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Economic development in Africa: Tackling illicit financial flows for sustainable development in Africa

Summary

In the aftermath of the current coronavirus disease pandemic, African countries will need to intensify their resource mobilization efforts to achieve the 2030 Agenda for Sustainable Development. The multidisciplinary methodology adopted in the *Economic Development in Africa Report 2020: Tackling Illicit Financial Flows for Sustainable Development in Africa* is geared towards tackling the relationship between illicit financial flows and the economic, social and environmental dimensions of sustainable development in Africa. This inclusive approach integrates a gender lens and gives voice from multiple vantage points to various actors, from civil society to firms doing business in Africa. Building on established measures of illicit financial flows, new insights are provided on country estimates of export misinvoicing on the continent and specific characteristics of mineral commodities are highlighted. Some of the motivations and root causes of illicit financial flows are also underscored in the report.



I. Introduction: Illicit financial flows are a shared problem between developed and developing countries*

1. The year 2020 is a milestone for Africa and for multilateralism. As many African countries celebrate their sixtieth anniversary of gaining independence from colonial rulers, the continent is making a significant stride towards transforming the promises of the 1960s into a reality as the African Continental Free Trade Area was due to open for trading on 1 July 2020, but had to be postponed due to the coronavirus disease (COVID-19) outbreak. The African Continental Free Trade Area is a landmark achievement on the continent's journey towards greater integration and prosperity. The year 2020 also marks the celebration of the seventy-fifth anniversary of the United Nations, the twenty-fifth anniversary of the Beijing Declaration and Platform for Action, and the beginning of the decade of action towards achieving the 2030 Agenda for Sustainable Development. Finally, the fifteenth session of the United Nations Conference on Trade and Development will be held in Barbados.

2. Beyond the milestones of 2020, the examination of illicit financial flows (IFFs) is motivated by growing concerns over its perceived effects on the world's economic, social and political stability. The *Economic Development in Africa Report 2020* provides an analysis of IFFs and sustainable development in Africa. It does so by considering the three dimensions of sustainable development: economic, social and environmental. The report uses the definition endorsed by the Inter-Agency and Expert Group on Sustainable Development Goal Indicators as the basis for the measurement of progress towards Goal 16, target 16.4. The definition is as follows: "Illicit financial flows are financial flows that are illicit in origin, transfer or use; that reflect an exchange of value (instead of a pure money transaction); and that cross country borders".¹

II. Illicit financial flows in multilateral discourse

3. The plethora of studies and forums on IFFs shows that the definitions and measurement reflect tensions between polarized views of the world embedded in a set of values, historical legacy, legal frameworks and economic ideology. For the World Bank, for example, "the term 'illicit financial flows' began to appear in the 1990s to describe a number of cross-border activities. The term was initially associated with capital flight".² The concern for capital flight in the least developed countries was, at the time, motivated by the need for capital funds from foreign loans, foreign equity and domestic sources to cater for the servicing of external debt and to provide capital for domestic investments. In a context of structural adjustment policies in most African countries, a sudden or prolonged outflow of domestic capital was likely to affect a country's macroeconomic performance, leading to these surges being labelled "capital flight" rather than "normal" flows.³ By the mid-2000s, studies from leading civil society organizations popularized the use of the term illicit financial flows by shedding light on the potentially significant magnitude of such hidden flows due to either the illicit origin of the capital or the illicit nature of the transactions. This strand of the literature focused on commercial tax evasion and the manipulation of trade prices as accounting for most IFFs.⁴ As a sign of the term's legitimization, most leading multilateral institutions such as the United Nations, the World Bank, the International Monetary Fund and the African Union now use the term illicit financial flows.

* Unless otherwise noted, all websites referred to in footnotes were accessed in April 2020.

¹ UNCTAD and UNODC, forthcoming, Conceptual framework for the measurement of illicit financial flows.

² World Bank, 2016, The World Bank Group's response to illicit financial flows: A stocktaking, p. 1.

³ Ajayi SI and Khan MS, eds., 2000, *External Debt and Capital Flight in Sub-Saharan Africa*, International Monetary Fund, Washington, D.C.

⁴ Baker RW, 2005, *Capitalism's Achilles' Heel: Dirty Money and How to Renew the Free Market System*, John Wiley and Sons, Hoboken, United States of America.

4. By 2015, the prominence of the coalition of stakeholders combating IFFs was such that the issue was included in the 2030 Agenda for Sustainable Development, in Goal 16, with target 16.4 specifically focusing on significantly reducing illicit financial and arms flows by 2030. Building on the 2015 historic step, the indicator framework for the monitoring of progress towards the Sustainable Development Goals adopted by the United Nations General Assembly in July 2017 includes indicator 16.4.1, on total value of inward and outward IFFs.⁵ Considering these significant milestones, evidence-based policy responses and regulatory measures to curb IFFs are urgently needed. However, IFFs remain a contested field characterized by broad agreements on the criminal sources and use of such financial flows but also a lack of consensus on the commercial components.

5. The diversity of approaches in the literature reveals that estimates of the magnitude of IFFs are shaped at the nexus of dominant economic principles and legal frameworks. On one hand, without an established theoretical model on IFFs, economists rely on a combination of economic ideology and rigorous analytical methods. On the other hand, variance across jurisdictions, layers of international and domestic laws and evolving legal frameworks problematize “distinctions between the ‘letter’ and ‘spirit’ of the law, on which the illegal/illicit distinction largely rests”.⁶ In effect, considering such a distinction is blurry given the primacy of the intention of the law in its interpretation. Furthermore, institutional and administrative capacities play a central role in shaping the measurement of IFFs, their regulation and the enforcement of existing laws and regulations.

6. In what Musseli and Bürgi Bonanomi⁷ termed the “common denominator definition”, IFFs are “cross-border transfers of money or assets connected with some illegal activity”. Multiple definitions of IFFs refer to elements of the following: movement of money and assets across borders that are illegal in their source, transfer or use. Sources are generally classified in three categories: criminal activities, commercial activities and corruption. While the illegality of corruption and most criminal activities related to different types of trafficking and smuggling gathers consensus, the legal versus illegal lens for commercial activities, such as trade mispricing, tax evasion, aggressive transfer pricing and tax avoidance, has been subject to an intense debate.⁸ Most disagreements centre on the treatment of tax evasion and avoidance. Tax evasion involves breaking the law, whereas tax avoidance involves the exploitation of national and international tax rules to gain advantages not intended by countries when they were adopted.

7. On one hand, most civil society organizations push for a broad definition of IFFs, beyond the legal and illegal divide, emphasizing their harmful impact on development. These views are echoed by the Independent Commission for Reform of International Corporate Taxation.⁹ For supporters of this view, an additional emphasis is placed on behaviours that are unethical or undesirable that result in unlawful and lawful (successful) avoidance.¹⁰

8. On the other hand, multilateral organizations address the tax-related dimensions of IFFs with varying degrees of caution. Such caution is motivated by fluctuating interpretations of the term across the legal, illegal, lawful and unlawful continuum. The prevalence of the presumption of innocence in most jurisdictions implies that, in practical terms, conceptualizing illicit to be equivalent to illegal would mean that activities cannot legally be construed as illicit/illegal unless they have been declared to be so by a court or competent authority. The inference is that such characterization would ultimately depend on the legal challenge of reaching a verdict. Doing so would be problematic because of

⁵ A/RES/71/313.

⁶ Musseli I and Bürgi Bonanomi E, 2020, Illicit financial flows: Concepts and definition. *Revue internationale de politique de développement*, p. 1.

⁷ *Ibid.*, p. 17.

⁸ See, for example, Cobham A and Janský P, 2019, Measuring misalignment: The location of US[United States] multinationals’ economic activity versus the location of their profits, *Development Policy Review*, 37(1):91–110.

⁹ Forstater M, 2018, Illicit financial flows, trade misinvoicing and multinational tax avoidance: The same or different?, Policy Paper No. 123, Centre for Global Development.

¹⁰ Picciotto S, 2018, Problems of transfer pricing and possibilities for simplification, available at <https://www.ictd.ac/publication/problems-of-transfer-pricing-andpossibilities-for-simplification/>.

differences in perceptions of standards in law-making and legal interpretation.¹¹ In addition, confining tax-avoidance practices to rigid legalistic examinations does not hold in light of the context-specific, fact-intensive assessment of corporate tax filing.¹² Preliminary assessments of the validity of tax claims in turn depend on the institutional capacity, including that of the revenue authority, to conduct the associated tasks.

9. Reflecting these challenges, elements of IFFs appear in the 2000 United Nations Convention against Transnational Organized Crime, with a focus on the criminal dimensions of the transfer and concealment of assets of illicit origin. The related resolution of the United Nations Economic and Social Council in 2001 further underlines the need for stronger international cooperation in preventing and combating the transfer of funds originating in acts of corruption, whereas the 2005 United Nations Convention against Corruption includes commitments on returning stolen assets. By 2015, IFFs were included in the Sustainable Development Goals, amid debates on the treatment of tax-avoidance issues.

10. United Nations research reports take a pragmatic approach to IFFs. The UNCTAD *Trade and Development Report, 2014: Global Governance and Policy Space for Development*, for example, states that “this report refers to tax-motivated IFFs whenever the international structuring of transactions or asset portfolios has little or no economic substance, and their express purpose is to reduce tax liabilities”.¹³ The UNCTAD *World Investment Report 2015: Reforming International Investment Governance* does not use the term illicit financial flows. Rather, it emphasizes, as a starting point, the critical importance of the need for greater financing for development. To this end, the report builds on the assessment by the *World Investment Report 2014: Investing in the [Sustainable Development Goals] – An Action Plan* of missing funds to cover the estimated \$2.5 trillion annual investment gap needed to build productive capacity, infrastructure and other sectors in developing countries. The 2015 edition of the report then provides a detailed and rigorous examination of tax avoidance by multinational enterprises, by addressing the key question as follows: “how can policymakers take action against tax avoidance to ensure that [multinational enterprises] pay ‘the right amount of tax, at the right time and in the right place’, without resorting to measures that might have a negative impact on investment?”.¹⁴ Tax avoidance is considered by many constituencies as a critical component of IFFs.

11. Notwithstanding these conceptual variations, in December 2018, the United Nations General Assembly adopted a resolution on the promotion of international cooperation to combat illicit financial flows and strengthen good practices on assets return to foster sustainable development. The resolution places emphasis on the development dimension by “reiterating its deep concern about the impact of illicit financial flows, in particular those caused by tax evasion, corruption and transnational organized crime, on the economic, social and political stability and development of societies, and especially on developing countries”.¹⁵ In addition, the second International Expert Meeting on the Return of Stolen Assets was held in Addis Ababa in May 2019. More recently, IFFs featured prominently in the President’s summary of the High-level Dialogue on Financing for Development held by the General Assembly on 26 September 2019.¹⁶

12. The IFFs discourse in the intergovernmental African context is shaped by the High-level Panel on Illicit Financial Flows from Africa, commissioned by the African Union and the Conference of African Ministers of Finance, Planning and Economic

¹¹ Musselli I and Bürgi Bonanomi E, 2020.

¹² Picciotto S, 2018.

¹³ UNCTAD, 2014, *Trade and Development Report, 2014: Global Governance and Policy Space for Development* (United Nations publication, Sales No. E.14.II.D.4, New York and Geneva), p. 174.

¹⁴ UNCTAD, 2015a, *World Investment Report 2015: Reforming International Investment Governance* (United Nations publication, Sales No. E.15.II.D.5, New York and Geneva), p. 176.

¹⁵ United Nations, General Assembly, 2019, Promotion of international cooperation to combat illicit financial flows and strengthen good practices on assets return to foster sustainable development, A/RES/73/222, New York, 10 January, p. 2.

¹⁶ United Nations, General Assembly, 2019, Summary by the President of the General Assembly of the High-level Dialogue on Financing for Development (New York, 26 September), A/74/559, New York, 21 November.

Development of the Economic Commission for Africa of the United Nations. Marking a departure from the ambivalent treatment of IFFs by most multilateral institutions, the ensuing 2015 report, also known as the Mbeki report, states that “the various means by which IFFs take place in Africa include abusive transfer pricing, trade mispricing, misinvoicing of services and intangibles and using unequal contracts, all for purposes of tax evasion, aggressive tax avoidance and illegal export of foreign exchange”.¹⁷ Some of these concerns are shared by the Organization for Economic Cooperation and Development (OECD), as reiterated in a 2016 joint statement issued by the Secretary-General of OECD and the Chair of the High-level Panel: “The issue of illicit financial flows is at the forefront of the international agenda”.¹⁸ The joint statement calls on the international community to come together as “money-laundering, tax evasion and international bribery which form the bulk of illicit financial flows, affect all countries”. The statement does not mention tax avoidance, aggressive or otherwise.

13. With regard to the treatment of IFFs at Bretton Woods institutions, in a factsheet, “The [International Monetary Fund] IMF and the fight against illicit financial flows”, the International Monetary Fund lists combating tax-avoidance activities as part of its mandate to ensure the stability of the international monetary system. This role includes helping member countries guard against “base erosion and profit shifting”.¹⁹ The World Bank considers that cross-border movements of financial assets are illicit only when they are associated with activities that are deemed to be illegal in the local jurisdiction.²⁰ It specifies that “tax avoidance activities, such as legal tax planning and optimization, do not belong to illicit financial flows”²¹ while adding, in a footnote, that “the clarity of these distinctions is easier to maintain conceptually than in real life”. The World Bank further acknowledges that it is the nature of tax crimes that determines the degree of level of “opaqueness” in defining IFFs and states that the differences between legal tax avoidance and illegal tax evasion can only be ascertained further to a legal ruling. Despite conceptual difficulties, the institution acknowledges dealing with tax avoidance in multiple ways through its work on international tax policy and its country-level support for improved tax administration and preventive measures for tackling abusive transfer pricing.

III. Conceptual contours of illicit financial flows

14. The report builds on the increasing engagement on IFFs in multilateral circles, sensitivities associated with the use of the term and the new body of work on the legal and illegal divide on tax-related matters. The report considers the developmental impact of IFFs, reviews existing evidence on selected criminal activities associated with such flows, addresses trade-related commercial activities and considers corruption as a cross-cutting issue. It also investigates channels of IFFs through the global network of actors and analyses the roots of IFFs in the international legal and economic order.

15. As a starting point, the report takes note of the indications of the Mbeki report, including its treatment of IFFs originating in commercial activities. This definition has led to findings that show that 65 per cent of IFFs in Africa originate in commercial activities.²² The magnitude of this estimate illustrates the central role that definitions play in the measurement of such flows and ultimately in the design of appropriate regulations. In addition, the political legitimacy of the High-level Panel in the African context has established this definition as the basis for Africa-based intergovernmental meetings. However, a full account of the Mbeki report definition would imply a consideration of the

¹⁷ United Nations, Economic Commission for Africa, 2015, *Illicit Financial Flows: Report of the High-Level Panel on Illicit Financial Flows from Africa*, available at <https://repository.uneca.org/bitstream/handle/10855/22695/b11524868.pdf>, p. 24.

¹⁸ See www.oecd.org/g20/topics/international-taxation/joint-statement-on-the-fight-against-illicit-financial-flows-by-angel-gurria-and-thabo-mbeki.htm.

¹⁹ See <https://www.imf.org/en/About/Factsheets/Sheets/2018/10/07/imf-and-the-fight-against-illicit-financial-flows>.

²⁰ World Bank, 2016, *The World Bank Group’s response to illicit financial flows: A stocktaking*.

²¹ *Ibid.*, p. 2.

²² United Nations, Economic Commission for Africa, 2015.

capacity of domestic legal systems in Africa to address aggressive and developmentally harmful tax avoidance. In this regard, regulators' ability to play cat and mouse with businesses has resulted in what has become known as the "balloon effect", that is, filling a regulatory gap in one place merely leads to new loopholes elsewhere.²³ This feeds into a never-ending game that constantly requires alertness and regulatory adjustments, even in countries with well-developed legal systems.

16. The report posits that a definition of IFFs for analytical purposes should acknowledge the evolving nature of the concept in a changing global environment on international corporate taxation. These developments happen concurrently with progress in the conceptualization of tax avoidance in the legal literature, as shown in the latest research conducted by Musseli and Bürgi Bonanomi (2020) as part of a project entitled "Curbing illicit financial flows from resource-rich developing countries". These authors argue, for instance, that the evolving nature of regulatory reform of tax law, including the OECD-led base erosion and profit shifting agenda, further challenges the distinction between illegal and legal tax schemes. They contend that the general anti-abuse rules of base erosion and profit shifting contribute to making this distinction increasingly irrelevant, as they enable previously lawful practices based on the exploitation of loopholes to be turned into unlawful ones. The pragmatic inclusion of anti-tax-avoidance activities in the technical assistance programmes of major multilateral organizations somehow echoes Musseli and Bürgi Bonanomi's deconstruction of the illusion of a clear dichotomy between legal and illegal.

17. Finally, the report takes the view that the measurement and monitoring of IFFs, and the definition of appropriate policy and regulatory measures to curb them, depend on the consideration of both sets of commercial and criminal activities. In this regard, the dominant emphasis on tax-related IFFs should not divert attention away from criminal activities, illicit trade and corruption, as these compromise the international financial system for money-laundering purposes and negatively impact prospects for achieving all 17 Sustainable Development Goals.

IV. Policy recommendations

18. Analytical contributions are provided in this report on tackling IFFs at the multilateral, regional and domestic levels in Africa. In this chapter, recommendations are made for the multilateral community and for African Governments. The recommendations build on the landmark Mbeki report.²⁴

19. Critically, in the report, it is argued that IFFs are a shared responsibility between developed and developing countries, at the core of multilateralism. IFFs appear to be large (an estimated \$86.2 billion per year), but irrespective of their scale, they need to be tackled as a significant impediment to the economic development of Africa. High levels of IFFs, as shown by the prevalence of misinvoicing and capital flight, indicate that many African Governments do not benefit from a significant portion of their international trade transactions and experience significant losses in capital and foreign exchange. The main findings from the report are outlined below.

A. Strengthen African engagement in international taxation reform

20. African countries should aim for an intergovernmental African position on Organization for Economic Cooperation and Development/Group of 20 proposals to be reflected given the current momentum for international taxation reforms. The negotiations on the second wave of the OECD secretariat proposals on the base erosion and profit shifting initiative, labelled pillar one and pillar two, began in early 2019 and are planned to be held through multiple meetings until the end of 2020. In effect, though the consultation process is inclusive, as of March 2020, there were no official statements on an

²³ Musseli and Bürgi Bonanomi, 2020.

²⁴ United Nations, Economic Commission for Africa, 2015.

intergovernmental African position on the negotiation of the inclusive framework on base erosion and profit shifting, raising questions about the extent of engagement of the African members in the inclusive framework.

21. The proposal for a unified approach under pillar one primarily focuses on the reallocation of taxing rights to market jurisdictions. On scope, the document explicitly states that “the approach covers highly digital business models but goes wider – broadly focusing on consumer-facing businesses with further work to be carried out on scope and carve-outs. Extractive industries are assumed to be out of the scope”.²⁵ The proposal further reiterates that sectors “such as commodities and extractives” (labelled as such) would be carved out.²⁶ While acknowledging the need for an “administrable” simplification of the arm’s length principle, especially for emerging and developing countries, the proposal also stipulates that “it would retain the current rules based on the arm’s length principle in cases where they are widely regarded as working as intended, but would introduce formula-based solutions in situations where tensions have increased – notably because of the digitalization of the economy”.²⁷ The pillar two proposal, titled Global Anti-Base Erosion Proposal, focuses on tax challenges arising from the digitalization of the economy.²⁸

22. As they stand, these proposals do not sufficiently address the specific loopholes that limit the taxation rights of African countries. This point is also corroborated by the Independent Commission for the Reform of International Corporate Taxation for developing countries at large. The gaps in the OECD proposals underline the urgency of strong political leadership from Africa on international taxation reforms.

1. Increase space for other multilateral engagement and alternative views

23. Unless the underlying distribution of taxing rights is addressed, African countries will continue to be vulnerable to significant revenue losses. African interests must be defended in spaces where the concerns of countries are fully heard and where alternative and substantiated views on international corporate taxation can be elaborated. As shown in the report, the dichotomy that arises from the location of real economic activity and of permanent establishment status lies at the core of the perceived injustices. At the global level, it could be argued that only the United Nations, with its near universal membership and democratic structure, can provide a truly global tax body.²⁹ Reflecting these concerns, as of March 2020, OECD proposals did not fully address the priorities of African countries in a satisfactory manner. Other spaces where taxation issues are discussed include the Platform for Collaboration on Tax, a joint effort of the International Monetary Fund, World Bank, OECD and the United Nations, and in academic research undertaken by entities supporting the interests of developing countries.

24. Africa’s voice in these spaces is carried by the African Tax Administration Forum. From 25 members at the time of its creation in 2009 to 38 members in November 2019, the African Tax Administration Forum has increasingly gained legitimacy and capacity in defending African interests on taxation issues. Building on the expertise of representatives of the African Tax Administration Forum, political leadership at the highest level is needed to take Africa’s multilateral engagement on proposals for international reforms to the next level. African academic institutions should receive greater support in developing Africa-based taxation expertise and data-sharing initiatives, such as that initiated by the multi-disciplinary team of the Committee on Fiscal Studies. Ezenagu, for instance, puts

²⁵ OECD, 2019a, Public consultation document: Secretariat proposal for a “unified approach” under pillar one, available at <https://www.oecd.org/tax/beps/publicconsultation-document-secretariat-proposal-unified-approach-pillar-one.pdf>, p. 5.

²⁶ Ibid., p. 7

²⁷ Ibid., p. 6.

²⁸ OECD, 2019b, OECD and Group of 20 inclusive framework on BEPS [base erosion and profit shifting]: Progress report July 2017–June 2018, available at www.oecd.org/ctp/inclusive-framework-onbeps-progress-report-june-2017-july-2018.htm.

²⁹ Independent Commission for the Reform of International Corporate Taxation, 2018, A road map to improve rules for taxing multinationals, available at www.dbriefsap.com/bytes/Feb2018_3.IndependentCommissionforReformofInternationalCorporateTaxreport.pdf.

forward proposals for taxation reforms that would be more appropriate to the administrative capacity of African countries.³⁰

2. Review tax treaties and aim for more taxing rights

25. Countries should avoid signing tax treaties that impinge greatly on taxing rights. Tax treaties that include anti-abuse clauses make tax avoidance through treaty shopping harder. For example, withholding taxes is a strong frontline protection against profit-shifting for countries with limited administrative capacity.³¹ In this regard, countries should not accept having them lowered to a very large degree by tax treaties. Similarly, tax treaties often exempt some types of income earned in the source State from taxation in that State altogether (for example, tax dispute on capital gains). Countries should assess the costs of removing these taxing rights against the expected benefits in attraction of foreign direct investment. Current evidence does not support the argument on expected benefits in attraction of foreign direct investment. In this regard, it is recommended that African countries keep and expand their taxing rights.

26. Countries are best protected by a combination of specific anti-abuse rules, applying to individual treaty clauses, and a general anti-abuse rule, covering the whole treaty, along with an anti-avoidance rule in domestic law. Such clauses are becoming increasingly common and are now found in the main model treaties used for negotiations.

27. Considering the continent's revenue losses to tax havens and secrecy-based jurisdictions, African countries should be among those leading the charge to pressure tax havens to sign treaties with all countries. Progress on this is critical, taking account of the evidence that tax havens complied with the minimum number of tax treaties by signing many treaties among themselves.³² Zucman's findings further suggest that the signing of bilateral treaties providing for exchange of bank information led to a relocation of bank deposits between tax havens rather than to significant repatriations of funds, concluding that "the least compliant havens have attracted new clients, while the most compliant ones have lost some, leaving roughly unchanged the total amount of wealth managed offshore".

3. Make tax competition consistent with protocols of the African Continental Free Trade Area

28. In addition to such engagement, African countries need to incorporate international taxation matters in relevant regional and continental initiatives. Without a harmonized taxation system at the continental level, African countries should aim at defining ways to curtail tax competition. Related efforts should include context-based analytical assessments of the welfare effects of falling headline tax rates and the proliferation of tax incentives across the continent and leverage the African Continental Free Trade Area as a platform to avoid a race to the bottom. UNCTAD continues provision of technical assistance, in the context of ongoing and forthcoming negotiations on phase 2 of the African Continental Free Trade Area on investment, competition and intellectual property rights.

29. More critically, African countries should build on the formidable negotiations forum that the continent has established in the context of the African Continental Free Trade Area. For now, the governance mechanisms of negotiations include senior officials of trade ministries and ministers of trade. There should be mechanisms to bridge the gap between these trade-focused groups, ministers of finance and the High-Level Panel on Illicit Financial Flows, while considering negotiations on phase 2. These include the protocols on investment, competition and intellectual property rights. There are also proposals either to

³⁰ Ezenagu A, 2019, Safe harbour regimes in transfer pricing: An African perspective. ICTD Working Paper No. 100. Available at <https://www.ictd.ac/publication/safeharbour-regimes-in-transfer-pricing-an-african-perspective/>.

³¹ See Hearson M, forthcoming, International tax avoidance in Africa, Background paper for *Economic Development in Africa Report 2020*, UNCTAD.

³² Zucman G, 2014, Taxing across borders: Tracking personal wealth and corporate profits, *Journal of Economic Perspectives*, 28(4):121–148.

give the African Tax Administration Forum an intergovernmental dimension or, as argued by other authors, for the creation of an African tax body.³³

B. Intensify the fight against corruption and money-laundering

1. Support and scale up African anti-money-laundering initiatives

30. In addition to being party to global level initiatives and subject to third-party legislation on corruption and money-laundering, African countries should collectively intensify initiatives to fight these problems on the continent. In this regard, good practices, such as those of the Intergovernmental Action Group against Money-Laundering in West Africa, should be supported and further developed. Initially created by the Economic Community of West African States in 2000 to combat the financing of terrorist groups, over the years, the Intergovernmental Action Group has provided assessment and capacity-building on anti-money-laundering and counter-financing of terrorism of countries located in the region. The initiative has improved countries' capacity to identify suspicious transactions related to anti-money-laundering. However, performance varies greatly across countries, with some countries showing worse results than in previous years. In addition, assessment reports show that successful records of financial intelligence units of tracking suspicious transactions are poorly matched by adequate action of investigative authorities.³⁴ This highlights the need for all African countries to strengthen their capacity to track suspicious transactions and ensure that the latter are properly investigated.

31. In the same vein, existing peer review mechanisms of the African Union on governance should be given a clear mandate to devise binding legislative tools to address matters related to corruption and money-laundering. In addition to cross border movements of funding, the increase in the prevalence of real-estate transactions in money-laundering methods in West Africa,³⁵ for instance, warrants greater capacity in identifying and regulating specific characteristics of anti-money-laundering at the continental level.

2. Invest in data infrastructure and transparency (including gendered data)

32. Good data play a critical role in allowing an effective fight against IFFs. The vast literature on profit-shifting by multinational enterprises of the United States, for example, is due to United States data being particularly good.³⁶ As custodian agencies of Sustainable Development Goal indicator 16.4.1 (total value of inward and outward IFFs, in current United States dollars), UNODC and UNCTAD are leading the work to develop a statistical methodology and a measurement standard to estimate IFFs. This will be critical to developing a set of methodological guidelines that can be used at the national and international levels to estimate the total value specified by the indicator. In the context of analysing the impact of IFFs on African communities and the Sustainable Development Goals, more and better data on gender in financial services, trade, employment and taxation are required to generate new insights to inform policy interventions on the economic, social and environmental pillars of sustainable development.

3. Collect better and greater trade data

33. Alleviation of trade misinvoicing in African countries will require better trade data, including where appropriate at the gender-disaggregated level, for risk-exposure analysis and enhanced regional cooperation on common reporting standards for firm-level tax and commercial information. Critically, there needs to be a greater exchange of information on trade data with trade partners to identify anomalies and discrepancies that warrant further investigation. The report's analysis on the detection of systemic customs fraud linked to the

³³ Ezenagu, 2019.

³⁴ Intergovernmental Action Group against Money-Laundering in West Africa, 2014, *2014 Annual Report*, Dakar; *ibid.*, 2018, Summary of countries' activity reports: October 2017–September 2018, prepared for the thirtieth plenary meeting of the Technical Commission, 12–16 November 2018.

³⁵ Intergovernmental Action Group against Money-Laundering in West Africa, 2018.

³⁶ Zucman G, 2019, Taxing multinational corporations in the twenty-first century, Research Brief 10, Economists for Inclusive Prosperity.

export of primary extractive resources shows that, while the analysis of macro trade data can be a useful indicator, it has its limitations. Such limitations can be addressed with better access to and use of microtransaction-level trade data. This could be done through several platforms, including the UNCTAD Mineral Output Statistical Evaluation System. This platform has already shown its beneficial results at the domestic level. In the case of Zambia, for example, the System allows for mineral value chain monitoring of the country's mineral exports. It includes a mineral production reporting and export permit tool, which allows companies to submit their mandatory monthly production export and request export permits online. This replaces the manual process which required companies to travel to Lusaka. Since its implementation in 2017, the Mineral Output Statistical Evaluation System has delivered significant benefits for the Government of Zambia.

34. Governments with access to microtransaction-level trade data can also implement a price-filter analysis. The price-filter analysis relies on a single country's transaction-level data by product and compares the value/price on a customs invoice to past prices or the free market price, to distinguish between normal and abnormal pricing.³⁷ Though both the partner-country trade gap and price filter methods have their flaws, they can be useful and intuitive tools for customs fraud detection. Global Financial Integrity has also developed its "GFTrade" tool based on the interquartile range price filter method, which provides direct feedback to customs officials. Prototype software based on blockchain technology is also being developed to provide transparency of global trade logistics and global value chains³⁸ from which Africa may usefully benefit in tackling trade misinvoicing. African countries should also look to leverage the provisions of article 12 of the Agreement on Trade Facilitation of the World Trade Organization to improve the exchange of trade data to better monitor IFFs.

4. Accelerate progress on tax reporting

35. African Governments should explore innovative means of utilizing voluntary tax reporting, for revenue mobilization purposes, and strengthen related initiatives. In this regard, increased goodwill of multinational enterprises to voluntarily publish their tax data for global reporting initiatives should be matched by similar enthusiasm for public country-by-country reporting.³⁹

5. Design a specific policy and regulatory framework on illicit financial flows

36. The prevalence of IFFs in Africa and the diversity in their origins, mechanisms and impact are such that countries should have their own national policy framework for combating these flows. Such a framework should include a full assessment of existing policies and legislation across countries.

37. In addition, countries should strengthen the set of standard legislations and regulatory measures of relevance to IFFs. These should also include strengthening of local judiciary systems, increase capacity for dispute resolution and consider adoption of UNCTAD reforms on international investment agreements.⁴⁰

6. Domesticate the African Mining Vision

38. The African Mining Vision was adopted by the African Union in 2009 to promote equitable, broad-based development through prudent exploitation and utilization of the

³⁷ Carbonnier G and Mehrotra R, 2019, Abnormal pricing in international commodity trade: Empirical evidence from Switzerland, Discussion Paper No. R4D-IFF-WP01-2019, The Graduate Institute of International and Development Studies.

³⁸ McDaniel CA and Norberg HC, 2019, Can blockchain technology facilitate international trade?, Mercatus Research Paper, available at <https://ssrn.com/abstract=3377708>.

³⁹ Tax Justice Network, 2020, Financial Secrecy Index 2020 reports progress on global transparency – but backsliding from US[United States], Cayman [Islands] and UK[United Kingdom] prompts call for sanctions. Available at <https://www.taxjustice.net/2020/02/18/financial-secrecy-index-2020-reports-progress-onglobal-transparency-but-backsliding-from-us-cayman-and-uk-prompts-call-forsanctions/>.

⁴⁰ UNCTAD, 2018, UNCTAD's reform package for the international investment regime, Geneva and New York.

continent's mineral wealth. The African Mining Vision aims at setting the path to broad-based sustainable growth and socioeconomic development, including through the adoption of global norms for the equitable governance of the natural resources sector. Its objectives are far-reaching and actions of intervention are spread across six major areas, namely: improving the quality of geological data, as a bargaining tool for fairer deals and more equitable returns on mining investments; contract negotiation capacity; resource governance; management of mineral wealth; tackling infrastructure constraints; and recognizing the developmental role of artisanal and small-scale mining.

39. Considering the comprehensive coverage of the African Mining Vision, countries should use existing guidelines to enact policies and regulations aimed at its implementation.⁴¹ The expectations of mineral-rich countries in Africa on development benefits from the extractive sector are justified by its status as a key generator of export revenues and foreign exchange in mineral-exporting economies. To fulfil these expectations and considering the magnitude of the extractive sector as a source of IFFs, African countries should build on lessons learned from past engagement on international commodity governance.

7. Establish cross-institutional collaboration

40. The multi-dimensional nature of IFFs requires coordinated multi-institutional actions at the domestic level. In this regard, a combination of interministerial actions and strengthening of lead institutions in the fight against tax avoidance, money-laundering and other crimes is needed.

41. Efforts to invest in strengthening the capacity of the range of domestic institutions involved in monitoring, identifying and regulating IFFs should be supported. National financial intelligence units are public agencies that play a central role as receivers of notifications about large and/or suspicious transactions. They analyse and forward them to law enforcement bodies, where appropriate. Tax authorities should have the capacity to scrutinize company contracts and accounts and tax declarations, identify accurate product prices and combat abusive practices. Customs authorities are responsible for monitoring and evaluating the veracity of export and import prices and quantities, while judicial authorities are responsible for law enforcement. Designing policies and laws to combat IFFs is the responsibility of policymakers. This underscores the importance of supporting institutional capacity-building across all levels of national authorities in Africa.

42. More specifically, in many African countries, tax authorities are in urgent need of additional resources and capacity-building activities and training. They are understaffed and lack the required expertise. For example, in a survey of Nigeria, 62 per cent of firms expressed concern with the lack of knowledge of tax authorities during audits.⁴² To build its domestic capacity in revenue collection, an issue for many African countries, the Government of the United Republic of Tanzania, for example, invested resources in auditing capacity after a decade of private investment in the mining sector and persistently low revenue collection. It created the Tanzania Mineral Audit Agency as an autonomous agency under its Ministry of Energy and Minerals in 2009. The Agency is responsible for monitoring the quality and quantity of minerals that mining companies produce and export, and for conducting financial audits. Owing to sufficient funding and staffing, including tax experts, environmental scientists, information technology analysts, engineers and gemmologists, the Tanzania Mineral Audit Agency has been successful in financial auditing and addressing transfer pricing. Thanks to the effective cooperation between the Tanzania Revenue Authority and the Tanzania Mineral Audit Agency, tax authorities

⁴¹ United Nations, Economic Commission for Africa, 2014, *A Country Mining Vision Guidebook: Domesticating the Africa Mining Vision*, available at https://www.uneca.org/sites/default/files/PublicationFiles/country_mining_vision_guidebook.pdf.

⁴² Andersen Tax, 2019, *Review of transfer pricing development in Africa: A study of key sub-Saharan African countries*, available at https://andersentax.ng/docs/review_of_transfer_pricing_development_in_africa_10042019.pdf.

collected an additional \$65 million in corporate income tax between 2009 and 2015, accounting for about 7 per cent of mining tax receipts in that period.⁴³

C. Devote more resources to the recovery of stolen assets

43. The slow pace of progress on the recovery of stolen assets emphasizes the need for greater capacity at the domestic and international levels to quicken the pace for recovery in the context of the decade of action. In this regard, the international community should provide greater support to initiatives, such as the Stolen Asset Recovery Initiative of the World Bank–UNODC, in efforts to offer practical advice on the strategy and management of asset recovery efforts. The multilateral nature of the organizations leading the project makes it an appropriate platform for dialogue and collaboration on specific cases as they often involve different jurisdictions, spanning developed and developing countries.

D. Protect and support civil society organizations, whistle-blowers and investigative journalists

44. Civil society organizations, whistle-blowers and investigative journalists have played a critical role in revealing the magnitude of IFFs and the mechanisms that support them in Africa and beyond. As part of this chain of actors, transparency initiatives must be encouraged and supported, including in their use of new technologies.

45. At the global level, organizations such as Open Ownership and the Financial Transparency Coalition work on ending secrecy legislation that is holding back full beneficial ownership transparency. In addition to the central leading role played by the African Tax Administration Forum on taxation issues, other organizations such as the Tax Justice Network–Africa also provide capacity-building initiatives.

46. Whistle-blowing comes with enormous risks, but as it can serve the public interest, it should be protected by law. For instance, in October 2019, the Council of Ministers of the European Union adopted new rules to ensure that member countries change domestic laws to protect insiders who report on misconduct. The impact of the Panama papers on the design of legislation illustrates the powerful reach of whistle-blowing. Following the press revelations, many countries, including Australia and France, for example, established parliamentary commissions to consider actions to tackle tax evasion. Some of these measures were the catalysts for legislative change on multinational anti-avoidance laws.

E. Build bridges between multinational enterprises, taxation and the 2030 Agenda for Sustainable Development

1. Curbing illicit financial flows for structural transformation

47. African countries should communicate to all actors, including multinational enterprises, the primacy of the role that curbing IFFs would play in the financing of sustainable development on the continent. In addition, Governments and multinational enterprises should focus on constructive engagement with a view to eliminating tax evasion and curbing tax avoidance. Doing so is likely to help addressing the effects of IFFs on economic, political and social stability in Africa and beyond.

2. Include taxation... in environmental, social and governance reporting

48. The report's review of the international corporate taxation regime and of the associated theoretical economic literature on multinational enterprises and transfer pricing provides justification that they provide for developmentally harmful tax practices among multinational enterprises. Furthermore, international guiding principles for better practices are soft laws and not legally binding, while domestic regulatory systems are insufficiently

⁴³ Redhead A, 2017, Improving mining revenue collection: [United Republic of] Tanzania's Mineral Audit Agency, Natural Resource Charter Case Study, Natural Resource Governance Institute.

developed. As a result, African countries have become dependent on mining contracts and case-specific community development agreements. Considering increasing interest in sustainability issues among private sector stakeholders, African countries should build on the rise in environmental, social and governance reporting to identify links between these reporting mechanisms and the objectives of curbing IFFs for sustainable development. Progress in the Sustainable Stock Exchanges Initiative shows that there is an increasing number of stock exchanges mandating environmental, social and governance disclosure for listed companies, which provides good grounds for pioneering greater consideration of taxation components. In this regard, efforts to strengthen the capacities of Governments to measure and monitor private-sector contribution to the 2030 Agenda for Sustainable Development should be encouraged. Examples of such efforts include an UNCTAD project on enabling policy frameworks for enterprise sustainability and Sustainable Development Goal reporting in Africa and Latin America. Other examples include transparency pacts between Governments and the private sector, such as Publish What You Pay. Pioneering of the inclusion of taxation in environmental, social and governance reporting should be done with recognition of the mixed performance of private-sector engagement in sustainability initiatives.

F. Invest in research to account for links between illicit financial flows, environmental sustainability and climate change

49. The report's review of sources of IFFs highlights the magnitude of environmentally harmful activities, such as illegal logging, illegal fishing, illegal mining and illegal waste trafficking. Similarly, as shown in the report's empirical analysis, negative externalities from the extractive industry not only have ripple effects on other sectors, such as agriculture, but also affect critical water resources at the community level. However, challenges related to the dominant features of established economic models of structural transformation and data constraints make it difficult to establish causality links in econometric models on IFFs and sustainable development.

50. In light of these findings, there should be greater research on integrating the value of environmental damage caused by dominant sources of illicit flows into ongoing initiatives on the measurement of IFFs. Such efforts could allow African Governments to strengthen the case for bridging negotiation agendas on curbing IFFs and making claims on climate finance.

G. Rekindle trust in multilateralism through tangible actions in the fight against illicit financial flows

1. Support multilateralism at the Economic and Social Council and United Nations General Assembly to curb illicit financial flows

51. Multilateralism implies use of international cooperation to attempt to find solutions to transnational problems. Globalization has brought a new set of challenges to multilateralism, as globalization is associated with the spread of problems of a transnational dimension and involving many non-State actors.⁴⁴ IFFs are part of such transnational problems and, hence, could be resolved through multilateral means. Such efforts could benefit from lessons learned from multilateral engagement on the international commodity agenda.

52. Beyond the multiple United Nations resolutions on IFFs, recent initiatives, such as a joint initiative to establish a high-level panel on financial accountability, transparency and integrity under the President of the General Assembly and the President of the Economic and Social Council, provide hope of moving towards more concrete action on addressing IFFs through inclusive multilateral action. The joint initiative is set in the context of the decade of action to help promote faster progress towards achieving the 2030 Agenda on

⁴⁴ Newman E, Thakur R and Tirman J, eds., 2006, *Multilateralism Under Challenge: Power, International Order and Structural Change*, United Nations University Press, Tokyo.

Sustainable Development. A panel is expected to produce a report with recommendations in January 2021.

2. **Walk the talk: Put more resources in international cooperation on illicit financial flows**

53. More resources are needed to amplify the work of various agencies and donors to enhance the capacity of local revenue authorities in Africa. Several donors committed to double their aid for tax capacity-building between 2015 and 2020 through the Addis Tax Initiative. This initiative aims at increasing the volume and quality of technical assistance to enhance domestic resource mobilization in partner countries. Furthermore, OECD along with three countries (Germany, Italy and Kenya) launched the pilot programme, Africa Academy for Tax and Financial Crime Investigation, at the Group of 20 Africa Conference held in Berlin in June 2017. This programme will cover all aspects of conducting and managing financial investigations, including complex money-laundering and the role of tax investigators, investigative techniques, identifying, freezing and recovering assets, managing international investigations and specialty topics, such as value added tax/goods and services tax fraud.

3. **Enhance cooperation on tackling illicit financial flows in relation to achieving health-related Sustainable Development Goals and building resilience to shocks**

54. The current coronavirus disease outbreak is first and foremost a health crisis. Second, it is an impediment to progress towards achieving health-related Sustainable Development Goals. Third, it is fast becoming the starting point of a global economic and financial crisis with severe economic and social consequences for the world's poorest countries. Tackling the crisis will not be easy in a context of inadequate funds for health services globally, including in Africa. The Ebola crisis triggered debates on the creation of an international health emergency fund.⁴⁵ The Ebola crisis also underlined the critical role that global governance for health could play, through partnership and financial and technical assistance and the reduction of health inequalities.⁴⁶ These issues remain relevant today and missed opportunities in fiscal revenue due to tax avoidance and tax evasion should be addressed.⁴⁷ Although the current epidemic appears to affect fewer women than men, it is likely that women will be affected by the socioeconomic impact of the crisis as core care providers for their families. Achievement of the Sustainable Development Goals in the context of the emerging implications of the current coronavirus disease crisis will likely be more challenging and depend critically on the capacity of African countries to tackle IFFs, which hinder the mobilization of sufficient resources to finance development.

4. **Identify win-win solutions**

55. In addition to engagement through existing mechanisms of information exchange, despite difficulties in avoiding tax competition, developing countries can jointly decide to identify common areas of interest. These could include, for example, an agreement not to give tax incentives on profits, but rather provide incentives on actual business activities based on a set of indicators pertaining to the real economy. Similarly, greater resources could be pooled in undertaking capacity-building initiatives with dual objectives: (a) exchanges of experiences and capacity and (b) coalition building in areas of common interest.

56. In this regard, African countries could engage in exchanges on negotiation tactics on the combination of multiple agendas with other countries from the global South. However, given differing economic interests, achieving consensus on tackling IFFs among countries will be difficult, but should be fully considered.

⁴⁵ Ooms G and Hammond R, 2014, Financing global health through a global fund for health?, Working Group on Financing, Paper 4, Chatham House.

⁴⁶ Waris A and Latif LA, 2015, Towards establishing fiscal legitimacy through settled fiscal principles in global health financing, *Health Care Analysis: Journal of Health Philosophy and Policy*, 23(4):376–390.

⁴⁷ Ibid.

H. Engage on illicit financial flows and ethics

57. In many ways, addressing IFFs is a matter of ethics. These ethical concerns are recognized by all stakeholders, including multinational enterprises, involved in the fight against IFFs. In the African context, the emphasis on ethics is apparent in the African Peer Review Mechanism. The Mechanism's methodology includes a corporate governance thematic area and an objective on ensuring ethical conduct within organizations, which seeks to address corruption and illicit flow of funds.⁴⁸

V. Conclusions

58. The role of multilateralism in reducing the harm from IFFs and encouraging greater participation by African countries in global governance on the matter is clear. The expectation is that the recommendations drawn from the analysis presented in this report will strengthen the policy approaches taken to tackle the incidence and impact of IFFs. A stronger and more resilient Africa, as a result, would be better situated to tackle the current coronavirus disease pandemic, as well as future challenges.

⁴⁸ African Union Commission, 2019, *Domestic Resource Mobilization: Fighting Against Corruption and Illicit Financial Flows*, Addis Ababa.