritius is also a member of the Early Adopters Group committed to the early implementation of the common reporting standard on the automatic exchange of financial account information.

#### **8.3.2.4.2. Banking Information**

As stated above, our banking laws allow sharing of banking information with public sector agencies, law enforcement agencies and more importantly with foreign regulatory agencies. The Banking Act 2004 allows access to bank information following the issue of an order of disclosure by a Judge in Chambers. Banking information may be accessed for sharing with other institutions, without a Judge's order, in cases of drug trafficking, tax investigations or for reporting a suspicious transaction to the FIU.

## **8.4. International Cooperation**

Mauritius has adopted the necessary applicable and appropriate norms, standards and best practices set by International Bodies, as far as it has, *inter alia*:

- i) Subscribed to and included banking supervision and core principles associated therewith (under the Basel Committee on Banking Supervision);
- ii) Subscribed to and included insurance supervision and core principles associated therewith (under the International Association of Insurance Supervisors); and
- iii) Subscribed to and included securities supervision and core principles associated therewith (under the IOSCO).

Mauritius has signed the IOSCO Multilateral MoU (MMoU) to become full signatories. The IOSCO MMoU sets an international benchmark for cross-border cooperation which is critical in combating violations of securities and derivatives laws. The law was also amended to enable the Bank of Mauritius to share banking information with the FSC to enable it to meet its obligations under the IOSCO MMoU. The Bank of Mauritius and the FSC have signed MoUs with their counterparts in several jurisdictions on exchange of information within the purview of their respective laws.

#### **8.4.1. Financial Intelligence Unit**

The FIU is legally mandated to share information under section 13(1) of the FIAMLA. It states that where there are grounds to suspect money laundering, predicate offences or terrorism financing, the FIU shall disseminate information and the results of its analysis to the relevant investigatory authority, supervisory authority, overseas financial intelligence unit or comparable body for appropriate action.

Moreover, the FIU Mauritius has been a member of the Egmont Group since July 2003. The Egmont Group of Financial Intelligence Units is an international informal network of FIUs established since 1995. The Group provides a platform for the secure exchange of expertise and financial intelligence between FIU members to combat money laundering and terrorist financing (ML/TF).

Pursuant to section 20 of the FIAMLA and the Egmont Group Charter Memorandum, the FIU Mauritius can exchange financial intelligence either proactively or upon request from other overseas FIUs on the basis of reciprocity and mutual agreement. To date, the FIU has signed 29 MoUs with foreign counterparts from South Africa (2003); Australia (2003); Principality of Monaco (2004); Kingdom of Thailand (2004); Belgium (2005); Canada (2006); France (2006); Cayman Islands (2006); United Kingdom (2007); Netherlands Antilles (2007); Republic of Indonesia (2007); India (2008); Nigeria (2009); Senegal (2009); Malaysia (2009); Egypt (2010); Qatar (2010); Luxembourg (2011), USA (2011), Bermuda (2011), Malawi (2012), Seychelles (2013), United Kingdom (UK) (2015); Poland (2015); Japan (2016); Zimbabwe (2016); Zambia (2016); Ethiopia (2016); and Swaziland (2018).

In addition, the FIU Mauritius and other FIUs of the ESAAMLG signed a declaration on sharing of information in August 2015. The declaration commits the FIUs to unite in their efforts to ensure the effective exchange of information, upon request and spontaneously, to combat money laundering, associated predicate offences, the financing of terrorism and proliferation in the region. The document also ensures that information received and requested from another FIU shall always be protected and safeguarded and be used only for the purposes for which it was requested.

#### **8.4.2. Independent Commission against Corruption**

The Prevention of Corruption Act, 2002, makes provision for the promotion of links between the Commission and international organizations so as to foster international cooperation in the fight against corruption. The Act also encourages links between the Commission and similar agencies in other countries. Accordingly, Mauritius has subscribed to the following international Conventions and Protocols:

- The United Nations Convention against Corruption;
- The United Nations Convention against Transnational Organized Crime;
- The SADC Protocol against Corruption; and
- The African Union Convention on Preventing and Combating Corruption.

Mauritius is an active member of the Southern African Development Community (SADC) Anti-Corruption Committee, the International Association of Anti-Corruption Authorities (IAACA), and the Association of Anti-Corruption Agencies of Commonwealth Africa (AAACA). Mauritius regularly attends the Conference of States Parties of the UN Convention Against Corruption and participates in various fora and working groups.

The ICAC has also developed links with many anti-corruption agencies and signed MoUs with five Anti-Corruption Agencies namely:

- i) Zambia Anti-Corruption Commission;
- ii) Anti-Corruption Commission of Seychelles;

- iii) Anti-Corruption Commission (KPK) Indonesia;
- iv) Bureau Independent Anti-Corruption (BIANCO), Madagascar; and
- v) Office de Lutte Contre L'Enrichissement Illicite (OCLEI), Mali.

The ICAC is committed open regional cooperation to share its expertise and best practices with a view to building and increasing the potential to fight corruption and financial crimes in the region.

#### 8.4.2.1. Providing Technical Assistance to Sister Anti-Corruption Commission

Following a needs assessment mission undertaken by the Commonwealth Secretariat in June 2017, the latter requested ICAC Mauritius to place an anti-corruption expert to work in consultation with the Chief Executive Officer (CEO) of the **Anti-Corruption Commission (ACC) Seychelles** to address issues affecting the effective operation of the ACCS. The expert was tasked to assist with the strengthening of the ACCS and the capacity of officials, in particular, its operational processes and procedures in the FIU, in order to improve effective execution of its mandate.

#### 8.4.2.2. Small Island Developing States (SIDS)

ICAC Mauritius hosts the SIDS Anti-Corruption Research Platform (SACRP) which is an online research platform which aims at promoting research work and discussions on anti-corruption and anti-money laundering issues of particular relevance to the SIDS. It supports the generation and use of country-led research and data amongst the SIDS. The SACRP is one of the outcomes of Resolution 6/9 of the Conference of State Parties to the United Nations Convention against Corruption, held in St Petersburg, Russia in November 2015 where it was agreed that Mauritius would host this on-line research platform. A maximum number of SIDS were motivated to join the platform and the topical forum discussions.

#### 8.4.2.3. Domestic Collaboration

At the national level, an **Inter-Agency Cooperation Committee** was set up comprising heads of different agencies for all the stakeholders to discuss the need of going ahead with the ambitious project of developing a platform to formalize inter-agency collaboration and partnership.

The heads of these institutions have agreed on the need for better and more effective cooperation and coordination among the different LEAs and have welcomed the idea of a permanent structure to formalize this partnership and collaboration to financial crime.

Objectives of the Committee:

- i) To work in close collaboration in the national interest and support one another in the prevention and detection of financial crimes including corruption, money laundering, fraud, tax evasion, smuggling, and terrorist financing, among others.
- ii) To share relevant intelligence to allow each party to take relevant action in furtherance of their respective mandate under the law.
- iii) To provide for timely exchange of information in relation to the detection of corruption, money laundering, terrorism financing and of any predicate offence.
- iv) To formalize the inter-agency partnership through a MoU.
- v) To ensure, despite diverging priorities, that all the partners do take ownership of the project and contribute positively in its advancement for the benefit of all the stakeholders in the pursuance of our respective mandate.

### 8.4.3. ICAC Achievements and Results

Achievements of ICAC are both tangible in terms of figures and intangible in terms of change in culture, mindset and attitudes. The following should be noted:

- i) For a population of around 1.2 million, the number of complaints of allegations of corruption, as a result of increasing awareness of corruption by the population has increased by 800% from 2002 to 2017 (Table A8.1 of Annex 8).
- ii) During the course of investigation, the ICAC has referred several cases to the Asset Recovery Investigation Division (ARID) for Restraining Orders. Restraining Orders amounting to USD 297 632 have been requested and obtained (Table A8.2 of Annex 8).
- iii) As at July 2018, 202 convictions had been secured involving 240 persons in cases of corruption and money laundering. 111 cases are pending before the Intermediate Court.
- iv) Outcomes of investigations results in prosecution in court, disciplinary measures against officers involved in malpractices, and systems enhancement through conduct of corruption prevention reviews.
- v) Following convictions, the Court has ordered forfeiture of several properties of accused parties involved in Money Laundering offences. Assets amounting to around USD 124 000 have been forfeited (Table A8.3 of Annex 8).
- vi) The conduct of CPRs helps in reducing opportunities of corruption in public bodies. The number of CPRs conducted by the Systems Enhance Branch was 171 from 2003 to 2017.
- vii) The work of the Community Relations Branch evolved from sensitisation of the population to the dangers of corruption, corruption offences and reporting channels to the engagement of stakeholders. The engagement of stakeholders demonstrates a change in mindset, thus recognizing that corruption is wrong and needs to be fought. Engagement of stakeholders is sustained through various platforms, namely:
  - Public Sector Anti-Corruption Framework;
  - Public Private Platform against Corruption;
  - Civil Society Network against Corruption;
  - Private Sector Anti-Corruption Task Force;
  - Anti-Corruption Academic Forum;
  - Inter-University Students Anti-Corruption Forum;
  - Construction Industry Anti-Corruption Committee; and
  - Trade Union Against Corruption.

### 8.4.4. Challenges

The challenges are multi-faceted. The joint efforts against corrupt persons and money launderers will be fruitful if the aforementioned persons are brought to justice and their ill-gotten assets are confiscated. At the level of investigations, no effort is spared in order to bring the criminals to justice. Our biggest challenge is to gather admissible evidence to pass the required test of 'beyond reasonable doubt' in court. Once this stage is complete, asset recovery, whether conviction-based or through civil proceedings, can be initiated. However, our asset recovery legislation is relatively new and untested, in which case the ultimate objective has no guarantee of success.

Emerging money laundering schemes pose new and evolving challenges to investigators. Whilst the traditional schemes (such as casinos, horse racing, the use of nominees and investment in property and assets) carry their usual load of complexity, we have had a specific case in which there was an indication that a particular group is using crypto currencies, particularly Bitcoin, to acquire assets. Given the unregulated market of crypto currencies as well as the anonymity surrounding it, the tracing of criminal money now has an added level of difficulty.

The increasing use of technologies driving globalisation to move criminal monies and assets across the world is a big challenge. Evidence to strengthen an investigation is therefore not necessarily bound within the territorial limits of a given country. However, the concrete effectiveness of mutual legal assistance (MLA) to a criminal investigation is subject to much debate, given the lengthy duration of the whole process and the non-guarantee of obtaining admissible evidence. The MLA issue is a recurrent problem which is regularly discussed in international forums and, in spite of stated commitments on the part of Member States to facilitate assistance, an established solution is yet to be found.

Other challenges include the following:

- i) Citizens tend to report all types of malpractices to the ICAC.
- ii) Meeting public expectations to put an end to impunity.
- iii) There is resistance to change, especially where advantages are at stake.
- iv) The existing electoral system favors corrupt practices.
- v) The funding of political parties in Mauritius has yet to be regulated.
- vi) Getting the full collaboration of the media in relation to its education and prevention mandate.
- vii) Sustaining public trust.
- viii) Transparency International Corruption Perception Index which is the main index relayed by the media does not fully capture efforts in the fight against corruption.

#### **8.4.4.1. Asset Seizure and Forfeiture**

Due to the acute focus that the ID is putting on money laundering investigation, the number of search and seizure operations is increasing. Among the various articles which are seized upon reasonable suspicion that they are proceeds of money laundering, are movable assets like motor-vehicles, including speed boats and yachts, expensive furniture and other digital apparatus. At present, the Commission does not have a dedicated space to house these types of exhibits. Hence, instead of securing these suspected proceeds of crime, they are attached into the hands of the suspected owners in view of eventual confiscation, if they are convicted by the court for money laundering. An attachment order does not preclude an owner from enjoying an asset which has been attached. Therefore, at the time the court will issue an order for its forfeiture, we are more likely to be left with a largely depreciated article.

#### **8.4.4.2. Inter-Agency Cooperation**

Inter-agency cooperation stands high in the recommendations of the FATF to fight money laundering and counter the financing of terrorism. Uncoordinated effort in the fight against crime not only results in wastage of time and resources but often goes to the advantage of criminals. The need for enhanced cooperation among the law enforcement agencies and the regulators of banking and non-financial institutions of the country is being strongly felt at the present time where criminals are using technology to commit their unlawful avocation.

#### **8.4.4.3. Powers**

To carry out its investigative mandate, the Prevention of Corruption Act, 2002, has given the Commission and the Director-General certain powers. However, when there is a need to place a suspect under judicial control, the Commission must resort to the assistance of the Commissioner of Police (CP) to arrest and provisionally charge the alleged offender. For this purpose, the Director-General sends an executive summary to the CP with enough details of the evidence to enable the latter to take an informed decision. This necessary practice means that the Commission must go outside the limits of confidentiality to be able to enlist the assistance of the Police. There are instances where the Commission's requests were turned down.

#### 8.4.4.4. Whistleblower Protection

Unlike money laundering, corruption is known to be a secretive crime. People are encouraged to report suspected acts of corruption within an organization to the ICAC. However, in the absence of a proper legal framework to protect whistleblowers, the latter are often reluctant to make denunciation. In order to step up efforts to detect, investigate and prosecute high-profile and complex corruption cases, an adequate system to protect witnesses and deal with confidential information is required. The Commission is advocating for legislative reform in this important area of law.

#### 8.4.4.5. Specialized Anti-Corruption Court

Whilst agencies with investigative and prosecutorial powers have attracted more attention, one issue has constantly come up regarding the challenges that the present judicial system could bring about to the effective prosecution of corruption and money laundering offences. These challenges could range from lack of adequate judicial expertise and competencies to adjudicate on these crimes as well as excessive delays to dispose of them. The ICAC is advocating to have specialized anti-corruption courts in Mauritius in order to be on the same footing as countries like Indonesia, Kenya, Uganda, the Philippines and Slovakia.

#### 8.4.4.6. Other Initiatives

Mauritius has accepted and subscribed to the ongoing assessment program by the IMF/World Bank and has so far satisfactorily completed two assessments under the Financial Sector Assessment Programme (FSAP).

In view of further supporting its pledge as a cooperative International Financial Centre, Mauritius has actively participated in the Ad-Hoc Group set up by the OECD to work on the drafting of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (BEPS) (also known as the Multilateral Instrument or MLI). Mauritius has joined the Inclusive Framework to implement the BEPS Recommendations and thereafter signed the MLI thereby committing to implement the BEPS Recommendations. Mauritius has also joined the new initiative on exchange of Beneficial Ownership information.

Government has ratified the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, commonly known as the Vienna Convention and on 18 April 2003, Government ratified the United Nations Convention against Transnational Organised Crime, the Palermo Convention.

With regard to terrorism, Government has already ratified or acceded to, as the case may be, the following United Nations Conventions:

- i) The Convention on Offences and Certain Other Acts Committed on Board Aircraft was signed in Tokyo on 14 September 1963 and ratified on 5 April 1983.
- ii) The Convention on the Suppression of Unlawful Seizure of Aircraft was signed at the Hague on 16 December 1970 and ratified on 25 April 1983.
- iii) The Convention on the Suppression of Unlawful Acts against the Safety of Civil Aviation was signed in Montreal on 23 September 1971 and ratified on 25 April 1983.
- iv) The International Convention against the Taking of Hostages was signed in New York on 18 June 1980 and ratified on 17 October 1980.
- v) The Protocol for the Suppression of Unlawful Acts of Violence at Airports Serving International Civil Aviation, supplementary to the Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation of 1971 was signed in Montreal on 24 February 1988 and ratified on 17 August 1989.



- vi) The International Convention for the Suppression of the Financing of Terrorism was signed on 11 November 2001 and ratified on 14 December 2004.
- vii) The International Convention for the Suppression of Terrorist Bombings was acceded on 24 January 2003.
- viii) The Convention on the Prevention and Punishment of Crimes against Internationally Protected Persons, including Diplomatic Agents was acceded on 24 December 2003.
- ix). The Convention for the Suppression of Unlawful Acts against the Safety of Maritime Navigation was acceded on 3 August 2004.
- x) The Protocol for the Suppression of Unlawful Acts against the Safety of Fixed Platforms located on the Continental Shelf was acceded on 3 August 2004.

In March 2005, Mauritius signed an Agreement with India on Cooperation to combat Terrorism.

A Combating of Trafficking in Persons Act was also enacted on 8 May 2009 effective from 30 July 2009, to give effect to the United Nations Protocol to Prevent, Suppress and Punish Trafficking in Persons; prevent and combat trafficking in persons; and protect and assist victims of trafficking.

## 8.5. Conclusion and Recommendations

Mauritius has over the years put in place the appropriate legal and institutional framework to combat IFFs. However, despite all the efforts to put in place the most secured system that would prevent abuses as time evolves it should be borne in mind that there will always be unscrupulous persons who would come up with devious schemes to help them beat the system. As such, Mauritius will continue to revisit its legislative and institutional framework with a view to reinforcing financial supervision, enhancing transparency and strengthening the regimes to fight tax evasion, terrorist financing, money laundering, corruption and other financial crimes.

### *Annex 8*

#### **ICAC Achievements/Results**

Achievements are both tangible in terms of figures and intangible in terms of change in culture, mindset and attitudes. The following can be noted:

**Table A8.1: Number of Complaints against Allegations of Corruption, as a Result of Increasing Awareness of Corruption by the Population**

Year	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Complaints	201	574	812	820	652	1 057	1 153	1 269	1 350	1 725	1 747	1 613	1 534	1 588	1 638	1 854

**Table A8.2: Details of Properties on which the Commission has Requested and Obtained Restraining Orders by the ARID**

SN	Predicate Offence	Details	Amount	
1	Drug trafficking	Plot of land of 2 1/2 p including house with extension at ground floor and 1 <sup>st</sup> & 2 <sup>nd</sup> Floors	MUR 2 305 000	
2	Swindling (Ponzi Scheme)	Pleasure Craft	MUR 1 400 000	
		Apartment	MUR 3 500 000	
	Drug trafficking	A plot of land of 365.12 sqm	MUR 2 625 000	
		50 000 shares	MUR 500 000	
3	Drug trafficking	Lorry	MUR 175 000	
		Van	MUR 300 000	
	Drug trafficking	Vehicle	MUR 200 000	
4	Embezzlement	Land and house	MUR 600 000	
		Vehicle	MUR 200 000	
5	Embezzlement	Minibus	MUR 660 000	
		Bus	MUR 1 400 000	
6	Swindling (Ponzi Scheme)	In bank account and investments	MUR 10 000 000	
7	Swindling (Ponzi Scheme)	Land and building	MUR 2 200 000	
8	Corruption/Forgery	Plot of land + house; 2 excavators; 1 horse; cash at bank	MUR 6 725 480	
9	Drug trafficking	Plot of land + house	MUR 6 000 000	
10	Embezzlement	(1) A Flat	MUR 2 500 000	
		(2) A Car make Mercedes	MUR 983 485	
		(3) Money in bank on several bank accounts	EUR 24 011 +	
			MUR 591 980	
<b>Total amount of restraining orders</b>			<b>MUR 10 417 118.20 (USD 297 632)</b>	

**Table A8.3: Assets Forfeited on Court Order Following Convictions of Accused Parties Involved in Money Laundering Offences**

Date of Judgment	Property	Value/Amount (MUR)
01/10/2012	House	450 000.00
06/02/2013	Cash	50 000.00
14/10/2014	Cash	277 500.00
05/12/2014	Cash	24 427.15
11/12/2014	Cash	480 500.00
11/12/2014	Cash	114 155.94
26/03/2014	House	2 000 000.00
10/09/2015	Land and House	500 000.00
19/03/2015	Cash	235 000.00
24/11/2016	Cash	191 829.51
06/01/2017	Cash	18 495.82
<b>Total</b>		<b>4 341 908.42 (USD 124 054)</b>

# CHAPTER IX.

## The Case of Uganda

Prepared by the Republic of Uganda



Effective domestic resource mobilization (DRM) helps to ensure that countries raise and spend their own resources to provide for their people. It is a sustainable source for development finance. However, a number of challenges continue to hamper the DRM efforts. Among the key challenges are corruption and illicit financial flows (IFFs).

Corruption and the illicit transfer of funds out of developing countries particularly in sub-Saharan Africa continue to undermine sustainable development by reducing the resources available for essential public services; undermining a country's capacity to provide basic essential services to the citizens reducing the ability to build infrastructure, thereby directly undermining growth; and discouraging investors, all of which reduce the capacity to create jobs and thus weakening the trust between the state and its citizens.

According to the report compiled by the High Level Panel on Illicit Financial Flows from Africa, the continent as a whole loses more than USD 50 billion in IFFs every year. The IFFs out of Uganda are estimated to be in excess of USD 750 million annually and it is feared that this could get worse once commercial production of oil and gas commences. The World Bank report (2018) on *Uganda's Economic Update, Financing Growth and Development Options for Raising More Domestic Revenues* indicates that while economic growth has rebounded from 4.5% to 5.5% in financial year 2017/18, tax collections currently account for 14% of the country's gross domestic product (GDP), lower than regional peers, and short of the government's target of 16%. Domestic tax collections, however, have been growing on an annual basis on account of improved tax management and a rebound in the economy. DRM currently contributes about 70% of the country's annual budget and is projected to rise by 0.3 percent of GDP in the current (2018/19) financial year, despite the growth in IFFs.

Available anecdotal evidence indicates that across Africa, multinational companies (MNCs) are the largest perpetrators of IFFs, contributing about 60%. This is through illegal and, at times, immoral methods. The consequence of these actions denies the continent its due share of revenue and frustrates local revenue mobilization by governments. IFFs are normally effected through tax evasion, money laundering and false declarations. Other illegal methods used include overpricing, transfer pricing, corruption and use of shell companies. The resulting loss of revenue ultimately hampers economic growth.

In an effort to curb money laundering (which is the single most important method of cleansing illicit funds), many jurisdictions in Africa have enacted anti-money laundering (AML) laws, consistent with the Financial Action Task Force (FATF) standards. In Uganda, the enactment of the Anti-Money Laundering Act (AMLA), 2013, paved way for the establishment of the Financial Intelligence Authority (FIA) which is a body charged with the mandate to combat money laundering. Since all crimes (predicate offences) that also generate IFFs are criminalized under the AMLA, the FIA is considered the de facto central institution that is taking the lead in the fight against IFFs.

FIA carried out a Money Laundering/Terrorism financing (ML/TF) National Risk Assessment (NRA) which, was concluded in March 2017. The purpose of the assessment was to establish the

level of threat, vulnerability and overall exposure that Uganda was exposed to with regards to ML/TF. Among the key findings of the NRA report is that corruption, tax crimes, fraud and counterfeiting pose a high money laundering threat to Uganda. The analysis of the money laundering threat showed that the above-mentioned crimes were the most proceeds-generating predicate offences.

Among tax crimes, mis-invoicing is noted to be generating significant amounts of proceeds. A study report published by Global Financial Integrity (GFI) (2014) over the period 2002 to 2011 for Uganda, indicates that the mis-invoicing of imports is by far the primary method through which funds are illicitly transferred out of the country. The money generated through under-invoicing of exports averaged UGX 887.4 billion (USD 261 million) per year, while that generated through import over-invoicing averaged UGX 27.2 trillion (USD 813 million) per year.

The 2015 Crime and Safety Report by Overseas Security Advisory Council on Uganda also indicated that there has been an increase in financial fraud cases involving credit cards, personal checks, and counterfeiting. One of the largest fraud cases involved six ex-employees of a telecom company (MTN), who were charged with defrauding the company of UGX 10 billion (USD 3.4 million), by creating and stealing e-money that was not backed by physical cash in the company's bank account.

The NRA also establishes that at a trans-national level (that is the predicate offences committed outside Uganda and the proceeds laundered in or through Uganda), the most proceeds-generating predicate offences are smuggling, wildlife offences, drug trafficking and human trafficking. Smuggling of gold and timber, and, to a lesser degree, of diamonds are a significant source of proceeds. Most of the gold is smuggled from the eastern DRC and the Central African Republic, through Uganda and other countries, to UAE, India, Lebanon and other Asian destinations. Uganda is estimated to lose about UGX 2 billion (USD 58.8 million) annually in wildlife offences ranging from commercial poaching to hunting for daily subsistence.

Although corruption cuts across in all categories of IFFs, the term is mostly associated with public sector corruption, such as bribery and abuse of office (ECA, 2014). Corruption has the potential to facilitate other criminal activities, including drug trafficking, racketeering, counterfeiting, terrorism financing, tax evasion and trade in contraband goods among others. Private sector businesses, however, also perpetuate these crimes by bribing public officials and using personal connections to influence administrative processes (ECA, 2013).

In addition to posing a high money laundering threat to Uganda, corruption, according to the Inspectorate of Government (IG) report (2014), estimated that the amounts paid in bribes in 2013 was about UGX 165 billion (USD 49.6 million). Further, the 2014 nationwide survey on governance undertaken by IG in 2013, showed that at least eight of every 10 Ugandans believe that corruption is a serious problem in the country. Embezzlement and diversion of government funds were identified as the main proceeds-generating crimes with regard to corruption. Funds are embezzled or diverted to the personal interests of the offenders through outright theft, misallocation and diversion to a wrongful purpose.

### 9.1. Why Combating IFFs from Africa is Key

The problem of IFFs is now widely recognized as a major challenge to creating and sustaining a sound revenue base for developing countries, like Uganda. These IFFs are occasioned through aggressive tax avoidance mechanisms, such as transfer pricing, thin capitalization, exploitation of double taxation treaties and profit shifting. In a bid to stop IFFs, governments' interventions have mainly been focused on enacting strong policy, legal and regulatory regimes. In Uganda, for the period 2002–2011, the GFI report (2014) estimates that the country lost about 2.6% of its GDP per year to IFFs. There is therefore no doubt that IFFs constitute a major source of domestic resource leakage.

Various reports on the subject matter, including that of the High Level Panel on IFFs in Africa, argue that if illicit outflows are curbed, and the funds used domestically, the value of the flows involved would have a significant positive impact on development by reducing Africa's reliance on aid and external borrowing to finance development.

IFFs have a source country and a destination country; they often also involve transit countries. Destination countries are primarily wealthy nations, since they offer secure facilities, a wide range of investment opportunities and political stability. Transit countries are often the small secrecy jurisdictions that are heavily dependent on handling these transactions. IFFs leave developing countries with little resources to meet local growing demands from its citizenry which, in turn, generates unrest and loss of trust in governments. In Uganda the establishment in 2014 of the Financial Intelligence Unit (FIU), the FIA-Uganda, is now helping to generate the necessary intelligence information on economic crimes involving money laundering. For example, such information on tax evasion has resulted in tax revaluations of some business entities by the tax body, the Uganda Revenue Authority (URA).

It has, however, been observed that despite growth in net URA collections over the past decade, the tax body has consistently fallen short of its revenue targets in the recent past. Specifically, the URA registered shortfalls of UGX 458 billion, UGX 404 billion, UGX139 billion and UGX 503 billion in the financial years, 2016/17, 2015/16, 2014/15 and 2013/14 respectively. Although these deficits appear small in relation to the respective annual set targets, the impacts in terms of the goods and public services, which could have been financed is huge. For example, the UGX 458 billion revenue deficit registered in 2016/17 was slightly more than half; the budget allocated to the Agriculture Ministry, a sector that supports livelihood of in excess of 75% of the population.

Therefore, enforcement of measures that reduce IFFs and other tax avoidance mechanisms remain one of the most important options available for URA and tax authorities across Africa to boost domestic revenue collections.

## 9.2. Conclusion and Recommendations

Combating IFFs remains the single most important prerequisite for effective domestic resource mobilization for financing sustainable development in Uganda and across other countries in Africa as a whole. The fight against IFFs in developing countries should be tagged to the fight against poverty, which may not be won without strong political will and commitment of leaders. Indeed, there is urgent need to sensitize leaders at all levels and involve them in the fight against IFFs. Provided there is political will, action will be needed on two major fronts: first, countries will have to put in place structures that detect and prevent new resources from illicitly flowing out of their jurisdictions; and second, given the size of accumulated resources that have left the continent over the years, it will be important to find ways of attracting them back.

Among the measures that could be taken to minimize IFFs out of countries in Africa, is first, to integrate specialized agencies that are involved in the import and export operations such as the Société Générale de Surveillance (SGS) in the formulation of appropriate mitigation strategies. This is because their role is critical in checking conformity of the physical quantities of the goods traded to their value, quality and quantity as specified on export/import documents. Second, governments should be encouraged to ensure transparency and disclose information relating to financial inflows and outflows from their jurisdictions. This will help to break the secrecy surrounding financial flows into and out of Africa, which is crucial in the fight against IFFs. In addition, authorities must strengthen efforts and work to minimize the corrupt practices that fuel IFFs. To this end, the Stolen Asset Recovery Initiative (StAR) should be fully embraced by all countries. The initiative is a partnership between the World Bank and United Nations Office on Drugs and Crime (UNODC) that supports international efforts to end safe havens for corrupt funds.

Finally, it is our considered view that the Africa Union Commission (AUC) should engage all relevant partners, to ensure that all countries explicitly designate a central authority to coordinate domestic initiatives in the fight against IFFs. It is our considered opinion that FIUs should be given this mandate. This is grounded on their inherent obligation to fight money laundering and the predicate crimes to money laundering; all of which generate the largest source of resources that are subject to IFFs. We recommend, in particular, that the AUC applies for Observer Status in FATF, from wherein they can engage the FATF and other key partners with a view to influence the adoption of combating IFFs to be incorporated as a standard for international best practice for all countries.

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# CHAPTER X.

## The Case of Algeria

Prepared by the People's of the Democratic Republic of Algeria



Money laundering, corruption and illicit financial flows (IFFs) are at the centre of criminal activities and pose a major threat to domestic security and economic stability. Therefore, measures initiated to combat this phenomenon remain a priority. Furthermore, the rise of terrorism has led to increased monitoring of financial circuits that could finance it.

The financial sector is the most commonly used channel for IFFs. This is largely due to the interconnection of national and international financial systems, which offer a wider geographical area through which illicit financial assets are moved and laundered.

Most African economies are characterized by an informal financial system based mainly on cash payments, although significant efforts have been made to improve the level of financial inclusion.

In order to respond to these realities, Algeria has adopted modern regulatory instruments in conformity with international standards, to ensure transparency in financial transactions.

Combating IFFs has always been one of the Government's priorities. Algeria was one of the first countries to express concern over the development of financial crime and has a considerable legal framework that is constantly adapted to combat it.

In addition, it contributes actively to efforts towards combating financial crime and participates in deliberations on the issue at international as well as regional levels within the framework of the United Nations (UN), the European Union (EU), the African Union (AU), the Middle East and North Africa Financial Action Task Force (MENAFATF), and the Egmont Group.

To combat all forms of economic and financial crimes, Algeria has adapted all legislation governing economic life, in particular those combating corruption, the Commercial Code, the Public Procurement Code, Law on Foreign Exchange Legislation Offences, Law on Currency and Credit, Preventing and Combating Smuggling, the Public Accountancy Act, the Tax Code, and Customs Code.

In the same context, other laws aimed at certain forms of specific crimes were enacted. They concern mainly preventing and combating money laundering and terrorist financing (ML/TF).

The revision of this legislation is essentially geared towards reinforcing control mechanisms, and introducing greater transparency in the management of public affairs.

Algeria has adopted a number of measures in the area of money laundering, the financing of terrorism, corruption and IFFs, namely by:

### 10.1. At the Legislative and Regulatory Level

**Adaptation and updating of national legislation and regulations** with a view to establishing control mechanisms and introducing greater transparency in the management of public affairs mainly through:

- Revision of legislation governing economic life (public procurement, combating corruption, violations of foreign exchange laws, drug control, combating smuggling, counterfeiting, tax, customs, and banking and commercial offences);

- Establishment of a threshold beyond which all payments must be made by non-cash means of payment through banking and financial channels;
- Establishment of a national register of violators of laws and regulations on foreign exchange, and capital movements abroad;
- Establishment of a national register of fraudsters, serious violators of tax, trade, customs, banking and financial laws and regulations, as well as failure to comply with legal deposit of company accounts requirements;
- Establishment of a threshold for declaration of imports and exports of bank notes and/or negotiable instruments denominated in freely convertible foreign currencies;
- Publication of guidelines on electronic transfers of funds; and
- Publication of guidelines on customer due diligence measures for banks and non-financial professions.

**Ratification of international conventions to combat the phenomenon:**

- United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances
- United Nations Convention against Transnational Organized Crime, adopted by the United Nations General Assembly on 15 November 2000
- United Nations Convention against Corruption, adopted by the United Nations General Assembly in New York, on 31 October 2003
- African Union Convention on Preventing and Combating Corruption.

## 10.2. At Institutional Level

**Modernization and strengthening of basic institutions** with the specialization of structures in charge of combating the phenomenon of IFFs, namely Customs Department; Tax Department; Inspectorate-General of Finance; Bank of Algeria; Justice Department; Department of Trade; and Security Services.

**Strengthening the judicial system and specialization of institutions to combat** money laundering, the financing of terrorism, corruption and illicit financial flows, mainly through the establishment of specialized judicial clusters (Criminal Code, Criminal Procedure Code, and the Code of Civil and Administrative Procedure).

### 10.2.1. Establishment of Organs to Combat the Phenomenon

- Financial Intelligence Processing Unit (CTRF – *Cellule de Traitement du Renseignement financier*) under the Ministry of Finance (Law of 2005 amended in 2012 and 2015, Decree of February 2001)
- National Anti-Corruption Organ (Law of February 2006)
- Central Anti-Corruption Office (Law of February 2006)

## 10.3. Through Capacity Building

- **Establishment of specific programs for training**, proficiency and upgrading of staff in charge of combating money laundering, the financing of terrorism, corruption and IFFs
- **Organization of information days and other workshops** on combating money laundering with the assistance of international institutions (European Union, United Nations Office on Drugs and Crime (UNODC), International Monetary Fund (IMF), World Bank, MENAFATF, and countries such as the United States of America, France, United Kingdom).



#### 10.4. Though Monitoring and Control

**Strengthening the systems and mechanisms for monitoring and control** of IFFs at national and international level, in collaboration with the Bank of Algeria for financial flows, and the Customs Department for physical flows.

#### 10.5. In the Area of International Cooperation

Algeria is a founding member of the Middle East and North Africa Financial Action Task Force, which was established in 2004 in Bahrain. The Regional Task Force is composed of 19 countries of the Middle East and North Africa (MENA) region.

The CTRF also joined the Egmont Group in July 2013, as recommended by the FATF. The Egmont Group currently consists of the FIUs of 158 countries.

In addition, the CTRF developed a policy for the negotiation of bilateral administrative cooperation agreements to facilitate exchange of financial information between FIUs. Within this context, to date the CTRF has concluded 21 Memorandums of Understanding and Exchange of Information with counterpart FIUs in Africa, the Middle East, Europe and Asia.

# CHAPTER XI.

## The Case of Cameroon

Prepared by the Republic of Cameroon<sup>98</sup>



### 11.1. Introduction

In a context marked by the institutionalization of 11 July as African Anti-Corruption Day and the consecration of the year 2018 to the fight against corruption, the African Union Commission (AUC) invited Cameroon to voluntarily contribute to the development of the reference work on the theme, 'Mobilizing Domestic Resources: Fighting Corruption and Illicit Financial Flows'.

The first section of this contribution will revisit the theoretical and empirical foundations of the scourges of corruption and illicit financial flows (IFFs), their magnitude and their consequences. It will then review Cameroon's experience in combating them. The third section will focus on the actions that need to be considered in order to contain the scourges.

In developing this contribution, the author consulted a variety of materials, for the most part, reports, studies, synthesis documents produced by international or national institutions, and legislative texts.

### 11.2. Corruption and Illicit Financial Flows as Social Facts

The fight against corruption and IFFs is a contemporary issue, on account of not only their impact on the economies of countries but also the efforts deployed by the international community to contain them. It is worth understanding these concepts if there is to be any hope that they will ever be eradicated.

#### 11.2.1 Concepts and Scope of Corruption and IFFs

Corruption is not always easy to define. It is generally considered to be a behavior consisting in making, soliciting, accepting or receiving offers, promises, gifts or presents, in cash or in kind, for the purpose of performing or postponing an act, or refraining therefrom, and obtaining favors or special benefits.

It follows from this conceptualization that corruption is characteristic of those who have access to resources. Going by this definition, two components of corruption are identified: the so-called 'village' corruption and 'grand corruption'. Village corruption derives from the dishonest behavior of civil servants vis-à-vis administrative rules and includes inappropriate comportment on the part of public officials; while the grand corruption incriminates the corruption that companies engage in to obtain huge government procurement contracts. Grand corruption includes the corruption perpetrated through foreign subsidiaries and offshore financial centers where looted capital (illicit flows) is lodged.

IFFs generally involve practices such as: money laundering, kick-backs by international businesses, tax evasion and falsification of commercial transactions. They may derive from illegal

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98 The chapter has been prepared By Mr Emmanuel Yangam, Statistician Economist Engineer.

or corrupt practices such as smuggling, fraud or counterfeiting, and may also be intended to finance terrorism or bribes or the legal consumption of goods.

Seven main causes of corruption and increased IFFs are as follows:

- i) Political system characterized by the inability to establish lines of demarcation between the public domain and the private domain, between the general interest and individual interest, between state assets and individual matters.
- ii) Lack of transparency in the management of public assets.
- iii) Special and privileged access to resources and their private appropriation under the guise of public monopoly.
- iv) A selection of heads of public enterprises who do not meet the need to achieve specific goals and accountability.
- v) Weakness of public institutions: public administration characterized by its hypertrophy, lack of transparency and massive inertia can only provide a fertile ground for corruption.
- vi) Acquisition of state-owned companies by organized crime, through the privatization programs instituted on the advice of certain development partners.
- vii) Rudimentary management of control instruments.

To fully understand the need to combat these scourges, their impact on domestic resource mobilization, growth and on the population has to be measured.

### **11.2.2. Magnitude and Cost of Corruption and IFFs**

Traditionally, corruption was considered a necessary evil (Elliott, 1997), closely linked to smooth conduct of business. In the early 1990s, several factors led the international community to an awareness of its dangers and the need to combat it. Corruption can distort competition, slow economic growth and undermine public confidence in the political system and state institutions. The consequences include:

- i) Damage to the credibility of State and public institutions;
- ii) The risk of state disintegration;
- iii) The loss of investor and citizen confidence in the State which is supposed to be their first protector; and
- iv) Impoverishment.

In addition, corruption negatively impacts the State's external credibility and the future of its youth. It rattles the foundations of the State and compromises development, and by extension the peace, security and well-being of citizens. Corruption has today become one of the major instruments of destabilization of the companies in search of markets in emerging regions. It is increasingly becoming a driving force in the spiral of violence.

Despite their wealth of natural resources, several African countries are among the poorest in the world as a result of corruption and IFFs, among other elements.

IFFs are generated mainly through methods, practices and offenses aimed at transferring financial capital out of a country, in violation of national or international law. Money placed abroad makes possible the procurement of luxury goods that are not available locally or to win the favor of countries likely to serve as safe haven in the event of escape. To address the misappropriation of wealth and its transfer out of the country, governments generally resort to external borrowing to fill the savings gap. The ensuing debt accumulation aggravates macroeconomic instability and renders the country vulnerable to shocks.

The flight of wealth from poor countries through tax evasion, money laundering, corruption and other misdeeds is becoming a growing concern for Africa.

Every year, large amounts of capital are illegally transferred out of developing countries: on the average, Africa lost USD 50 billion annually between 2003 and 2012. Cameroon, for its part, accounted for a USD 7 billion loss. According to the report of the High Level Panel on Illicit Financial Flows, Africa lost an estimated USD 854 billion between 1970 and 2008. This amount is equivalent to the development aid received by Africa during the same period.

In the face of this giant multi-armed monster, African economies are considerably weakened and all actions undertaken come up against various difficulties. IFFs encompass tax evasion, money laundering, drug, arms and medicines trafficking, corruption, and embezzlement. By way of illustration, falsified commercial invoices accounted for 68.8% of the illegal capital outflows from sub-Saharan Africa as per the evaluation carried out between 2003 and 2012. According to estimates by the Economic Commission for Africa, price falsification caused African countries a loss of USD 407 billion. These IFFs deprive our countries of the resources that could be used to finance essential public services. The immediate impact is felt in the form of reduced national spending and investment, public and private alike. According to Global Financial Integrity (GFI), multinationals play a leading role in increased IFFs. Another means of capital flight is the illegal exploitation of mineral resources sold in Europe without payment of an iota of tax. Banks are also the major transit routes.

All of this lost capital impedes the continent's ability to mobilize domestic resources to address the pressing issues of worsening social inequality and other development priorities. Whereas money laundering, corruption and tax evasion are harmful to all the victim countries, their impact on developing countries is particularly damaging. Incomes derived from corruption or criminal activity are generally spent on the consumption of goods such as luxury vehicles, or invested in real estate, art or precious metals which our countries do not produce.

IFFs result in the weakening of financial systems and economic potential. Indeed, the efficiency of a financial sector is predicated on the overall reputation for integrity which is compromised by money laundering. The latter can hinder economic growth, to the detriment of the well-being of populations particularly the most vulnerable.

On the whole, corruption and money laundering contribute to misallocation of resources in our countries. The idea that corruption is a necessary evil is no longer in vogue. It is no longer perceived as the inescapable legacy of a society lacking modernization. Awareness of the negative impact of corruption has generated a wide range of anti-corruption initiatives. Moreover, anti-corruption policies now form part of good governance policies and state modernization endeavours. The Government of Cameroon is a stakeholder in the crusade against these scourges.

### 11.3. Cameroon Experience in Combating Corruption and IFFs

Given the context of the propitious international environment, most governments have demonstrated their will to tackle corruption in its most pernicious forms. The tool of anti-corruption policies is increasingly being used by countries faced with such significant or serious problems.

In Cameroon, the discovery of petroleum resources, the abortive coup d'état of 1984, the disproportionate downturn in civil service wages in 1993, the financial liberalization (having triggered capital flight), and the advent of economic liberalism which enshrines the triumph of egotistical interests over the general interest, have been amplifiers of corruption and increased IFFs.

For their part, international financial institutions, by conditioning debt relief programs on public governance improvement actions, helped initiate government anti-corruption policies. Former World Bank President James Wolfensohn said, "Corruption is a phenomenon maintained by elites and business circles. It enriches them and further impoverishes the poor who, in fact, pay the price."

The State of Cameroon has, for several years, been establishing a range of structures to sanitize public wealth management.

### 11.3.1. Cameroon Mechanisms to Combat Corruption and IFFs

Cameroon authorities have taken up the international challenge of fighting corruption and IFFs and thus have put in place legal, jurisdictional, parliamentary and institutional mechanisms to combat the scourges. The Government has, in this regard, approved a number of guidelines aimed at establishing new standards to combat corruption and money laundering and confiscating the proceeds of economic criminality. Despite the obstacles, Cameroon has succeeded in developing national strategies to combat corruption and money laundering almost in conformity with international standards.

#### 11.3.1.1. Legal Mechanisms

Cameroon is party to the following legal instruments, adopted at least a decade ago, within the framework of the Economic Community of Central African States (ECCAS) and the Economic and Monetary Community of Central African States (CEMAC):

- The 12 September 1961 Tananarive Convention on Judicial Cooperation ratified by Decree No. 62/155 of 9 April 1962
- The Extradition Agreement between CEMAC Member States ratified by Decree No. 2006/04 of 30 January 2016
- The 18 March 2006 Agreement on Mutual Legal Assistance and Judicial Cooperation between ECCAS Member Countries ratified by Decree No. 2008/110 of 12 March 2018
- Cameroon is also party to the Agreement on Criminal Police Cooperation between the States of Central Africa. Cameroon is one of the 16 African States that have acceded to the Treaty on the Harmonization of Business Law in Africa (OHADA), signed in Port Louis on 17 October 1993.

#### 11.3.1.2. Jurisdictional Mechanisms

Cameroon has endowed itself with a mechanism consisting of repressive measures enshrined in the Penal and Electoral Codes or stemming from the country's accession to the United Nations Convention against Corruption. The crime of misappropriation of public funds is one of the offenses established as corruption by the United Nations Convention against Corruption (UNCAC) (see Article 17). It is the keystone of the judiciary anti-corruption mechanism in matters of the loot of public wealth in Cameroon. Since 2006, through what has been christened by the media as 'Opération Épervier' (Operation Sparrowhawk), many public managers, business persons and politicians have been prosecuted and convicted. For the record, in the area of public financial management, among the reforms initiated by the State for the prevention, control and repression of the loot of public wealth, Operation Sparrowhawk has been responsible for numerous arrests of public figures (members of government and senior State officials, among others) and private individuals suspected of embezzlement of public funds.

The Ministry of Justice materializes the judicial system in the government. It ensures compliance with laws through its various jurisdictions located all over the country: first instance courts, high courts, courts martial, appeal courts, the Supreme Court, the High Court of Justice and, more recently, the Special Criminal Court with the mission to try cases of embezzlement of public funds in the amount of 50 million CFA francs. The Special Criminal Court (SCC) created on 14 December 2011 and tasked to hear cases of misappropriation of public funds and related offenses, is one of the initiatives and instruments deployed to contain corruption in Cameroon.

#### 11.3.1.3. Institutional Mechanisms

On 11 August 1998, Cameroon set up a national governance program, of which one priority area of action is intensification of the fight against corruption. Several other reforms have been instituted, namely: (i) public accounting reform which is ongoing; (ii) a new budget nomenclature

which draws up a budget according to set economic and social objectives; and (iii) a computerized personnel and payroll system.

Cameroon's accession to the Mining and Extractive Industries Transparency Initiative in 2005 ushered in greater transparency in the management of petroleum resources and it was accepted as a candidate country on 27 September 2007. Implementation of the Initiative is monitored by a coalition comprising the State (ministries of Finance and of Mines, Industries and Technological Development and the National Hydrocarbon Society), civil society and the oil and mining companies. Its goal is to communicate to the greatest possible number of people the revenues collected by the State as a result of petroleum, mining and, soon, gas resources extraction operations.

The institutional framework, established by the anti-corruption plan adopted in December 1997, consisted of an *ad hoc* committee under the auspices of the Prime Minister, to which an observatory and ministerial unit are attached.

The National Agency for Financial Investigation (ANIF) was created in 2005 to fight money laundering and fraudulent fund movements. It carries out the traditional missions devolving on a financial intelligence unit such as receiving, obtaining, processing and, if need be, transmitting to the competent judicial authorities any financial intelligence relevant to establishing the origin of the amounts or the nature of the transactions which is the subject of a statement of suspicion in matters of ML/TF.

The presidential decree establishing the National Anti-Corruption Commission (CONAC) was signed on 11 March 2005. Its major mission is to collect, collate and put to use the denunciations and information on practices and facts or acts of corruption brought before it. In carrying out its mission, CONAC has achieved the following:

- i) Drawn up the charter of the national anti-corruption coalition;
- ii) Developed the anti-corruption strategy;
- iii) Developed a national integrity education program;
- iv) Carried out several physical and financial audits of public funded projects and procurement commissions; and
- v) Conducted several audits of public bodies and other organizations.

In addition, it has conducted several investigations in corruption cases and related offenses such as misappropriation of public funds or assets; violation of the Public Procurement provisions; interest in an act; bribery; favoritism; influence peddling; unjustified enrichment; involvement in a case; the abuse of duty; and conflict of interest.

ANIF, for its part, is tasked to combat money laundering in collaboration with CONAC, both of which are special agencies (gendarmes) charged with the protection of public wealth.

This mechanism is additional to the existing structures with the mission to prevent corruption, such as the Supreme State Audit, the Audit Bench of the Supreme Court, the Public Procurement Regulatory Agency, and others.

#### **11.3.1.4. Parliamentary Mechanisms**

The draft law on property and assets declaration was voted on by the National Assembly in 2005. The new financial regime of the State, which enshrines the program budget, was voted on by the National Assembly in 2007.

On 11 July 2018, the National Assembly adopted the draft law establishing the financial regime of the State and other public entities, as well as the law establishing the code of transparency and good governance in the management of public finances in Cameroon. While the first is a tool that

ushers in innovations in such aspects as the role of the parliament in the budget process and the information to be provided to the public on the main stages of the budget procedure, the second upholds transparency, legality, accountability and performance as the basis for the management of public finances.

One of the crucial areas of focus of these reforms has been compliance with the ethical rules and enhanced morality in an efficient and modern mode of management.

### **11.3.2. Achievements from the Afore-listed Mechanisms**

Some results of this fight deserve to be highlighted. As part of the accomplishment of its missions, this institution in 2010 developed a national strategy to combat corruption which aims to support the process of social transformation in Cameroon in the perspective of strengthening the rule of law, democracy, effective participation in public management, transparency and, above all, the rejection of corruption.

Thanks to the many missions of the State Supreme Audit, the Treasury has been able to recover lost resources.

For example, the audit of the Road Revenue Protection Programme resulted in the recovery of 5 billion CFA francs and the issue of debt securities valued at 45 billion CFA francs. With regards to convictions and confiscation of assets for predicate offenses (misappropriation of public assets), 14 cases involving around 35 people received definitive decisions by the end of May 2018. The General Delegation for National Security (DGSN) received 65 ANIF reports on suspected financing of terrorism. It conducted and transmitted 47 proceedings on suspected acts of terrorism and terrorism financing in respect of 163 presumed perpetrators. From 2006 to 2017, ANIF received 3 278 reports on suspicious transactions, and transmitted 638 cases of money laundering and terrorism financing to the courts.

For example, from 2 January 2008 to 31 December 2010, CONAC received 298 applications and denunciations on corruption related offenses and investigated 230 of such cases.

### **11.3.3. Limits to the legal arsenal established to curb the scourges**

A look at the civil society and government commitment in the fight against corruption reveals that the phenomenon persists and that its foundations have not been tackled. In 2017, the corruption perception index report of the NGO Transparency International indicated that Cameroon moved from the 145<sup>th</sup> place in 2016 to 153<sup>rd</sup> in 2017. Cameroon scored 25 out of 100, that is, below the average of 43.

Cameroon's results in the fight against corruption and IFFs are therefore mixed. In terms of behavioral change and corruption intensity decline, the results remain below expectations; this is the main reason for doubts cast on the control policies and strategies adopted thus far.

Analysis of success stories in this respect confirms the observation made on several occasions to the effect that political will alone is not enough. The mechanisms put in place to fight the scourges are quite often inefficient due to their sensitivity to the game of politics. According to Engeléguelé (2015), 'corruption cases' are implacable weapons in the local political game. Indeed, the instruments of repression and punishment fall within the ambit of criminal justice, the exercise of which is closely linked to the relation between the political forces. In Cameroon, the judicial institutions are relatively young; there is a real risk of exploitation of anti-corruption and money laundering policies. Every manipulation or suspicion of manipulation undermines the legitimacy and credibility of the strategies implemented.

As regards the promotion of good governance by certain international institutions, Jean Cartier Bresson (2000) holds that a strategy based on the virtue of social networks and on reduced areas of

economic and social competence of the public authorities, in a scenario of weak and undemocratic states, is likely to accentuate the transition from old to new corruption, but not reduce the phenomenon. Henri Eyebe Ayissi (2013) for his part, believes that the poor results so far achieved in the fight against corruption would be justified by the stakeholders' poor ownership of the roles and operation of all the bodies that make up the institutional mechanism for the prevention, control, observation and non-judicial repression of misappropriation of public property. One of the fundamental reasons for the lacklustre results is that the mechanisms do not tackle the source of corruption. One of the key elements of an anti-corruption strategy is precisely to unveil the mechanisms, unmask the actors and thus remove the veil on these practices for exposure to public judgment and the laid-down sanctions (Dommel, 1999). For this reason, an effective anti-corruption strategy may paradoxically be short-term, lead to an increased number of officially listed cases of corruption and generate a false perception that corruption is on the rise. In the absence of in-depth thinking to provide robust solutions, corruption has the tendency to become more sophisticated.

#### 11.4. Some Lines of Action to Contain Corruption and IFFs

An effective fight against corruption will be possible only if its sources are tackled. Besides, a large-scale and long-term fight requires the uninterrupted mobilization of enormous national resources.

An anti-corruption strategy can address certain cyclical factors that impact the dynamics of corruption, such as the profit-grabbing opportunities offered by public enterprises privatization processes. It can leave intact many socio-cultural and political factors of which influence on the dynamics of corruption is more durable (Myrdal, 1978a; Huntington, 1968), and manifestations of which appear only slowly and subtly. The independent nature of CONAC in relation to political, police and bureaucratic bodies is essential to legitimize the process. Lastly, the specialization and professionalism of the officials can contribute to the credibility of the program.

The quality of a strategy depends as much on the relevance of the objectives and the means of realization as on the way the said objectives and means have been chosen. We must be able to appreciate the correspondence of the choices (objectives and means) made with the results of theoretical or empirical analyses, the purpose of which is to prevent or reduce corruption.

A good anti-corruption strategy must contain policies and structures that directly address the causes recognized in the literature on corruption (Mauro, 1998). When bribes are significant, the degree of subjectivity in the decision high, the possibilities of being accused and sentenced low, and the penalties derisory or even non-existent, even the most honest persons bear the risk of yielding to temptation.

Corruption and money laundering account for losses that can be prevented through reforms. An effective fight should be global and focus on information and training; prevention; and repression.

##### 11.4.1. Information and Training

One of the main challenges to be overcome in the fight against corruption in Africa in general and Cameroon in particular is access to information by the various stakeholders involved in the process. Informing the public of the harmful effects of corruption should be part of the objectives of the public anti-corruption program. One crucial prerequisite to effectively fight corruption is to dispel the prejudices that discourage action. In this regard, it is important to eradicate in speeches those statements that undermine the desired goal, such as: "corruption is inevitable and inherent in the human nature", or "corruption is ubiquitous".

Moreover, businesses and governments should embark on action when public opinion so demands. In order to fill the gap in corruption data, a multi-disciplinary research program on



corruption should be set up, the outcomes of which could be incorporated in a detailed report on the status of the scourge. Such analysis of corruption would come up with the most appropriate approach to this problem. Universities should initiate, organize and promote research in the fight against corruption and IFFs.

Training programs aimed at combating corruption should be encouraged for target audiences (managers, controllers, financial systems regulators or bribe takers, and economic operators). Training helps to prevent the emergence of corruption in organizations and assists auditors to detect fraud and corruption. According to Saturnin Tsayem Dongmo (2015), the evangelization and the training of the populations, dispensed within the Catholic Church, is a solution to the endemic problem of corruption in Cameroon. It would be interesting to consider creating a centralizing body for transmission of information on corruption, training, prevention and research.

#### **11.4.2. Prevention**

Prevention consists in increasing the risk of being caught and, to this end, in making transparency the order of the day: in public procedures, company accounts, the assets of civil servants, authorities and elected officials. It consists in reducing the opportunities for corruption, organizing the financing of political life, limiting administrative interventions, distributing power, judiciously managing the selection, rotation and remuneration of personnel. It is needed to ensure the effectiveness of public investments which is always predicated not only on the transparency of invitations to tender, but also on the fight against all such illicit forms of understanding as can be formed between the administration and private operators, and that can go as far as diverting public resources.

On the other hand, the worsening of corruption in Cameroon has its roots in the drastic decline in wages in the civil service. Researchers have recognized that low-paid public officials are easy targets for corruption (McMullan 1978, Myrdal 1978b, Rose-Ackerman 1978, Wraith and Simpkins 1978). An incentive improvement policy will have to begin with the establishment of an evaluation system linking pay to performance for everyone (Klitgaard, 1998). An anti-corruption strategy must reform the system of remuneration and evaluation of public officials to change their behavior and that of corrupt officials, in a way that reduces the attractions of corruption for the former and increases the costs for the latter.

Recent studies show that factors of institutional inefficiency – several of them aggravated by corruption, such as political instability, the weakness of legal and judicial systems and excessive rigidity of the bureaucracy – contribute significantly to poor economic performance. According to Mauro (1998), it is impossible to separate things because, the two weaknesses – corruption and institutional inefficiency – are intricately linked since they feed on each other and are mutually reinforcing. Poor governance is therefore seen as both a catalyst and a consequence of IFFs.

It is therefore necessary to promote sound public financial management, good financial governance, accountability and oversight. Good governance policies aimed at developing better institutional capacities would thus contribute to overcoming corruption.

The Government should make every effort to address the following:

- i) Modernize public administration to become truly user-friendly;
- ii) Consolidate the rule of law;
- iii) Promote a culture of accountability in economic and financial management;
- iv) Enhance transparency in the management of public affairs.

Administrative reform can improve matters, but it will not solve anything unless citizens are guaranteed the right to defend themselves against abuses by the administration. Governments could consider establishing a central corruption prevention service.

Strengthening the institutions and the macroeconomic framework can help stem and prevent capital flight. Improved banking governance and the rigorous control of irregular payments significantly halt capital flight. By improving its policies and strengthening the effectiveness of its institutions, our countries will gradually succeed in stemming capital flight.

Prevention also involves propagating a culture that proscribes corruption and upscales its moral or political costs. Beyond the moral cost, there is the penal cost which entails effective crackdown: first patch up the large breaches, through which the grand corruption rushes, but not allow petty corruption to flourish, petty corruption which often hits the poorest and is easily diffused from bottom to top.

### **11.4.3. Repression**

This reposes on a national legislative framework. In the detection of corruption, the statement of suspicion has become an essential instrument that requires establishing good collaboration with professionals. To punish corruption, an independent honest judiciary must be endowed with sufficient hands and adequate legal tools.

The Government of Cameroon has deployed appreciable efforts in this direction. It could also consider a draft legislation to tax the outward signs of wealth. ANIF could already play a key role in this respect.

In the same vein, a specific law sanctioning corruption in international operations carried out by companies and the public administration may be considered. It is important to develop a law incriminating the companies that give bribes to public servants. A first step in the right direction would be, for example, a government policy that would reduce monopolies and/or aim at effectively controlling the same.

To access a property, even moderate property, it is often necessary to transgress the law. Therefore, any form of enrichment should be suspect, and any accumulation should be considered illegitimate. The civil society, for its part, could consider the creation of an independent body for the constant monitoring of the authorities in our countries.

As regards IFFs in particular, tax collection structures should improve the efficiency of their surveillance. To curb tax evasion, it is crucial to establish an effective information sharing mechanism between countries. Automatic sharing of intelligence can be an effective tool capable of dissuading tax evaders. More generally, our countries must continue to build effective and accountable institutions. In this respect, building the capacity of the tax administration seems crucial. Our countries' development partners should also enhance their own capacity to prevent and investigate economic crimes. Developing countries need to strengthen their regulatory and supervisory regimes, and fully implement the new recommendations issued by the Financial Action Task Force (FATF).

## **11.5. Conclusion and Recommendations**

All in all, the political will to eradicate corruption in Cameroon is real. The fight against corruption is embedded in the collective consciousness. The country has a National Anti-Corruption Strategy and a National Integrity Education Programme. The National Anti-Corruption Coalition exists and is enshrined in a Charter. Civil society involvement is real. The visibility of the fight against corruption in Cameroon is high in the international community as well as vis-à-vis technical and financial partners.

However, much remains to be done and it would be unreasonable to sit idly by.

It would be important to avoid limiting analysis and action to repression or punishment alone. A pragmatic approach is needed to identify the contours of corruption. To this end, the development

of an ambitious and global strategic vision is crucial. Behind this desire to define the phenomenon and construct a standardized representation thereof, lies a normative issue. In describing and identifying the causes, what needs to be done is to come up with proposals that would be used to treat, punish and crackdown on corruption which constitutes a real threat to development.

The authorities in countries with success stories are developing real capacities for change, by mobilizing all resources and taking the time required to upscale the chances of success of their anti-corruption strategies.

By and large, it may be argued that a good strategy to combat corruption or IFFs must contain policies and the means to strengthen, improve or repair systems that are vulnerable to these scourges.

It is imperative to take time to build and consolidate the support of all relevant institutions for the design and implementation of the strategy and ensure that the actors have the means to identify needs and measure progress. It would also be crucial to formulate a concise, resolute and realistic policy, properly developed, to be credible and understandable to both the general public and the institutions concerned.


The combat strategy should focus on the goal to be achieved and not on the scourges that are to be avoided. This approach can have a powerful impact on prevention; and the measures taken in this direction are as important as conventional measures designed to detect and deal with acts of corruption and money laundering.

It would be preferable to use manageable indicators to monitor the implementation and the impact of policies. Monitoring the progress achieved should be systematic and lead to constructive reports being made available to the public.

All in all, the ultimate goal of a strategy to combat corruption and illicit financial flows must be to change behaviors and attitudes in a way that creates a collective climate hostile to these phenomena which are dangerous for our economies.

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# CHAPTER XII.

## The Case of Burkina Faso

Prepared by Burkina Faso<sup>99</sup>



This chapter presents firstly the institutional framework and the new procedures adopted in Burkina Faso to rationalize domestic resources (Le ministère de l'Économie, des Finances et du Développement [MINEFID] Cabinet). The concrete actions carried out by the Inspector-General of Finances (IGF), the National Unit for the Processing of Financial Information (CENTIF), the Directorate General of Cooperation (DGCOOP), the Directorate General of Customs (DGD) and the Directorate General of Taxes (DGI) are then presented successively.

### 12.1. The Institutional and Procedural Dynamism of the Anti-Corruption Fight in Burkina Faso

While domestic resources are undeniably a rational source of financing for the economy, especially for developing countries such as Burkina Faso, the major difficulty lies in the optimal mobilization of these types of resources.

The National Plan for Economic and Social Development (PNDES) takes into account this concern in its Thrust 3 devoted to the revitalization of the growth sectors of the economy and jobs.

In late 2016, an international symposium on optimizing internal resource mobilization was held in Ouagadougou, which provided relevant recommendations to stakeholders and policy makers.

It is worth noting that the strategy adopted in Burkina Faso for the mobilization of domestic resources is consistent with that drawn up by the African Union (AU).

Indeed, the many initiatives undertaken in the field reflect a direct translation of the combat as envisaged at the level of the Economic Commission of the AU, namely “to overcome corruption” to be able to mobilize the maximum of domestic resources.

Therefore, in accordance with international and regional instruments (the United Nations (UN), AU, Economic Community of West African States (ECOWAS) and West African Economic and Monetary Union (WAEMU), to which it has subscribed, Burkina Faso has adopted its anti-corruption law under the transitional regime to break with the past, when the fight against corruption was managed by various provisions (criminal code and others). However, legislative compliance must necessarily be complemented by the establishment of adequate institutions and procedures to ensure the required modernization of the administration responsible for mobilizing domestic resources. How then has this whole array of domestic resource mobilization (DRM) and anti-corruption measures been handled in Burkina Faso? What was the institutional and procedural reform adopted? Is it dynamic enough to meet its objectives for mobilizing internal resources as prescribed by the PNDES?

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<sup>99</sup> The chapter has been prepared by Dr. Hien/Zerbo Mariame, Technical advisor, Mr Savadogo Saïdou, Officer, Mr Issouf Toe, Head of the Department of Analysis of financial information/CENTIF, Mr Ambroise Kafando, Director General of Cooperation, Mr Adama Sawadogo, Director General of Customs, Mr Badolo Adama Director General of Taxes.

Our contribution to this issue will focus on the following two areas:

- An overview of the institutional framework for combating corruption; and
- Recall of the new procedures adopted for the rationalization of domestic resources.

### **12.1.1. Rationalization of the Anti-Corruption Institutional Framework**

In conformity with Thrusts 1 and 3 of the PNDES and international texts, particularly the United Nations Convention against Corruption (UNCAC) and regional texts, including the African Union Convention on Preventing and Combating Corruption as well as the WAEMU 2015 Directive On Combating Money Laundering and Terrorist Financing, Burkina Faso has a coherent and dynamic anti-corruption framework, supported by a set of measures streamlining administrative procedures, especially as regards taxation and customs.

Therefore, beyond the anti-corruption instruments at the centre of which is Law No.004-2015/CNT of 3 March 2015 on the prevention and punishment of corruption in Burkina Faso, it was necessary to set up state structures to combat corruption or reorganize existing ones for greater efficiency.

Accordingly, the Supreme State Control Authority (ASCE) which is the umbrella structure in this area has been constitutionalized and reformed with its powers strengthened. It became the Supreme State Control and Anti-Corruption Authority (ASCE-LC) with the adoption of organic Law No. 082-2015/CNT of 24 November 2015. Judicial bodies specialized in the punishment of economic and financial offences as well as crime were also set up by Law No. 005-2015/AN of 19 January 2015.

Already existing and known anti-corruption structures have experienced a reinforcement of their competences and duties to enhance efficiency. In this respect, the Audit Court, the Public Procurement Regulatory Authority (ARCOOP), the General Inspectorate of Finance and especially the High Authority for the Coordination of Anti-Corruption can be mentioned.

Anti-Corruption agencies stepped in to foster good working relationships with government agencies, civil society, the private sector and other stakeholders to build a broad coalition against corruption.

Civil society works together with the National Anti-Corruption Network (RENLAC), acting as the police upstream and downstream and counterbalancing state structures, which gives some originality to the fight against corruption in Burkina Faso.

### **12.1.2. Streamlining the Procedural Framework**

The streamlining of the procedural framework to facilitate the collection of tax revenue is reflected in the dematerialization of the relationship between the tax administration and taxpayers and in the updating of tax provisions.

As far as dematerialization is concerned, the inclusion in the 2017–2020 strategic plan of a number of reforms should lead to modernization and a more flexible tax administration. The use of various platforms should facilitate the real-time processing of tax transactions, for example, the Virtual Link System for Import and Export Operations (SYLVIE) commissioned on 16 February 2016.

SYLVIE makes it possible to interconnect public and private structures that issue documents required for customs clearance of goods.

The same applies to the integrated one-stop-shop system (SIGU), which is an innovative computer platform that should make it possible to interconnect the land one-stop shops, the corporate formalities centres, as well as the facilitation centres for building permits in Ouagadougou, Bobo-Dioulasso and other centres thereafter. The aim is to enable different land service applicants

to be able to express their needs online in a short time. Subscription to the E SYNTAX platform should allow the online declaration and tele-payment of taxes.

The systematization of the check formula for any payment with the Treasury and the introduction of the digital invoice are all intended to simplify and clarify relations between the administration and taxpayers.

The adoption by the National Assembly in December 2017 of a General Tax Code (GTC) is the culmination of this strategy to modernize the tax administration implemented in recent years. The guiding principles of this reform of Burkinabé taxation were the securing of state tax revenue, the search for transparency in the application of taxes and duties and the elimination of bad practices related to the ignorance of tax rules.

In short, Burkina Faso is fully aligned with the AU in its strategy to fight corruption and IFFs. It has been part of this dynamic for several years as indicated in the PNDES and previous development plans. The anti-corruption implementation instruments are sometimes complex, and progress is gradual according to available means. But the institutional and procedural arrangements put in place seem to be reassuring.

## 12.2. Anti-Fraud and Tax Evasion Mechanisms

Tax collection must be based on efficiency and equity. Indeed, unpaid taxes create budgetary difficulties for any state and may disadvantage compliant taxpayers who properly fulfill their obligations. Fraud and tax evasion reduce the ability of countries to implement their economic and social development policies.

Fraud is a naturally pernicious phenomenon, uncivil, economically harmful and legally reprehensible. Fraud is perceived by economic actors as “an unlawful act whose practice would be for an individual to circumvent the State structures responsible for the collection of taxes and duties in order not to pay all or part” of taxes.

Fraud and tax evasion are among the acts or behaviours designed to contest fiscal power, that is, the refusal of tax. These are forms of resistance, conscious or not, to the tax system.

The main causes of the phenomenon of fraud are the lure of easy gain, the cost of living and poverty, the high cost of taxes in relation to the standard of living of the population and corruption.

The effective fight against fraud is compatible with efforts and tangible results of specialized administrative units involved in combating the phenomenon. They testify, albeit imperfectly and incompletely, to the reality of combating the phenomenon, the progressive awareness of the need for the involvement of all actors in the economic life of the country in the struggle against fraud. In all cases, the extent of fraud in Burkina Faso requires the uncompromising implementation of vigorous measures in order to guarantee a minimum of success in the countless efforts undertaken and to allow honest economic operators to take advantage of a healthy climate to invest.

Therefore, in its Strategic Thrust 1, Strategic Objective 1.2 (Promoting Good Economic Governance), the PNDES intends to pursue a proportion of judicial files on fraud and laundering that have remained inconclusive and obtain a zero rate by 2020. It advocates the establishment of a much more conducive climate for private enterprises through, *inter alia*, the fight against fraud, unfair competition and corruption. Given the disastrous consequences of fraud on the economy and public finances, the need for implementation of a Comprehensive Enforcement Strategy should be emphasized.

In the current context, each of the various public and private structures develops its own anti-fraud approach depending on the areas or sectors of intervention. They do it in a more or less strategic way with the funds available and their interventions in solving their own problems. The

ambition of the Comprehensive Anti-Fraud Strategy is to pool energies and decompartmentalize the duties of each structure, while clarifying the role of each actor, in close collaboration with existing public and private initiatives.

The implementation of the action plan of the strategy will make it possible to answer the priority questions related to:

- Strengthening the institutional framework and promoting good governance and citizenship;
- Promoting information exchange and the prevention of fraud internally;
- Conducting fraud investigations; and
- Strengthening and effectively applying the legal provisions on the punishment of fraud.

Beyond the development of the strategy, its implementation remains closely linked to the political will and commitment of the Government to support the fight against fraud. For the objectives of the strategy to be achieved, it is necessary to establish a basic structure responsible for stimulating the fight and adapting the strategy (ANLF, for example).

The SGLF must be able to anticipate, taking into account the fact that the world has become more complex. Indeed, both companies and fraudsters are operating in a globalized environment. Anti-fraud and tax evasion measures must also transcend national borders to be effective. While national measures are important, they can never be effective on their own. This is why countries must collaborate based on common instruments and systems as well as on the exchange of best practices. Cross-border cooperation remains essential to obtain convincing results.

The successful implementation of the strategy strongly requires the development and implementation of a communication plan to support the qualitative change process initiated with the SGLF.

Success also depends on general mobilization. The slowdown in the world economy has resulted in the scarcity of external financing and the drastic reduction in official development assistance.

However, no development policy can be carried out without financial resources. Hence the need to involve everyone in the building of the country, according to its lifestyle, its ability to contribute and activities generating added value without circumventing the law.

The SGLF can be a good lever to inspire and translate into reality the aspirations of a country that has embarked on a dynamic of equality, justice and tax fairness. To achieve this, it would be necessary to set up at the operational level, mechanisms making it possible to achieve the following:

- Strengthen the control of exemptions and special schemes;
- Improve communication with taxpayers;
- Adopt and apply the code of ethics;
- Strengthen tax audit coverage by giving priority to spot checks on value-added tax (VAT) and other charges;
- Intensify the controls and audits of the Service Technical Inspections (STI);
- Clarify the powers of the National Anti-Fraud Authority and revenue authorities to make them complementary and not competing;
- Ensure greater transparency in tax rules;
- Continue to use information collected from partner administrations (COTECNA; CBC; Direction Générale du Transport Terrestre et Maritime [DGTMM]; Société Nationale d'électricité du Burkina Faso [SONABEL]; Office National de l'Eau et de l'Assainissement [ONEA]; CNSS; La Direction générale du contrôle des marchés publics et des engagements financiers [DG-CMEF]; Directorate General of Cooperation [DGCOOP]; FEER);



- Continue and increase awareness of registration with the Investment Fund for Developing Countries (IFU) by a new approach method;
- Continue the special operation of monitoring exempt market records;
- Organize information and awareness campaigns for economic operators and socio-professional groups;
- Train employees of the services responsible for investigations and research in modern methods of detection and treatment of tax fraud and forgery;
- Strengthen international, regional and sub-regional cooperation in the fight against forgery, fraud and corruption through conventions and agreements on fiscal cooperation and the exchange of tax information;
- Strengthen the technical equipment for detecting fraud and forgery and increase database processing (cross-referencing DGD databases, ANLF, Directorate General of Treasury and Public Accounting [DGTCP] and DGI);
- Implement the appointment of tax advisers at embassies, institutions and major projects to facilitate the exchange of tax information;
- Formalize collaboration with “informants or whistleblowers” in order to better deal with the denunciation by workers of fraud processes and practices taking place within companies;
- Strengthen the national tax investigations department within the Directorate General of Taxation; and
- Revitalize the anti-corruption committees of MINEFID structures.

It would therefore require coordinated and collegial action among all national economy actors and in particular the structures responsible for combating fraud at both the national and sectoral levels to overcome the phenomenon of fraud, tax evasion and corruption.

Consequently, the whole struggle must be strongly marked by a firm commitment without delay of politicians, if we aspire to dynamic economies and strong and independent States.

### 12.3. Experience of the General Inspectorate of Finance in Combating Corruption

The General Inspectorate of Finance was established in 1961 and is today governed by Decree No. 2016-0204/MINEFID of 04 July 2016. It has competence to ensure the control of all the financial, fiscal and accounting services of the State, local authorities, State institutions, projects, programs, state-owned companies, semi-public companies, private structures and institutions that receive state subsidies as well as the diplomatic missions of Burkina Faso abroad.

With the implementation of the program budget, which has been in force since 2017, the Inspector-General of Finances (IGF) has been assigned responsibility for the program entitled ‘Control, Audit of Public Finance and Combating Fraud, Forgery and Corruption’.

In the exercise of its duties, the IGF audited, from 2011 to 2017, 1 085 public contracts worth a total of CFAF 421 billion. Each year, it carries out the audit and control of entities under its jurisdiction and produces an average of 50 reports that are transmitted to the ASCE-LC, which analyses them and decides on appropriate administrative or judicial proceedings.

In addition, with a view to preventing corruption, the Ministry of Finance issued Order No. 2012-401/MEF/IGF of 16 November 2012 which set up anti-corruption committees (CACs) within the central directorates of the ministry.

The General Inspectorate of Finance supervises and coordinates the activities of the CAC.

### 12.3.1 Duties of CACs

These committees, number 10 to date and are responsible for the following:

- Identifying areas at risk;
- Informing and raising awareness among ministry officials about corruption and its effects;
- Receiving and studying denunciations;
- Investigating economic delinquency practices and corruption within MINEFID structures;
- Conducting all studies, reflections and actions necessary for the accomplishment of their mission; and
- Assisting anti-corruption structures and organizations, liaising with them and monitoring the implementation of recommendations on corruption in the finance administration.

### 12.3.2. Status of Implementation of CACs

CACs have already been set up at the following State institutions:

- The Directorate General of Customs (DGD)
- The Directorate General of Treasury and Public Accounting (DGTCP)
- The Directorate General of Taxes (DGI)
- The Directorate General for Control of Public Procurement and Financial Commitments (DGCMEF)
- The Directorate General of Budget (DGD)
- The Directorate of Public Procurement (DMP)
- The National Institute of Statistics and Demography (INSD)
- The Burkina Faso Fund for Economic and Social Development (FBDES)
- The Directorate General of State Real Estate Affairs (DGAIE)
- The Directorate General of Economy and Planning (DGEP).

CACs are being set up at the following State institutions.

- The Directorate of Administration and Finance (DAAF)
- The Support Fund for Women's Remunerative Activities (FAARF).

### 12.3.3. Results Achieved by the CACs

The results achieved by nature of main activity are as follows:

- Information and awareness of employees: 127 field missions were carried out by CACs, in both the central structures and certain deconcentrated structures;
- Treatment of 22 denunciation files received;
- A workshop on the anti-corruption law (Law No. 004-2015/CNT of 3 March 2015 relating to the prevention and punishment of corruption in Burkina Faso), organized by RENLAC for the benefit of the CACs; and
- Training on corruption modules conducted for the benefit of all CACs by PANAUDIT Private Consultancy.

#### 12.3.4. Prospects

To improve the operation of CACs, consideration should be given to:

- Making green numbers functional to receive calls and denunciations;
- Improving relations between CAC members and their superiors; and
- Conducting a study to identify challenges and propose solutions that will increase the buy-in of employees and citizens and make CACs more dynamic and effective.

#### 12.4. CENTIF Contribution to Combating Corruption and IFFs

The National Anti-Corruption Authority (CENTIF) of Burkina Faso was initially established by Law No. 026-2006/AN of 28 November 2006, which was repealed by Law No. 016-2016/AN of 3 May 2016 relating to combating money laundering and terrorist financing (CML/TF).

Pursuant to Law No. 016-2016/AN, the CENTIF is a permanent inter-ministerial administrative authority, placed under the supervision of the Minister of Finance. Its main mission is to receive, analyse, enrich and process financial intelligence on money laundering and terrorist financing circuits.

The Unit is both a financial intelligence collection centre, a financial expertise service and an operational anti-money laundering and terrorist financing service. As such, it receives and enriches suspicious transaction reports issued by taxable persons and approved Financial Intelligence Units (FIU). It analyses declarations and surveys, in which it makes financial cross-checks and, where appropriate, uses information from other actors, including internationally.

To carry out its mission, the CENTIF relies on staff composed of experts from tax and judicial administrations (treasury, taxation, customs, police and justice). In addition, it has specific prerogatives, such that:

- it may oppose the execution of the declared operation for a maximum of 48 hours. This period may be extended by the competent judicial authority; and
- it may request communication of documents relating to an operation from any public or private person, including the supervisory authorities, judicial police officers, any member of the professions subject to the CML/TF system and foreign FIUs.

Given its scope of action, the Unit fights almost all crimes generating illegal income, particularly corruption in all its forms, which today poses a serious threat to the country's economy.

Moreover, beyond its own missions, the CENTIF can render great support to other actors involved in combating economic and financial crime. Indeed, within the framework of national cooperation and for better effectiveness of the fight, the CENTIF can communicate information in its possession to the customs, taxation, treasury and judicial police services. It also shares with the supervisory authorities, the professional orders and the national representative bodies, all information useful for the accomplishment of their respective missions.

The CENTIF has therefore developed a relational network that allows it to be more efficient, and which consists of the following:

- National correspondents in all public administration services involved in the fight against these scourges;
- Officials of entities subject to the CML/TF law; and
- FIU counterparts abroad.

The CENTIF carries out its missions in accordance with not only a set of principles enacted at the international level but also the national strategy against money laundering and terrorist financing.

International standards are based primarily on the recommendations of the Financial Action Task Force (FATF) aimed at promoting the implementation of a CML/TF policy in states. In particular, they allow the application of an approach based on CML/TF risks and the establishment of an effective institutional and legislative mechanism.

At the national level, the CML/TF strategy developed in 2014 set a number of targets to be achieved by 2016. More recently, the national ML/TF risk assessment is nearing completion. It has made it possible to identify priority actions to be implemented in the areas at risk.

These measures and actions led the CENTIF to achieve significant results. Accordingly, since its operationalization in 2008 until 30 June 2018, it had processed 582 files and transmitted 72 reports to the Public Prosecutor for further action.

These files relate, *inter alia*, to suspicions of offenses underlying money laundering, such as tax evasion, misappropriation of public funds, fraud, including through computer, gold trafficking, forgery and use of forgery, theft and concealment.

### 12.5. Contribution of the DGCCOOP in Combating Corruption and IFFs

The actions of the DGCCOOP in the fight against corruption and IFFs are at two levels: consideration of good governance in external resource mobilization; and support to the CENTIF for the traceability of NGO/DA funding.

The concern for good governance in general and the fight against corruption in particular is taken into account in the financing agreements and conventions signed with the Technical and Financial Partners (TFPs). Therefore, some external resources mobilized are used to finance financial administration modernization projects (fiscal and budget execution) whose implementation strongly contributes to improving the mobilization of external resources and to minimizing the possibilities of fraud and corruption.

Other resources are used to support the strengthening of operational capacities of anti-corruption structures and IFFs, such as Supreme State Control Authority (ASCE) and CENTIF. Still others integrate civil society citizen watch actions into their financing plans.

In the fight against IFFs, DGCCOOP supports the CENTIF in identifying traces of financial flows received by NGOs/DAs. This is operationalized during the signing and renewal of the framework agreements of establishment in Burkina Faso where the required documents include the identification documents of the representative of the NGO/DA and the exhaustive list of the various donors of the NGO/DA as well as their country of origin or residence.

Beyond this, it is also worth recalling the government reforms relating to the ASCE-LC, which has seen its powers strengthened and the establishment of whistleblowing structures in the various directorates coordinated by the Inspector-General of Finances (IGF).

### 12.6. Contribution of the DGD

The Burkina Faso Customs Administration is responsible for the preparation and application of customs legislation and the collection of duties and taxes.

As such, it helps mobilize about 38% of the State's own resources.

Customs occupies a strategic position that allows it to control travellers and goods entering and leaving the national territory. As a result, it is often exposed to the phenomenon of corruption.

Consequently, the fight against fraud and corruption is an important issue since it also helps to mobilize more resources.

As part of customs revenue collection, the Customs Administration has since 2010 been engaged in a process of modernization of customs procedures. The fight against corruption hinges on the modernization of the Customs Administration through dematerialization.

One of the aims of the use of these tools is to make the procedures more transparent, less prone to interventionism and thus fewer obstacles related to corruption.

At this level the following reforms have been implemented:

#### ***i) Electronic declaration of transit***

Burkina Faso is a landlocked country and its supplies are acquired via the ports of Abidjan, Tema, Lomé and Cotonou, while opening at the same time several transit corridors for goods intended for domestic consumption as well as those for neighbouring countries.

This particular context of the country's geographical location and the requirements of international trade in fluidity have led the Customs Administration to modernize the transit system for the following reasons:

- The volume of traffic of vehicles in transit is important.
- The geographical position of Burkina Faso makes it a crossroads country.
- Transit monitoring is a major problem for the Customs Administration.
- The multitude of checks carried out on goods in transit is a source of much harassment and constitutes a major concern for economic operators.

Therefore, the modernization of transit monitoring has become a priority, hence the launch in January 2010 of the **electronic T1 transit declaration**.

#### ***ii) Satellite tracking system***

To strengthen the security of goods in transit and fight against fraudulent spills, the Customs Administration launched in February 2015 a satellite tracking system for goods in transit called COTRACK (Cotecna tracking).

It is a Geolocation of Goods System that reinforces Customs' capabilities in the real-time monitoring of goods in transit.

#### ***iii) Scanning system for vehicles carrying goods***

Eight scanners have been installed in the main customs offices since February 2015. This is a non-intrusive control tool that helps to combat fraud and illegal trafficking.

#### ***iv) Establishment of a one-stop shop for the collection of pre-clearance documents***

The SYLVIE whose main objective is to ensure transparency in import and export documents. Such transparency contributes to combating fraud and corruption.

This system also helps to reduce the time and cost of obtaining documents. Achieving this goal contributes significantly to combating fraud and corruption.

#### ***v) Computerised Customs Litigation Management System (SYGICOD)***

SYGICOD is an automated tool for risk analysis and management of customs controls. It is a database on customs fraud and a statistical tool for monitoring employee performance. As a transparent anti-fraud system, it helps to reduce corruption.

#### ***vi) Inter-connection of customs computer systems between Togo and Burkina Faso***

Customs computer systems in Togo and Burkina Faso have been inter-connected since March 2018. This is good regional cooperation.

### 12.6.1. Results Achieved

A summary of results achieved through these reforms detailed above, is given below:

#### ***For satellite tracking of goods in transit***

- Reduction in transit fraud;
- Reduction in sources of corruption such as harassment and racketeering; and
- Greater fluidity of trade.

#### ***For control by the scanning system***

- Reduction in false cash declarations; and
- Fraudulent shipments have been detected and sanctioned.

#### ***Regarding the SYLVIE platform:***

- File processing time has reduced from **21 days to 3 days with a target of 38 hours at the end of 2018**.
- The dematerialization of the documents collection procedures has allowed the customs administration to have reliable information for which the risks of disputes are low and therefore means less corruption.

#### ***For the SYGICOD application***

The presence of SYGICOD is a dissuasive tool for both customs auditors and importers. In fact, as a risk analysis tool, it makes it possible to identify the operators at risk and to systematically guide their declarations in control circuits.

#### ***On the inter-connection of customs computer systems between Togo and Burkina Faso***

- Abolition of the string of transit formalities at the border;
- Reduction in border crossing time from three days to two hours; and
- Reliability of the information on the import and export operations because the transport is done without breaking the load and the data recorded from the beginning can no longer be modified.

### 12.6.2. Difficulties Arising in Reform Implementation

Various difficulties were encountered during the implementation of the reforms and are detailed below.

- Lack of good-quality internet connection within the administrative services: in this respect, it is necessary to provide the administrative services with good broadband connectivity and good equipment (equipment, telecom, computers and network).
- The coexistence of old procedures (there are still non-computerized customs posts due to the absence of electricity) with modern procedures is not likely to facilitate the diligent routing of files and the complete digitization of procedures.
- Glaring insufficiency of computer scientists whose presence is indispensable for ICT-related reforms.
- Circumvention of regulatory procedures and reluctance to change some economic operators who continue to use corrupt practices to achieve their goal.

It is obvious that the Burkina Faso Customs Administration is preoccupied by this scourge which tarnishes its image. All the reforms undertaken are in line with the 1993 Arusha Declaration, revised in 2003, which is a set of practices advocated by the World Customs Organization (WCO) in the fight against corruption in customs administrations.

## 12.7. DGI: Mobilization of Internal Resources and Fight against Fraud

Fiscal policy choices, combined with tax legislation reforms and the organizational framework of tax collection are built in Burkina Faso on options that also take into account the reforms induced by our membership of the two major organizations, ECOWAS<sup>100</sup> and WAEMU<sup>101</sup>.

In fact, they define guidelines for the harmonization of fiscal policies in order to achieve optimum economic integration, which must be taken into account.

Burkina Faso has therefore embarked on a process of reform and modernization of the financial authorities since the 2000s in order to comply with community requirements and improve its performance in terms of mobilizing domestic resources. In this framework, all the authorities benefited from the technical assistance of departments of the International Monetary Fund (IMF) as well as those of the World Bank. Several diagnoses and assessments of the DGI have been carried out.

The implementation of the recommendations and conclusions of these diagnoses helped to improve the performance of the DGI and to introduce best practices in all administrative and fiscal management functions<sup>102</sup>.

The various diagnoses made internally by evaluations and studies explain that the low tax levy is due to structural and organizational factors as well as tax policies and procedures. The low tax revenue situation has led authorities to opt for a revenue-raising goal, with an approach called a 'collection unit' that has revealed its limits. The acceleration of the process of qualitative transformation and modernization of the tax administration was facilitated by the adoption and implementation of the comprehensive tax policy reform strategy in 2008 which accompanied the development, adoption and implementation of DGI's first strategic guiding plan. This tax policy reform has focused on four main areas supported by a development tax policy that reconciles both the requirements for investment incentives and the optimization of tax revenue.

Highlights of the Comprehensive Tax Policy Reform Strategy are aimed at improving performance in tax revenue mobilization and establishing a tax system for growth and achievement of development goals in the country. It is articulated around four main guiding principles, namely (i) streamlining of fiscal incentives; (ii) simplification and modernization of legislation; (iii) improving the management and performance of indirect taxes; (iv) the reform of the taxation system for informal activities.

The reform of the tax legislation and the organizational framework for collecting taxes was built on the options outlined above. It also takes into account the reforms brought about by Burkina Faso's membership of the two large sub-regional organizations, namely ECOWAS and WAEMU which define the guidelines for the harmonization of fiscal policies with a view to optimizing the achievement of economic integration.

The improvement in the mobilization of domestic resources appears to have been built up in successive stages and in a sometimes difficult context. The combination of fiscal policy actions and short-term initiatives to improve tax administration and management have allowed an ever-increasing level of resource mobilization in Burkina Faso, despite the fiscal potential that has remained low until the coming on line of mining projects.

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100 ECOWAS: Economic Community of West African States.

101 WAEMU: West African Economic and Monetary Union.

102 Burkina Faso – EC Fiscal Mission Blue Prints, Evaluation of Tax Administration and Development of a Modernization Strategy, 25 October 2013.

Ministry of Economy and Finance, DEP, CAPES, Assessment of Tax Collection Performance in Burkina Faso, March 2014. TADAT Secretariat, Performance Evaluation Report, Burkina Faso, January 2018.

Prospects for progress in the mobilization of domestic resources exist and are being analysed, and finally, actions to combat fraud and tax evasion that incorporate best practices in terms of strategies. These aspects are discussed below.

### **12.7.1. Contextual Elements Conducive to Improved Collection of Domestic Resources**

**As a benchmark over the period 2003–2007, adoption of an action plan aimed at modernizing and strengthening tax and customs administrations:** It included a series of organizational and institutional measures, the most important of which concerned the establishment of the Large Enterprises Directorate (DGE) 2004–2005; the development and implementation of the DGI information technology (IT) Master Plan; the institution of withholding of non-chargeable taxes for informal sector actors; and the introduction of a new taxpayer identification system (IFU) 2006.

Following the implementation of these measures, progress has been made but is not sufficient to maintain sustained growth in domestic resource mobilization. This has resulted in a tax pressure rate remaining below the community standard set within the framework of the WAEMU.

It was within this context that the DGI's first strategic guiding plan was developed. The implementation of the 2007–2015 Reform and Modernization Strategic Plan of the Directorate General of Taxes has led to mixed results. While several significant reforms have been undertaken, significant weaknesses remain as highlighted by the assessment of the tax administration conducted in October 2013. The weaknesses concern the following:

- i) The lack of financial autonomy and the rigidity of DGI rules on budget management and organization of its services;
- ii) A non-optimal allocation and management of human and material resources;
- iii) An unsuitable organizational chart;
- iv) A phase shift in the structure of the tax services still based on the traditional division of services between basis, recovery and control;
- v) Insufficient reliability of taxpayer data;
- vi) Inadequate reporting and payment procedures;
- vii) Low coverage of control; and
- h) Incomplete computerization.

### **12.7.2. Tax Policy Actions**

DGI conducts routine policy analyses aimed at simplifying tax systems, reducing performance barriers and enhancing revenue collection by filling gaps in the tax system.

In this respect, the goal of reducing the corporate tax burden in order to attract investors and increase compliance with tax obligations by them has led to a reduction in the nominal tax rate levied on companies from 30% to 27.5% instead of 30% for 'low-end' and 'standard' products and 40% for 'luxury' products, a single rate of 45% is introduced to increase tobacco tax. The tax rate on beverages increased by 5 points from 25% to 30%. The increase is consistent with the WAEMU and ECOWAS directives on excise duties.

Efforts to generate new revenue have led to the introduction of withholding tax on gains from gambling and slot machines. The generalization of withholding taxes on the remuneration paid to residents and non-residents has broadened the tax base. In order to increase the efficiency of VAT and reduce revenue losses, the DGI raised the VAT thresholds and introduced a standard invoice the use of which is mandatory for all taxpayers. It has also authorized the online consultation of the taxpayer's registry as well as unique numbers (IFU) by every citizen, for verification purposes.



The quest for the consolidation of the corporate tax base led in 2015 to removing the rules of assessment relating to the fiscal and customs stabilization regime granted by the mining code of 2003 and mining conventions. The introduction of the taxation of any capital gains realized on the direct and indirect sales of mining titles and other forms of transactions relating to mining titles (farm-out agreement and leasing) has generated additional revenue for the State budget.

The ordinary law tax at a rate of 27.5% on profits is henceforth applicable to the mining sector with regard to company tax since the adoption of the new mining code in order to increase tax revenue from this sector. The levy of a 0.2% land tax on built and undeveloped properties and the valuation of the property tax base have broadened the tax base.

The DGI also raised the tax base and encouraged compliance with tax obligations. It reviewed the rates of withholding tax on wages with an exemption on salary brackets considered social.

Finally, the adoption of a General Tax Code in 2017 helped to simplify and clarify certain provisions, notably the taxation of movable capital income by merging the two pre-existing taxes, namely the tax on income from receivables, deposits and guarantees and the tax on income from securities.

The adoption of tax provisions to consolidate the taxable base of a number of business sectors practicing techniques to erode the tax base of certain taxes in order to combat the indirect transfer of profits by manipulating intra-group transfer pricing according to the most recent recommendations of international organizations (Organisation for Economic Co-operation and Development [OECD], United Nations [UN], African Tax Administration Forum [ATAF], ECOWAS). The reduction in tax expenditure has resulted in the elimination of the deductibility of certain expenses or tax benefits with uncertain effects, such as study and prospecting expenses and tax reduction for reinvestment of profits.

Finally, more recently, the assessment of the first Strategic Orientation Plan 2007–2015 that was coming to an end and the development, adoption and implementation of the new strategic plan 2017-2021, makes it possible to maintain consistency in the effort and tax policy guidelines. The new Resource Mobilization Plan is aimed at increasing annual tax revenue by 0.4 percentage points of gross domestic product (GDP).

In 2015 and 2016, the main reforms to improve the performance of the DGI focused on: the introduction of a single VAT threshold (CFAF 50 million); using the VAT threshold to define medium-sized enterprises and raising the threshold of competence of the DGE from CFAF 500 million to CFAF 1 billion; strengthening the exchange of information with other financial administrations with the introduction of computerized links; the use of the IFU made mandatory for all financial administrations and banks ; and the improvement of DGI's information system and business software with the development of a database for cross-checking tax information, taxpayer detection and risk analysis. The establishment of a real estate file updated in view of controlling the real estate market and the profitability of the property tax. In 2018 the online-procedure was launched and taxpayers were given access to e-services, thus facilitating the fulfilment of their filing obligations and tax payments, as well as access to information and other services offered by the DGI.

All these measures allowed continued sustained growth in domestic resource mobilization, which can be analysed as follows:

#### **12.7.2.1. Assessment of the Mobilization of Internal Resources by the DGI**

The collection of internal tax revenue made by the DGI in favour of the State budget increased from CFAF 186 billion in 2006 to CFAF 503 billion in 2015, showing an increase of CFAF 317 billion in 10 years, or an annual average increase of 10.62%. The collections in 2017 stood at CFAF 673 billion, compared to 2015, showing an increase of CFAF 170 billion in two years, or 33.79%.

Over the past 12 years (2006 to 2017), there has been an average annual increase of CFAF 44 billion. The best variations were recorded in 2016 (91.5 billion), 2012 (78.6 billion) and in 2017

(78.4 billion) while the smallest change was -18.3 billion in 2015, due to the difficult socio-political context that Burkina Faso has gone through.

**Table 12.1: DGI Collections from 2006 to 2017 for the State Budget**

Year	Collection	Variation in Collection	
		Absolute	Rate
2006	186 892 992 699	-	-
2007	212 499 115 321	25 606 122 622	13.70%
2008	226 761 214 318	14 262 098 997	6.71%
2009	266 542 761 379	39 781 547 061	17.54%
2010	313 556 977 985	47 014 216 606	17.64%
2011	386 119 929 033	72 562 951 048	23.14%
2012	464 729 759 348	78 609 830 315	20.36%
2013	521 542 636 114	56 812 876 766	12.22%
2014	521 888 239 588	345 603 474	0.07%
2015	503 539 298 537	-18 348 941 051	-3.52%
2016	595 019 204 931	91 479 906 393	18.17%
2017	673 373 605 846	78 354 400 915	13.17%
Average	406 038 811 258	44 225 510 286	12.66%

In 2016 and 2017, the annual growth rate was 18.17% and 13.17% respectively. In terms of implementation rates over the past decade (2008 to 2017), the average implementation rate is 94.59%. The analysis of the collection of the main taxes makes it possible to establish a good collection level, or CFAF 577 billion in 2017 against CFAF 505 billion in 2016 and CFAF 429 billion in 2015, with a growth rate of 17.69% (76 billion) in 2016 compared to 2015 and 14.27% (72 billion) in 2017 compared to 2016 against a decrease in 2014 (-2.04) and in 2015 (-4.03).

The best performances of the five leading taxes can be explained by the excellent level of VAT mobilization, which rose from CFAF 9.24 billion in 2015 to CFAF 23.36 billion in 2016 and CFAF 26.18 billion in 2017.

**Table 12.2: Collection of Taxes between 2015 and 2017**

Items	2015	2016	2017	
<b>Forecast</b>	Total State Budget	520 845 146 000	622 942 000 000	720 688 000 000
	Including leading taxes	444 487 000 000	526 128 549 000	608 329 000 000
	Of which VAT	181 520 000 000	206 396 151 000	234 871 000 000
	Total Local Budgets	19 206 481 919	21 256 526 219	24 691 232 371
<b>Achievement</b>	Total State Budget	503 539 298 537	595 019 204 931	673 373 605 846
	Including leading taxes	429 325 071 439	505 252 758 993	577 365 109 930
	Of which VAT	178 480 108 018	201 849 380 212	228 039 020 829
	Total Local Budgets	19 103 614 615	22 833 391 565	22 374 745 455
<b>Achievement Rate</b>	State Budget	96.68%	95.52%	93.43%
	Leading taxes	96.59%	96.03%	94.91%
	VAT	98.33%	97.80%	97.09%
	Local Budgets	99.46%	107.42%	90.62%

### 12.7.2.2. The Weight of Tax Revenue in the GDP

Indeed, the assessment of the budget efficiency coefficient of Burkina Faso's VAT in 2014, measured at 35.5% of GDP<sup>103</sup>, indicates that it is close to that of Senegal, 41.1% or Benin, 37.8%, while the latter countries benefit from more favourable structural factors (accessibility to the coast,

103 International Monetary Fund, Department of Public Finance, Strengthening Fiscal and Customs Operations, Technical Assistance Report, May 2017, page 24.

higher consumption per capita). It is higher than that of Mali, a landlocked mining country, sharing many common characteristics with Burkina Faso and countries such as Rwanda, 24.8%, Togo, 31.7%, Côte d'Ivoire, 21.7%, Cameroon, 26.0% and Niger, 12.0%.

This consistency in the progress of tax revenue mobilized by the DGI is due to the combination of short-term initiatives and tax policy actions implemented through the reforms undertaken and supported steadily.

However, the performance of the tax and customs administrations shows a decline in domestic tax revenue (which includes VAT and excise duties collected by customs) during the period of crisis that the country crossed in 2014 and 2015. Revenue declined from 17.2% of GDP in 2013 to 15.1% of GDP in 2015. From 2016, the revenue curve is reversed with an increase of 0.8 percentage points of GDP<sup>104</sup>.

The following table shows the progress in domestic resource mobilization.

**Table 12.3: Revenue Collected by the DGI in CFAF Millions and in % of GDP<sup>105</sup>**

Domestic Tax Revenue	2013		2014		2015		2016	
	Total	% PIB	Total	% GDP	Total	% GDP	Total	% GDP
Direct Taxes	284 488	4.8	270 021	4.4	242 443	3.8	294 595	4.2
Indirect taxes	490 148	8.3	467 242	7.7	471 204	7.3	531 951	7.6
Registration, Stamp Duty	9 332	0.2	12 242	0.2	30 793	0.5	11 035	0.1
GDP (in billions)	5 896		6 086		6 454		6 962	

#### 12.7.2.1. Short-Term Initiatives to Improve Tax Administration and Management

Initiatives are regularly taken as part of a cross-cutting strategy that allows the DGI to reduce the complexity of the tax system and promote voluntary tax compliance by taxpayers.

##### ***Supervision of services and relations with taxpayers***

Initiatives taken include education tours for large taxpayers as well as strengthening the audit functions of revenue-intensive sectors and small taxpayers.

##### ***Organization of services***

Organizational restructuring has led to the establishment of a second Directorate of Medium Enterprises (DME) in Ouagadougou to improve monitoring and supervision thereof. The National Directorate for Investigations and Tax Research and Audit Brigades within MEDs has been established.

The reorganization in 2016 enabled the realization of interconnections between Automated System for Customs Data (ASYCUDA), IFU and RESINA aiming at a real-time sharing of information with the partner administrations, in order to combat fraud and tax evasion. This action helped to identify 196 high-risk fraud cases, which were selected and verified, after which over CFAF 10 billion taxes, duties and taxes were recalled.

Tax management initiatives have resulted in the opening of an imprest account to facilitate VAT reimbursement within a reasonable period of time.

104 International Monetary Fund, Department of Public Finance, Strengthening Fiscal and Customs Operations, Technical Assistance Report, May 2017, page 15

105 International Monetary Fund, Department of Public Finance, Strengthening Fiscal and Customs Operations, Technical Assistance Report, May 2017, page 15

#### 12.7.2.4. Prospects for Improving the Level of Collection

There is room to maneuver, which can help to further improve the level of mobilization of domestic resources. One of the three major weaknesses to be addressed, which can contribute to this improvement remains the lack of autonomy, particularly with respect to recovery since the responsibility for recovery still remains with the Treasury (the DGI collectors are mere secondary collectors who depend on the main collectors of the Treasury). This situation has consequences particularly on tax payment procedures, VAT credit refunds and the management of rests-to-recover (RTR).

Comprehensive computerization of procedures is necessary in order to speed up the update of the SINTAX software and the development of additional modules that could make it mandatory to use the operational modules that are not currently used by the services (capture of returns, monitoring of tax control and management of RTR).in particular). For example, the tax return capture rate was 66% in 2016. This reflects the difficulties in obtaining reliable information, monitoring VAT credit trends such as RTRs, instituting a reform monitoring system and the efficient management of services via automated performance indicators. Inadequate control of the tax population will result in high default rates and a limited number of actual taxpayers (for example, one in two for VAT paid by large companies). This led to the ongoing audit of the taxpayer registration process and of the software that manages and generates the registrations that will encompass all individuals, businesses and other entities subject to the obligation to register.

#### ***Taxation of the agricultural sector***

The agricultural sector, which takes up 80% of the active population, accounts for 40% of GDP formation and generates 70% of the country's export earnings. It is therefore a vital sector for the country. With the exception of a few agricultural areas in the process of being modernized under the impetus of the agricultural development strategy, incomes in the rural world are generally very low and, moreover, highly dependent on the vagaries of the weather and the international situation.

With regard to taxation, it is therefore advisable to look for ways and means of taxing this sector without compromising the achievement of the objectives pursued by the agricultural development strategy.

The adoption of the General Tax Code in 2017 put an end to the tax system, which was characterized by a variety of sources (Tax Code, Registration Code, Law on the Establishment of a Corporate Tax, Manual of Tax Procedures, law laying down the residence tax, law on the IRF ...). The adoption of a General Tax Code thus facilitates access to and knowledge of the system in force and such adoption is the starting point for stabilization of the tax system that has undergone several reforms in recent years.

From the point of view of fiscal potential, estimated by the tax pressure rate consistent with the objective of accelerating economic growth, the Burkinabè tax administration has the latitude to recover tax revenue whose amount as a percentage of GDP would fluctuate between 25.9% and 29.1%. Indeed, the optimal tax rate calculation model, estimated alternately over the periods from 1970 to 2008 and from 1970 to 2012, set the optimal tax rate at 25.9% and 29.1% of GDP respectively<sup>106</sup>.

#### 12.7.2.5. Combating Tax Fraud

The tax approach of today has changed considerably. Initially perceived as a financial and regulatory constraint weighing on the company, it is today considered as a criterion of choice to invest first-rate or to carry out operations and as an instrument of optimization.

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106 Ministry of Economy and Finance, DEP, CAPES, Assessment of Tax Collection Performance in BURKINA FASO, page xiii March 2014

In other words, taxation has taken a decisive dimension with the evolution of business life and in particular its internationalization and group restructuring movements.

Therefore, in some cases, the fiscal parameter has become the first element in the choices relating to the configuration of groups or the organization of certain commercial operations.

### ***Improving the Management and Performance of Indirect Taxes***

Given the changes in the economic environment and tax behaviour of taxpayers vis-à-vis certain taxes such as VAT (fraud, evasion), a review of the segmentation to simplify the tax system and enhance tax performance has been conducted. The new segmentation was therefore adopted by the 2015 Finance Law in a bid to control the portfolio of VAT-liable persons.

Segmentation can be defined in taxation terms as the management of companies by category. This entails organizing them into more or less homogeneous segments (companies with identical or similar characteristics).

The management of each segment should be entrusted to a specialized service with a strategy adapted to better meet their support needs as well as to optimize tax revenue. This has been translated into legislative reform by revising the criteria for defining tax thresholds. The multi-criteria classification of companies (sector of activity, legal form and turnover) were abandoned to retain only one criterion of classification which is the turnover. This option has led to the adoption of the following organization chart for the DGI:

- The DGE and the Directorate of Medium Enterprises (DME); the DCIs or DPIs that manage small and micro enterprises where it is necessary to focus on investigations and research and promote transfers to medium-sized enterprises.

The institution of the standardized invoice is undoubtedly one of the major legislative innovations advocated by the reform whose legislative provisions were introduced in 2013. It aims to establish the culture of invoicing, the compliance of invoices issued under the required standards and authentication of said invoices. It is a way of fighting against false or no billing. It is based on the principle of traceability of invoices issued by companies using appropriate technologies.

The establishment and operationalization of the Directorate of Investigations and Tax Research (DERF) made it possible to realize interconnections between SYDINIA, IFU and RESINA. The aim was to achieve real-time sharing of information in order to combat fraud and tax evasion. One hundred and ninety-six (196) high-risk fraud files selected were audited with more than CFAF 10 billion of taxes and duties recalled. The development of the mining sector in recent years has necessitated the completion of a study on risk mapping in this sector.

The reorganization has made it possible to strengthen tax audit programming by directing document control to programing and improving risk analysis. It has also made it possible to improve the quality of controls through the training of auditors specializing in high-risk sectors (including mining companies, financial institutions, insurance companies, telephony, etc.) and training in the use of the spot check procedure.

It appears that performance in revenue mobilization largely depends on the administration of such revenue. It is increasingly important to focus on quantitative and qualitative indicators that include elements that can be used to evaluate the efficiency and capacity of the tax administration. They range from organizational structure, costs and staffing to modernization and service delivery to taxpayers.

Periodic evaluations seem to lead to a significant improvement in tax systems and a permanent adaptation of structures to the environment and missions. Several major projects underway are at the heart of Burkina Faso's tax administration. They include tax policy actions that focus on the simplification of the taxation of small taxpayers, the beverage sector and that of transport.

# CHAPTER XIII.

## The Case of Morocco

Prepared by the Kingdom of Morocco



The Kingdom of Morocco has embarked on the fight against corruption and is also engaged in other related endeavours such as raising moral standards in public life, the promotion of the values of integrity, transparency and good governance at all levels. Consequently, the Kingdom of Morocco has introduced several initiatives at both institutional and regulatory levels in order to meet international standards and comply with international recommendations.

Among the initiatives is the establishment of the Central Authority for the Prevention of Corruption in 2009.

### 13.1. Concretization of Initiatives through the Implementation of Constitutional Arrangements

The 2011 Constitution also injected a new dynamism in the fight against corruption with the introduction of measures such as:

- the strengthening of the principles of good governance;
- the obligation to align public services to the norms of transparency, responsibility and accountability;
- the strengthening of governance institutions as constitutional organs, especially the National Authority for Probity and the Fight Against Corruption, the Ombudsman and the Competition Authority; and
- the strengthening of human rights, the recognition of the new roles of civil society.

To backstop these measures, the Kingdom of Morocco deemed it necessary to:

- make the right to information a constitutional obligation;
- criminalize offenses relating to conflict of interest, insider trading, influence peddling, abuse of monopoly; and
- adopt participatory democracy as the political dispensation of choice.

To ensure the effectiveness of the system put in place, building the capacity of the government and the parliament is very critical.

A new historical stage in the constitutional journey was attained with the advent of an independent judiciary which saw the transfer of oversight responsibilities of the Ministry of Public Affairs and Ministry of Justice (Executive Power) to the Royal Prosecutor General (member of the Highest Judiciary Body).

Parallel to the change, the country is also witnessing the development of a legal arsenal which has direct and indirect bearing on the fight against corruption. The approval of the law on the protection of whistleblowers and victims of corruption, as well as the updating of the Criminal Code, the Financial Jurisdiction Code, the Assets Declaration Code, the strengthening of the institutional framework through the creation of new national institutions such as the Competition Authority and the Office of the Ombudsman are important strides made in the fight against corruption.

The measures were crowned with the adoption in 2015 of the National Anti-Corruption Strategy (SNLCC 2015–2025) which mainly seeks to foster a national coalition to eradicate the scourge of corruption in the Kingdom of Morocco by 2025 and, by extension, boost the confidence of the international community (Ease of doing business rankings, Rule of law, Consumer Price Index – CPI, Mo Ibrahim index of governance ...). The strategy was prepared through a grass-roots approach (involving ministries, civil service, civil society, private sector) and culminated in the establishment, by decree, of the National Anti-Corruption Commission (NACC), headed by the Prime Minister, to oversee the implementation of the strategy.

### 13.2. Measures Taken in the Area of Governance

In the same vein, several projects related to public and political governance have been carried out, namely the streamlining and digitization of administrative procedures (e-government, online services); improvement in the reception and orientation of citizens; promotion of access to information in the public service; the affirmation of the principle of equal access to all positions of responsibility and to the civil service thanks to the enactment of the law on the principles and criteria for appointment to high office in line with Articles 49 and 92 of the Constitution; the adoption of the Public Service Charter containing all the principles of good governance relating to the functioning of the civil service, regions, local authorities and public organizations in accordance with Article 157 of the Constitution; the enhancement of transparency, integrity, and crack-down on conflict of interest, fraud and corruption in public procurement; the organization and management of government organs; the reinforcement of transparency in political party financing and the combating of electoral fraud; independent elections observation and the organization of awareness campaigns against the scourge of corruption (setting up a website, a toll-free hotline ...).

### 13.3. Implementation of International Conventions

The Kingdom of Morocco is party to the Convention of the League of Arab States against Corruption. This commitment is in line with its involvement in the international dynamic, its experience as an active member of regional and international organizations and its attachment to the gains of the “Marrakesh Declaration on the Prevention of Corruption” which is an important text and a reference in the fight against corruption at the level of the United Nations.

Furthermore, the Kingdom of Morocco is favorably disposed to cooperating fully with all the stakeholders in the area of technical assistance provided to requesting Member States within the context of South-South or Tripartite Cooperation to help them implement the UNAC Convention and to harmonize its provisions with their national laws. To this end, at the 7<sup>th</sup> session of UNCAC, which took place in Vienna from 6 to 10 November 2017, the States Parties adopted by consensus a resolution presented by the Kingdom of Morocco on the ‘follow-up of the Marrakech Declaration on the Prevention of Corruption’.

At the continental level, the African Union Convention on Preventing and Combating Corruption (AUCPCC) together with other African Union (AU) instruments relating to Human Rights, Democracy and Governance, are being considered by the relevant Moroccan Ministerial Departments with a view to assessing the suitability of the Kingdom of Morocco’s accession to the instruments.

# CHAPTER XIV.

## The Case of Benin

Prepared by the Republic of Benin



### 14.1. Policies Implemented in the Fight against Corruption in Benin

The fight against corruption has always been a major concern of the leaders who have succeeded in Benin since its independence. This fight against corruption reached a remarkable level at the normative and institutional levels between 1990 and 2016.

In this regard, with the advent of democratic renewal in 1990, several mechanisms have been put in place to effectively fight against corruption and illicit financial flows (IFFs) in Benin. Some are essentially legal instruments while others concern the treaty bodies.

#### 14.1.1. Legal and Institutional Framework Covering Anti-corruption Issues

##### 14.1.1.1. The Legal Framework

This arsenal includes national, regional and international instruments. These instruments include:

##### *At the national level*

At the national level, the following are relevant:

- The Constitution of 11 December 1990 in Articles 35 and 37 provide that: “Citizens in a public office or elected to a political office have the duty to fulfil it with conscience, competence, probity, dedication and loyalty in interest and respect for the common good” and that “public property is sacred and inviolable and every Beninese citizen must scrupulously respect and protect it”. Any act of sabotage, vandalism, corruption, misappropriation, squandering or illicit enrichment is punishable under the conditions provided by the law. In particular, Article 52 of the same text requires the President of the Republic and the ministers, to declare assets as a preventive measure in the fight against corruption;
- The Penal Code (Bouvenet) of 1958;
- Law No. 2006-14 of 31 October 2006 on the fight against money laundering;
- Law No. 2008-07 of 28 February 2011 on the Code of Civil Procedure Commercial, Social, Administrative and Accounts;
- Law No. 2011-20 of 12 October 2011 on combating corruption and other related offenses in the Republic of Benin, which incorporates the asset declaration measure already provided in Article 52 of the Constitution of 11 December 1990 and extends to senior state officials and assimilated;
- Law No. 2012-21 of 27 August 2012 on combating the financing of terrorism in the Republic of Benin;
- Decree No. 2012-15 of 18 March 2013 on the Code of Criminal Procedure in the Republic of Benin published in OJ No. 10 bis of 29/05/2013;



- Decree No. 2012-338 of 2 October 2011 on the application of Articles 3 and 10 of Act No. 2011-20 of 12 October 2011 on the fight against corruption and other related offenses in the Republic of Benin; and
- Decree No. 2013-122 of 6 March 2013 on special conditions for the protection of whistleblowers, witnesses, experts and victims of acts of corruption.

#### *At regional and sub-regional level*

- The African Union Convention on Preventing and Combating Corruption (AUCPCC) signed on 11 July 2003 in Maputo and ratified by the Republic of Benin in 2006; and
- The Economic Community of Western African States (ECOWAS) Protocol A/P3/12/01 of 21 December 2001 on the fight against corruption, signed on 1 December 2001 and ratified by Benin on 1 December 2005.

At the level of the West African Economic and Monetary Union (WAEMU), certain legal instruments bind Benin and they are associated with corruption. For example, Community legislation on public finances provides for clear standards on transparency in the management by the Member States of their public finances. The following are relevant:

- Directive N. 002/2000/CM/WAEMU adopting the Code of Transparency in Public Financial Management of June 29, 2000, replaced by Directive No. 001/2009/CM/WAEMU on the Transparency Code in Public Financial Management within the WAEMU;
- Directive No. 05/97/CM/WAEMU on the Finance Laws of 16 December 1997; and
- Directive No. 002/99/CM/WAEMU amending Directive No. 005/ 97/CM/WAEMU on the financial laws of 21 December 1999.

#### *At the international level*

- Adoption of the United Nations Convention against Transnational Organized Crime (UNTOC). This Convention was adopted by General Assembly resolution 55/25 of 15 November 2000. It entered into force on 29 September 2003 and was ratified by Benin on 5 August 2009.
- The United Nations Convention against Corruption (UNCAC) of 31 October 2003, entered into force on 14 December 2005, signed by Benin on 11 December 2003 and ratified by Benin on 12 August 2004.

#### **14.1.1.2. The institutional framework of the fight against corruption in Benin**

Several bodies have worked and still work for the fight against corruption in the Republic of Benin. Political bodies are distinguished from technical or specialized bodies.

##### *Political bodies*

Historically, Benin has known several commissions, including:

- The special commission known as the AHOUNSSOU Commission for the Asset Verification of the Heads of the Revolutionary Regime, State Institutions and Authorities, and State Corporations and Entities between October 1972 and December 1989;
- The Asset Verification National Commission, called the AMOUSSOU Kpakpa Commission, which succeeded in 1990 to the previous one to continue the same investigations; and
- In May 1999, the Adrien AHANHANZO-GLELE Commission was set up in order to identify all cases of embezzlement and misappropriation of public funds from 1996 to 1999.

With regards to budgetary matters, the National Assembly has three possibilities to control the executive. This is the consideration of the vote of finance law of the year (State Budget) and the traditional means of control of government action.

Moreover, corruption is an offense that the various political personalities can commit and no other body is competent to judge them when this offense is committed in the exercise of their functions.

We realize that the High Court of Justice is one of the most important anti-corruption bodies in Benin. In practice, this political jurisdiction has never investigated and tried a case, despite the existence of requests for referral.

**The Audit Chamber of the Supreme Court:** its main mission is to ensure regularity in the management of public funds and also their good use, whether it is at the level of the centralized structures of the State, decentralized structures, local authorities or any other structure using public funds partially or totally.

### *Technical or Specialized Bodies*

**National Anti-Corruption Authority:** Law No. 02011-20 of 12 October 2011 establishes the National Anti-Corruption Authority (ANLC) which succeeded the Observatory for the Fight against Corruption (OLC). Its vision is to create an anti-corruption environment and a society based on civic and ethical values for sustainable development in the Republic of Benin. The ANLC's mission is to promote and strengthen measures to prevent and combat corruption effectively, promote integrity and accountability, and the proper management of public affairs and assets.

**National Anti-Corruption Authority (CENTIF):** The unit was established by Law No. 2006-14 of 31 October 2006 in the fight against money laundering. It is under the supervision of the Minister of Finance. The CENTIF is an administrative service, with financial authority and autonomous decision-making power over matters falling within its remit. Its mission is to collect and process financial intelligence on money laundering channels.

**The oversight bodies of the administrative order:** With the new decree reorganizing the oversight bodies of the administrative order in the Republic of Benin adopted in the Council of Ministers on July 4, 2018, apart from the Bureau of Analysis of Investigations (BAI) under the supervision of the Office of the President, we have the Inspector-General of Finances (IGF) and the Inspector-General for Public Service and Employment (IGSEP), which are both national bodies.

At the level of each ministry, the following have been established:

- A General Inspectorate of the Ministry to carry out the general mandate of internal audit, study and evaluation within the areas of competence of the Ministry;
- A Risk Management Ministerial Committee whose mandate is to define and support the implementation of procedures or measures aimed at strengthening the safety, efficiency and effectiveness of central technical departments and other structures attached to or under the supervision of the ministry; and
- An Internal Audit Committee whose role is to ensure the proper functioning of the internal control systems set up under the auspices of the ministerial committee for risk management.

The IGF is the central body responsible for the operational coordination of the activities of the state control and internal audit structures and the follow-up of the main recommendations.

Apart from the supervisory bodies, mention should also be made of the Economic and Financial Affairs sub-directorate of the Republican Police (previously Economic and Financial Brigade) and the Central Office to Combat Illicit Traffic in Drugs and Precursors (OCERTID).

### *Civil Society Organizations*

The Front of National Anti-Corruption Organizations (FONAC) is a network of 25 organizations set up since 1998 to fight against corruption at state level and civil society in the sectors; their

fields of intervention are: the fight against corruption, the good governance, investigations, denunciations, and citizen control of public action.

Apart from FONAC, other civil society organizations active in the field of the fight against corruption in Benin include the Association against Racism, Ethnocentrism and Regionalism (ALCRER); Social Watch Benin and *Nouvelle Ethique*.

Overall, it should be noted that the current normative and institutional framework is characterized by:

- The existence of an anti-corruption law containing preventive provisions relating to the declaration and the control of inheritance, conflicts of interest, the security and the regularity of the public markets; and the repressive provisions which qualify the facts of corruption and punish them with particular severity;
- The existence of a state anti-corruption structure (ANLC) and non-state structures led by civil society. The state structure is placed under the supervision of the President of the Republic, as a guardian, independent of hierarchy as recalled by the Constitutional Court in its decision DCC-11-064 of 30 September 2011; and
- The existence of a judicial system composed of a common law jurisdiction and a financial institution, in this case the Chamber of Accounts of the Supreme Court. This judicial system has the mission to uncover, among other things, corruption issues and judge the insensitive who fall under different texts recalled.

## 14.2. Implementation Approach

### 14.2.1. The National System of Integrity (NSI)

In 2016, as part of the affirmation of its political will to fight against corruption and impunity, the Government of Benin solicited and obtained support of the European Union (EU) for carrying out a study on the evaluation of the National System of Integrity (NSI).

Thus in 2016, this evaluation of the NSI was entrusted to the ALCRER-Social Watch Benin in partnership with Transparency International (TI).

The evaluation of the NSI focused on the 13 pillars which consist of the Parliament, the Executive, the Judiciary, the Administration, the institutions charged with ensuring the respect of the Law (Police, Gendarmerie, Attorney ...), the Election Control Commissions, the Mediator of the Republic, the Supreme Audit Chamber, the ANLC, political parties, the media, civil society and private enterprises.

At the end of this evaluation, a report was presented to the Government in September 2016. This report is supported by an action plan to promote integrity and the fight against corruption.

The report and its action plan were submitted for the approval of the Council of Ministers at its meeting on 30 November 2016.

By adopting them in Report No. 029/PR/SGG/REL/Ord of 30 November 2016, the Council of Ministers instructed the Members of the Government, among others, to disseminate, within their respective administrations, the results of the evaluation of the NSI and support the implementation of the action plan for the promotion of integrity and the fight against corruption that ensued.

Referring to governmental institutions, the Minister of Economy and Finance, after consultation with the ALCRER-Social Watch, drafted an Inter-ministerial Decree for the establishment of bodies to monitor the implementation of these recommendations.

On April 4, 2017, the draft order was signed by the Minister of Economic Affairs and Finance, the Minister of State for Planning and Development and the Minister of Justice and Legislation.

This decree made possible the establishment of the following three bodies:

- The Steering Committee for the implementation of the Integrity and Anti-Corruption Action Plan chaired by the Minister of State in charge of the Plan;
- The Inter-ministerial Executive Committee for the implementation of the Integrity and Anti-Corruption Action Plan, chaired by the Cabinet Director of the Minister in charge of Finance; and
- Sectorial focal points for the implementation of the action plan to promote integrity and the fight against corruption, which are Secretaries-General of the Ministry or their counterparts in other structures.

In addition, at urging of the EU, a tripartite consultation framework is set up to monitor the progress of the implementation of the recommendations resulting from the NSI evaluation. It includes representatives of the technical and financial partners, the private sector, the ANLC, civil society and the Administration.

#### **14.2.2. Strengthening Justice**

At this level, we note the following non-exhaustive actions:

- The rehabilitation and strengthening of the General Inspectorate of Judicial Services;
- The creation and commissioning of the Cotonou Commercial Court;
- The recruitment of junior magistrates and court clerks; and
- The revision and adoption of new texts, particularly the Code of Criminal Procedure, the Penal Code, the Law on Judicial Organization, the Statute of the Judiciary.

#### **14.2.3. Dematerialization of Procedures and Related Actions**

In order to ensure the fluidity of the internet and to promote a digital economy, the Government has launched a policy to extend optical fiber throughout the country.

This extension is an enabling accompaniment to the dematerialization policy of the procedures undertaken in all the sectors in order to reduce the contact between the users and administration agents considered as sources of rigidity and corruptive practices.

Thus, each ministry and institution have initiated reforms in the dematerialization of procedures:

- At the level of the ministry in charge of finances, several procedures are dematerialized at the level of the Budget, the Customs, the Taxes, the Treasury, the National Agency of Estate and Land; and
- At the level of the ministry in charge of Public Service, the same applies: the organization of competitions, management of career acts and customer service.

Today, the CENTIF is revitalized and ensures oversight of all financial transactions thanks to the reporting of suspicious transactions (DOS) which are systematically transmitted by the banks. It has signed information exchange protocols with structures such as the Inspector-General of Finances (IGF).

Finally, at the end of June 2018, the Government adopted the texts to reform and reorganize the public administration control bodies in order to enable them to effectively combat acts that contribute to the mismanagement of public resources.

#### 14.2.4. Specific Case of the Directorate General of Taxes

As part of the fight against corruption, the Directorate General of Taxes has implemented reforms in line with its modernization. The main purpose of these reforms is to automate procedures and make them more accessible to taxpayers, and to reduce contact between tax administration officials and taxpayers, and the risks of corruption and fraud.

The Directorate General of Taxes, in the performance of its auditing mandate, makes use of certain prerogatives granted to it by law. Among these prerogatives are:

- The exploitation of ASYCUDA and the Integrated Public Finance Management System (SIGFIP), customs information management platforms and public finances, allowing almost real-time cross-checking of anything that contributes effectively to the fight against IFFs;
- The exercise of the right of communication to banks and financial institutions, allowing for the monitoring of financial transactions of taxpayers; and
- The capacity, under the law (article 1102 of the CGI), to requalify a legal act concealing a realization or transfer of profits or income and to draw the tax consequences.

The reforms implemented relate to:

- The implementation of the Integrated Tax and Assimilated Taxes Management System (SIGTAS), integrating a system of remote electronic tax procedures;
- The establishment of a national taxpayer file with a system of updating, encouraging companies to be in good standing vis-à-vis the tax authorities, contributing to the control of the taxable population and reducing the scope tax avoidance;
- The implementation of the submission of online declarations and the payment of taxes through bank accounts;
- The imposition of a 10% penalty levy on taxpayers not known to the tax authorities;
- The institution of a tax certificate as part of the documents required to obtain a foreign exchange authorization; and
- Ongoing popularization of tax laws and instructions, and raising awareness among taxpayers through various channels to increase the level of tax compliance and reduce the risk of tax evasion.

The Benin Tax Administration supports the fight against corruption and IFFs through the implementation of international tax assistance and the exchange of information for tax purposes. International tax assistance aims to combat tax fraud and tax evasion. In this context and as part of strengthening relationships with national structures operating in the same field, the General Tax Directorate has carried out several actions, namely:

- Joining the Global Forum on Transparency and Exchange of Information for Tax Purposes in May 2017;
- Participating in the Global Forum's 'Africa Initiative' program, which aims to help African countries tackle cross-border fraud and evasion by taking advantage of improvements in global infrastructure for tax transparency and exchange of information; and
- Signing of a Memorandum of Exchange with the CENTIF.

In the same context, provision is also made for:

- The imminent establishment of a specialized information exchange unit with the required IT infrastructure;
- The creation of a platform for consultation of all actors involved at national level, in the implementation of the standards of fiscal transparency and standards of transparency of the beneficial owner;

- Accession to the Organisation for Economic Co-operation and Development (OECD)'s Tax Inspectors Without Borders (TIWB);
- The updating of the tax legislation to take into account:
  - transfer prices;
  - the notion of the beneficial owner;
  - international standards for the exchange of information; and
  - improved provisions for examining personal tax situations.
- The training of target groups to accompany these activities.

### 14.3. Results from the Fight against Corruption in Benin

Since their creation, the bodies in charge of fighting the scourge of corruption have led many activities with mixed results. This assertion can be corroborated by the final report of the implementation of the second-generation Growth Strategy for Poverty Reduction (SCRP 2). This report specifies that "at the end of the implementation of the SCRP 2, mixed results of rigor and transparency in the management of public finances, improvement of the institutional framework of business environments, fight against corruption and strengthening the rule of law".

Indeed, the fight against corruption is not a solitary race of substance or speed, but a relay race involving several actors, including the executive who, through the establishment of disciplinary councils, imposes sanctions on criminal offenses against persons convicted of active or passive bribery.

To this end, it is important to point out that the fight against impunity has intensified in the past two years with President Talon pledging to make the fight against corruption a constant battle.

This political will is reflected in the conduct of audits in several sectors of the national sphere. The results of these audits have shed light on certain practices that are detrimental to ethics and financial orthodoxy.

On this basis, several heads of companies and state offices, officials, managers and agents of different administrative structures received administrative sanctions of varying degrees (suspension or postponement of duty, suspension of salary, bank account blocking and referral to economic and financial authorities). Most of them were placed under judicial detention and imprisoned.

Since 6 April 2016, when these initiatives were started, Benin has moved up the rankings published each year by TI. According to the Corruption Perception Index of Transparency International, the Benin score improved slightly in 2017 compared to 2016: from 95<sup>th</sup> position in 2016, Benin ranks 85<sup>th</sup> in 2017 which is a very remarkable advance of 10 positions. These efforts must be continued and consolidated.

The operationalization of the action plan to combat impunity and corruption resulting from the evaluation of the NSI by setting up support units for the focal points should be noted.

Moreover, it can be emphasized that people, through awareness-raising and education, are increasingly aware of the misdeeds of corruption and its manifestations. Thus, rejection of reprehensible practices and the adoption of ethical behaviors by citizens will manifest over the years.

## 14.4. Difficulties Encountered

The difficulties encountered include:

- **Sociological and cultural difficulties**

The fight against corruption and other related crimes grapples with some sociological and cultural difficulties in Benin. These are pressures of all kinds (political, attempted corruption of actors, physical and verbal threats, occult, family, social influences, and the interweaving of the importance of ethnic and/or religious commitment of certain actors who are not convinced of the necessity of the fight or post or interests), which sometimes block the sanction of offenders to accepted standards. The strong political will currently manifested will eventually circumvent these socio-cultural obstacles to the repression of corruption and other related offenses in Benin.

- **Financial difficulties**

For optimal operationalization of the various institutions involved in the fight against corruption and IFFs, financial resources will have to be mobilized. The budget allocated annually by the State is not sufficient. An anti-corruption support program initiated by international, regional and sub-regional institutions will be of great help.

- **Difficulties related to human and material resources**

Several anti-corruption institutions lack sufficient qualified staff to effectively fulfill their mandate. We also note the insufficiency of material resources, the administrative burden characterized by a lack of mastery of the procedures or their inefficiency, the lack of computerization of procedures and information, bad preservation of archives, and weak collaboration between the services or the actors to provide information.

We hope for a program which strengthens the technical and operational capacities of anti-corruption bodies initiated by international, regional and sub-regional institutions.

## African Union Commission 2019

### Domestic Resource Mobilization: Fighting against Corruption and Illicit Financial Flows

This volume assesses the current efforts and strategies that are being implemented to mobilize domestic resources, fight against corruption and curb illicit financial flows (IFFS) in Africa. This report is the result of collaboration between the African Union Commission, continental and international organizations and AU Member States.

Individual contributions help the reader to understand the nature and scope of the IFFs to identify good practices aimed at improving the fight against IFFs and corruption. It is hoped that peer learning amongst Member States and development practitioners will aid in reducing IFFs and corruption, and enhance domestic resource mobilization.

Illicit financial flows prevent Africa from mobilizing significant financial resources required for inclusive growth and socio-economic development. Tackling trade mis-invoicing, tax evasion, abusive transfer pricing, criminal financial flows and corruption will help mobilize additional resources to achieve the goal set out in the Africa Union Agenda 2063 and reduce Africa's reliance on external funding.



African Union Commission  
Department of Economic Affairs  
PO Box 3243  
Roosevelt Street (Old Airport Area), W21K19,  
Addis Ababa, Ethiopia  
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