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Progress report of the High-level Panel on Illicit Financial Flows from Africa

Theme: Industrialization for inclusive and transformative development in Africa

Acronyms and abbreviations

AU	African Union
ECA	United Nations Economic Commission for Africa
FATF	Financial Action Task Force
G8	Group of Eight
G20	Group of Twenty
HLP	High-level Panel
OECD	Organisation for Economic Co-operation and Development

Introduction

1. The High-level Panel (HLP) on Illicit Financial Flows from Africa was inaugurated in February 2012 following Resolution L8 of the Fourth Joint Annual Meetings of the Economic Commission for Africa (ECA) Conference of African Ministers of Finance, Planning and Economic Development and African Union Conference of Ministers of Economy and Finance.

2. The Panel was constituted after wide-ranging consultations both within and outside Africa, with ex officio members drawn from ECA and Norway. Its current composition is as follows:

Chair: Mr. Thabo Mbeki, former President of the Republic of South Africa (South Africa)

Vice-Chair: Mr. Carlos Lopes, Executive Secretary of the Economic Commission for Africa (Guinea-Bissau)

Mr. Olusegun Apata, retired Ambassador and Chairman of the Nigerian Coca-Cola bottling company (Nigeria)

Mr. Raymond Baker, Director of Global Financial Integrity (United States of America)

Ms. Zeinab El-Bakri, former Vice-President of the African Development Bank (the Sudan)

Mr. Abdoulaye Bio-Tchane, former Minister of Finance and Economy and former Africa Director of the International Monetary Fund (Benin)

Mr. Henrik Harboe, Director of Development Policy at the Norwegian Ministry of Foreign Affairs (Norway)

Mr. El Hadi Makboul, Secretary-General of the Ministry of Industrial Development and Investment Promotion (Algeria)

Mr. Akere Muna, President of the Pan-African Lawyers Union and Vice President of Transparency International (Cameroon)

Ms. Irene Ovonji-Odida, Board Chair of Action Aid International (Uganda)

3. In its terms of reference, the Panel was called upon to:

- determine the nature and patterns of illicit financial outflows from Africa;
- establish the level of illicit financial outflows from the continent;
- assess the complex and long-term implications of illicit financial flows for development;
- raise awareness among African governments, citizens and international development partners of the scale and effect of such financial outflows on development;
- propose policies and mobilize support for practices that would reverse such illicit financial outflows.

4. The Panel expects to finalize its report by July 2014. It is, however, submitting the present progress report to the Conference of Ministers in order to indicate the progress achieved thus far and highlight some of the emerging issues that require attention. The report is also intended to provide a basis for consultations between the Panel and the Conference prior to the issuance of the final report. The present progress report outlines the process undertaken by the Panel and underscores some of the issues that have emerged from its ongoing work.

Work of the High-level Panel

5. The Panel approached its work in accordance with its terms of reference. It undertook background research, advocacy, African country studies, and regional and global consultations.

Background research

6. The Panel tasked its secretariat to undertake background research on the issue of illicit financial flows from Africa. The purpose was to enable the Panel to gain a concrete African perspective on the issues involved and to provide a technical basis for its final report. The background report that was produced has helped to inform the Panel's priority areas of focus and framed its engagement in the consultations with various stakeholders.

Advocacy

7. From its inception, the Panel saw advocacy as an essential part of its work. It accordingly framed a communications strategy that included the creation of a website, the publication of a brochure on the Panel's work and a factsheet on illicit financial flows, and the coining of related slogans. The Panel adopted the mobilizing slogan, "Illicit Financial Flows from Africa: Track it. Stop it. Get it", to underpin its advocacy efforts. Such has been the success of the advocacy efforts that requests were received by others working on the issue to use the Panel's slogan. The Chair, panel members and the Technical Committee continue to be invited to make presentations and interact at various forums on the question of illicit financial flows.

Country studies

8. The Panel also commissioned country studies on illicit financial flows from Africa in order to obtain empirical country-level evidence of the phenomenon and its manifestation. Given that it could not cover all African countries, the Panel concentrated on studies of six countries. The criteria for choosing the six countries included subregional coverage, the importance of the extractive sector in their economies, and the process of recovery from conflict. The countries chosen were Algeria, the Democratic Republic of the Congo, Kenya, Liberia, Mozambique and Nigeria. The Panel also visited Mauritius as a representative of a small island economy. In addition, the Panel plans to visit South Africa to explore how the institutions and processes in that country are geared to addressing the issue of illicit financial flows.

9. The six countries were all visited and the Panel was well received in every case by Heads of State and Government, ministers responsible for the economy, parliamentarians, the police and the judicial authorities, and heads of various financial institutions, including central banks, customs agencies, internal revenue services, anti-corruption agencies and the like. The Panel also met leading civil society organizations, academic and media practitioners and related non-governmental organizations. At all stages, the Panel members explained that the purpose of the country studies was to gain empirical perspectives and insights on the manifestation of illicit financial flows in various jurisdictions and not to cast aspersions on the individual countries concerned. The Panel received full cooperation in all instances and as was intended, the insights from the country visits helped to provide empirical evidence of general application to its work. The Panel would like to extend its heartfelt thanks to the African Heads of State and Government, the Governments and peoples of Africa, all of whom did everything to facilitate its work.

Subregional consultations

10. The Panel also undertook a public consultation in Kenya and broad subregional consultations as part of its advocacy efforts. This was driven by the realization that stakeholders from all parts of the continent could make invaluable contributions to its work through insights, information and data not otherwise available. Subregional consultations for east and southern Africa took place in Lusaka, the one for west and central Africa was held in Accra, and the one for north Africa took place in Tunisia. Overall, more than two hundred participants from 48 countries and from a wide cross section of stakeholders participated in the subregional consultations.

Global consultations

11. As part of its outreach activities, the Panel interacted with United States of America government agencies, the Secretariat and Member States of the United Nations, the Organisation for Economic Co-operation and Development (OECD), the World Customs Organization and the European Parliament. Consultations were also held with the World Bank and the International Monetary Fund, as well as think tanks and private sector organizations in the United States of America such as the Brookings Institution and the Corporate Council on Africa.

Scale of illicit financial flows

12. As part of its background research, the Panel commissioned a study by ECA and also took account of existing literature on the scale of illicit financial flows. The results were broadly similar in terms of trends and volumes. The ECA study focused primarily on trade mispricing and the results obtained were broadly comparable to other similar authoritative studies. Studies undertaken under the auspices of Global Financial Integrity indicate that the scale of illicit financial outflows from Africa due to trade mispricing alone is approaching approximately $ 50 billion a year. For its part, the ECA study, which used a different data set and approach, estimated that the annual outflow of illicit finance through trade mispricing was closer to $60 billion. Also significant was the fact that illicit outflows through trade mispricing from Africa grew at a real rate of 32.5 per cent between 2000 and 2009, which was much more than outflows from other developing country regions.

13. These estimates for illicit financial flows from Africa are at best conservative. It is difficult to get a precise handle on outflows arising from criminal activities and proceeds of bribery and abuse of office because they are by their very nature quite secretive. However, in the course of its consultations, the Panel was given examples of how smuggling of cash has become rampant, including through the use of private and chartered aircraft. The estimates of illicit financial outflows also do not take account of the increasing importance of services and intangibles such as intellectual property rights in global economic activity. Such activities were estimated to account for about 24 per cent of global trade flows in 2012. Equally significant with regard to understanding the full scale of illicit financial flows from Africa is the emergence of aggressive tax avoidance strategies, which relate directly to the illicit outflows.

Emerging issues

14. An important number of issues emerged in the course of the research, country studies and consultations undertaken by the Panel. These emerging issues frame and impact upon the entire spectrum of the manifestation, drivers and responses to the problem of illicit financial flows.

Complexity and modalities

15. The issue of illicit financial flows is highly complex, with many technicalities relating to origins, destinations, scale, modalities, drivers, actors and regulatory responses, among other things. The very definition of illicit financial flows and which capital outflows should be considered as illicit have been a constant theme underpinning the ongoing work of the Panel. Accordingly, the Panel decided to adopt the definition provided by Global Financial Integrity, which is “money illegally earned, transferred or used”. In other words, relating to its origin, or during movement or use, the flow of money that has broken laws is considered illicit. The Panel spent time untangling all of these related issues but a constant starting point has been to break down illicit financial flows into three components, namely commercial activities, criminal activities and bribery and abuse of office.

16. The background research undertaken by the Panel has revealed that globally, commercial transactions, tax evasion and laundered commercial transactions account for up to 60 per cent of illicit financial flows. By comparison, the criminal element, including drug trafficking, racketeering, counterfeiting, contraband and terrorist financing, made up about 35 per cent of illicit financial flows, while the outflows generated through bribery and abuse of office by public officials accounted for about 5 per cent. The Panel felt that while those percentages might be somewhat different in Africa, it was fully satisfied that the ranking of the three sources of cross-border illicit financial flows remained the same – commercial illicit financial flows are the largest, criminal flows are next, and outright bribery and theft by government officials is the smallest. Regardless of the exact percentage, it was agreed that corruption is a cross-cutting issue affecting all three components of illicit financial flows from Africa.

Illicit financial flows are political

17. While the entire gamut of illicit financial flows is technical in the manner in which it is carried out, the Panel has come to the conclusion that to address the issues involved, they must be framed within the context of political considerations. This is mainly due to the nature of the actors involved and the fact that the most obvious solutions require strong political commitment and leadership. Illicit financial flows are of concern to Governments of developed and developing countries alike because of their implications for resource mobilization, policy and legislation, and international geopolitics. Among other things, illicit flows have an impact on fiscal policy and the transparency of financial transactions, regarding which States are naturally keen to have as much information as possible. They have also become an important area of focus because of the process of globalization. At the same time, some States are outrightly desirous of becoming financial secrecy jurisdictions, which would make them attractive destinations for illicit financial flows.

18. A set of key actors are multinational corporations, which in some cases have annual turnovers that exceed the gross domestic product of certain African countries. Intra-group trade of multinational corporations accounts for up to 30 per cent of international transactions in goods, services, capital and intangibles (intellectual property). This power gives multinationals disproportionate influence over inward investment flows and negotiations of contracts, especially for the extraction of natural resources. They also have greater capacity to attract teams of the best lawyers and accountants in their dealings with African countries particularly as concerns transfer pricing. Criminal networks with their shady transactions and increasingly innovative means of money laundering, along with an ability to infiltrate and undermine State structures, also occupy influential spaces in some African countries.

19. Civil society actors including international non-governmental organizations are actively engaged in the effort to stem illicit financial flows. These bodies have drawn on their extensive networks, research capabilities and strengths in advocacy to put the issue of illicit financial flows firmly on the global agenda. Civil society efforts have been an invaluable source of support for the campaign against illicit financial flows and they need to be mobilized even further to ensure that pressure is brought to bear on all the other actors to play their part. The objective must be to get both source and destination countries of illicit financial flows to buy into the agenda of curtailing the practice in all its manifestations.

Uneven or missing institutional architecture

20. The Panel has found that in some African countries, the institutional architecture for responding to illicit financial flows was at best uneven or, as in several key instances, non-existent. Lack of transparency, secrecy and the difficulty of obtaining information and systematic data remain key challenges across the board. However, there are global frameworks in place for tackling issues of corruption and bribery as well as for gauging criminal activities including money laundering. The same can hardly be said with regard to illicit flows arising from commercial activities, although it must be emphasized that all three categories are inter-related.

Bribery and abuse of office

21. While corruption was found to be a cross-cutting issue across all categories of illicit financial flows, it is clear that this term is often seen to be synonymous with public sector corruption such as bribery and abuse of office, often related to public procurement. It is, however, worth noting the key role played by private sector actors, for example through the payment of bribes to public officials and by exerting undue influence on public processes via personal connections.

22. In this regard, to combat this practice, there exist, among others, the African Union Convention on Preventing and Combatting Corruption and its related institutions, the United Nations Convention Against Corruption, the Intergovernmental Action Group against Money Laundering in West Africa, the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, the US Foreign Corrupt Practices Act and article 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The requirement here would seem to be the strengthening of these instruments and improving international cooperation with regard to their implementation. Notable in this regard are the World Bank Stolen Asset Recovery Initiative, the US Kleptocracy Asset Recovery Initiative and the Camden Asset Recovery Initiative, all intended to recover and repatriate the inter-related proceeds of abuse of office, which are often laundered. An issue of concern to the Panel is the governance of frozen assets in the sense that these resources should not be available to banks that knowingly receive illicit flows. Such monies would need to be held in escrow accounts until due process determined their final destination.

Criminal activities

23. Criminal activities, ranging from money laundering to drug, people and arms trafficking and smuggling, are also a key component of illicit outflows from Africa, and they have an uneven institutional framework. The Panel found that useful data on these forms of illicit flows is emerging from United Nations Office on Drugs and Crime. However, even its figures are limited by the shroud of secrecy that surrounds such criminal activities.

24. Money laundering is a key component of the global shadow economy and facilitates illicit financial flows. There has, however, been some progress in this area, especially as a result of the anti-money laundering and counter-terrorist financing regimes that have been put in place principally through the recommendations of the Financial Action Task Force (FATF). The Panel has observed that substantial progress has been made in this area, owing mainly to the political will to choke financing to terrorist organizations. It has, however, noted that significant weaknesses still exist in the implementation of the FATF recommendations as evidence abounds that major banks and financial institutions continue to receive, transfer and manage illicit outflows from Africa. Similarly, the United Nations Office on Drugs and Crime has estimated that while 40 per cent of cocaine and heroin shipments are interdicted, only 1 per cent of the money is traced and/or seized.

Commercial activities

25. As stated earlier, the Panel has found that commercial activities were by far the largest component of illicit financial flows. It is, however, the area in which the global institutional framework is least developed. Most of the related work in this area is being done by OECD.

This is partly due to the renewed interest of developed countries in illicit financial flows as a result of their own fiscal constraints following the recent global financial and economic crisis.

26. Most commercially induced illicit flows relate to tax evasion, aggressive tax avoidance and harmful tax holidays.[1] The key actors in this area are multinational companies operating across borders but dealing with different tax administrations. Resource extraction contracts that are shrouded in secrecy are another commercial source, structured deliberately to deny African countries of legitimate earnings from royalties and taxes. This is particularly important for Africa given that natural resources constitute the bulk of international tradable goods originating from the continent.

27. Integrated companies would, quite naturally, source some of their inputs and intellectual property from within the group, just as they also supply outputs and services to sister companies. A common practice, however, has been for the group to resort to declaring the most profit in the jurisdiction with the lowest taxes rather than where the profits were generated. Consequently, this phenomenon is not restricted to Africa. Recent examples have shown that some companies operating in countries declare losses for several years and never go bankrupt. Curbing such practices including insisting on greatly strengthened ‘arm length principle’ provisions for intra-group payments requiring financial, accounting and legal capacities that are not currently readily available in African tax administrations.

28. A source of more outright illicit financial flows is the mispricing of imports and exports, sometimes to avoid duties but also to transfer monies, especially foreign exchange, out of African countries. Closely related to this is the underdeclaration of quantities of oil, gas, minerals and natural resources (including timber and fish) that are taken out of African countries. Also of concern in this regard is the never-ending system through which multinational firms benefit from tax holidays and then sell out just before the expiry period of such concessions, only to re-emerge as a new firm with a new tax holiday period. The consultations undertaken by the Panel have revealed widespread awareness about such illicit means of taking finances out of Africa. The general concern and complaint in this regard is the lack of capacity to address such matters.

29. In addition to building relevant capacities in customs and revenue services and in the absence of a universal tax administration, it has been suggested that the required solution must focus on increased transparency along the following lines:

- Curtailment of mispricing in trade imports and exports;
- Country-by-country accounts of sales, profits and taxes paid by multinational corporations;
- Declaration of beneficial ownership in commercial entities, including banking and securities accounts;
- Automatic cross-border exchange of tax information;
- Harmonization of laws relating to anti-money laundering.

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[1] There is some debate about whether aggressive tax avoidance and harmful tax holidays are illicit. Once they are understood in the context of the intent to defraud the State of legitimate tax revenues from activities carried out in its territory then such flows must be considered illicit.

30. These issues have attracted attention in various forums including the Bretton Woods institutions, the European Parliament, OECD and the G8 and G20, and at the level of individual countries and regional groupings. Some of the emerging responses, which do not amount to an over-arching institutional framework to tackle illicit financial flows in the commercial sector, include:

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

31. Apart from the fact that these processes are not universal and are being undertaken by the concerned groups and countries in their own self interest, there is no clear understanding of how they will impact African countries. In some cases, complexity and costs of compliance could pose a problem. Similarly, the expected distribution of benefits between African countries and developed countries that are implementing these measures are not well known or clearly defined. These are issues that deserve further attention at regional and global levels.

Tax havens and financial secrecy jurisdictions

32. A cross-cutting issue in addressing illicit financial flows relates to the activities and practices of tax havens and financial secrecy jurisdictions. While not strictly the same thing, tax havens and financial secrecy jurisdictions provide a destination for illicit financial flows through tax evasion or money laundering. Indeed, by providing a location in which funds can be parked with no questions asked, tax havens and secrecy jurisdictions undermine efforts to stem illicit outflows from Africa. Tax havens and financial secrecy jurisdictions often ease registration requirements, thus allowing for the use of corporate vehicles and nominal owners (fronts) that mask beneficial owners. The Panel is particularly concerned that some African countries may be tempted to become tax havens and financial secrecy jurisdictions owing to the perceived benefits.

Implications for African development

33. The background research of the Panel and its widespread consultations have confirmed the understanding that illicit financial flows have serious consequences for African development. The most obvious effects are the loss of investment capital and revenues that

could be used to finance public services including infrastructure, education and health. Conservative estimates have shown that without illicit financial flows from the continent, the African gross domestic product would be at least 16 per cent higher. This has an obvious negative impact on economic growth and development and therefore the important issue of job creation. Indeed, tax abuse by international businesses places a disproportionate burden on smaller domestic firms, which are typically responsible for most employment in African countries.

34. Illicit financial flows also have a governance dimension in the sense that they undermine State institutions and public confidence in them as well as weakening the rule of law. This is particularly true of State capacity for tax collection and market regulation. Illicit outflows are damaging in the sense of diverting public money to private uses and through the weakening of the financial sector. They also threaten stability and security by facilitating criminal activities within and across borders, such as the illegal trafficking of people, weapons and drugs.

35. Money laundering affects the reputation of countries and the integrity of their financial systems. Equally pernicious is the temptation that African countries face to become tax havens and secrecy jurisdictions. This is the illicit financial outflow equivalent of the race to the bottom that occurs with regard to tax holidays.

An African problem with a global solution

36. Illicit financial outflows from the continent have correctly been characterized as ‘an African problem with a global solution’. While the problem manifests itself in stark relief in Africa, the solutions require international cooperation, including by building relevant capacities throughout Africa.

International cooperation

37. We have mentioned some of the initiatives that are emerging at the global level, particularly in OECD, G8 and G20 and economically powerful States. However, there remain gaps in global governance relating to illicit financial flows because the measures that have been taken or that are being contemplated do not have Africa or indeed other developing country regions in mind. The Panel will insist that the necessary effort must be exerted to ensure that Africa benefits from such initiatives without having to bear undue costs of compliance.

38. The Panel is undertaking its work at a time in which the international community under the auspices of the United Nations is drawing up a post-2015 development agenda. The Panel’s discussions with United Nations Member States, the President of the United Nations General Assembly and the United Nations Secretariat indicate that the reduction of illicit financial flows should be an integral part of the post-2015 development agenda. While the specific form that such a target would take is yet to be worked out, the Panel is of the view that the global consensus on fighting corruption and criminal activities should be matched by similar support for the fight against the ways and means which comprise the substance of illicit financial flows. This would make an important contribution to the matter of generating the resources to finance the post-2015 development agenda.

39. Also noteworthy in this regard are initiatives such as the Oslo dialogue on a whole-of-government approach to fighting tax crime, as well as the OECD-backed "Tax Inspectors Without Borders" initiative, which uses international cooperation to tackle aspects of illicit financial flows, including lack of capacity.

40. Based on the above, a coordinated response involving source, transit and destination countries is imperative.

Capacity and governance issues

41. It is clear from the work undertaken by the Panel that the prevalence of illicit financial flows in Africa and the inability to check this growing trend is owed in large part to capacity constraints. This is clearly the case with regard to the inability to arrest mispricing in the trade of goods, services and intangibles. It is also the case with regard to lack of capacity to negotiate contracts in the extractive sector or indeed to ensure that Africa's views are properly reflected in the emerging global architecture to stem illicit financial flows. The Panel has also observed some institutional deficiencies such that even when problems have been identified and structures established to tackle them, these bodies often do not function as envisaged or intended.

42. The lack of capacity often cuts across sectors and even causes tension between different departments of State. For example, instances of tension relating to alleged financial crimes between a national prosecuting authority and the judiciary were brought to the Panel's attention. This was fundamentally due to the capacity imbalance between the prosecuting authority on the one hand and the multinational corporations on the other, which the authority was prosecuting. The multinationals were all able to hire the best internationally available legal and accounting experts, which the African State in question simply could not afford. This had resulted in the prosecutors almost always losing their cases, leading them to suspect prejudice on the part of the judiciary.

Final report

43. The Panel is submitting the present progress report to appraise the Conference of Ministers of its work, emerging issues and findings thus far. The progress report is also intended to guide consultations with the Ministers in the sense that the Panel has not had the opportunity for an exchange of views with the Conference as a corporate body since it was established.

44. The final report will also contain a range of recommendations directed at different stakeholders in line with their involvement and responsibility for the issue. The report will include a results-based action plan to facilitate the implementation of the various recommendations. The final report of the Panel is nearing completion and we intend to present it to the Ministers between June and July 2014.

45. We hope that the consultations with the ECA African Ministers of Finance, Planning and Economic Development and African Union Ministers of Economy and Finance will provide additional information and insights to further inform and enrich our findings and recommendations.