

CHAPTER 4.

Stemming illicit financial flows for Africa's sustainable development

4.1. INTRODUCTION

Illicit financial flows[94] out of Africa remain a serious impediment to Africa's sustainable development. This poses a significant challenge to domestic resource mobilization because such flows deprive African countries of vital financial resources for financing investment in Sustainable Development Goals. Since illicit financial flows move from Africa to developed countries, they perpetuate existing global inequalities. Therefore, tackling illicit financial flows is key to ensuring fairer and more equitable globalization. If the problem of illicit financial flows is not addressed as a matter of urgent priority, African countries will fall further behind in social and human development, with a large number of people languishing in grinding poverty.

This has become even more urgent considering the devastating impact of the COVID-19 pandemic on Africa. As fiscal space is threatened by declining tax revenue, African countries will need to harness all the available resources to fill the widening financing gap. A major challenge to addressing illicit financial flows identified by the 2015 High-level Panel on Illicit Financial Flows from Africa (the Mbeki Panel) is the lack of a global framework.[95] Although there are several initiatives and instruments to address various aspects of illicit financial flows developed under the United Nations, the African Union, the Group of 20, OECD and IMF, they are disparate and do not amount to a coherent and overarching institutional system. Therefore, the adoption of a comprehensive global framework will be indispensable to addressing illicit financial flows out of Africa.

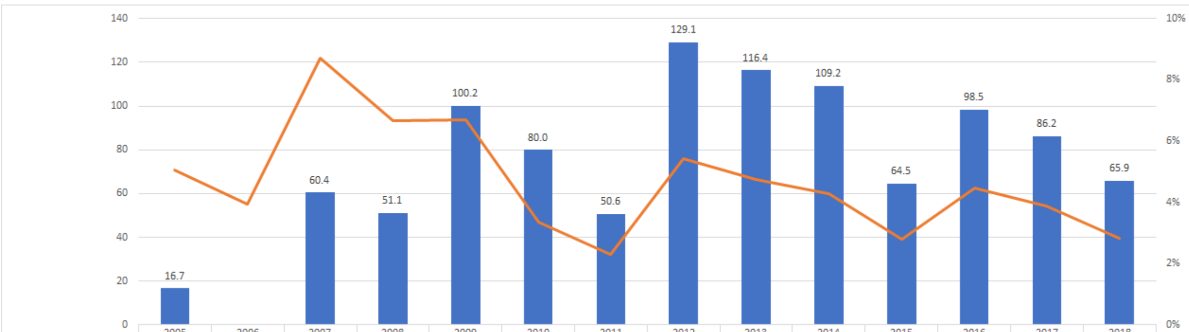
94 UNCTAD defines illicit financial flows as cross-border exchanges of value, monetary or otherwise, which are illegally earned, transferred or used. This is broadly in line with the definition adopted by the African Union's High-level Panel on Illicit Financial Flows from Africa.

95 African Union Commission and ECA, "Illicit financial flows: report of the High-level Panel on Illicit Financial Flows from Africa" (Addis Ababa, 2015). Available at https://repository.uneca.org/ds2/stream/?#/documents/0ca955c2-2e56-5120-a605-9e8a7566c7d3/page/3

4.2. TRENDS IN ILLICIT FINANCIAL FLOWS

Illicit financial flows out of Africa are large and growing. Capital flight from the continent, which serves as a good proxy for illicit financial flows, grew substantially over the period 2008–2018, peaking in 2012 at $129.1 billion (figure 17). This is comparable to the figure reported by UNCTAD in its report entitled *Economic Development Report 2020: Tackling Illicit Financial Flows for Sustainable Development in Africa*. Africa has lost a combined $2.0 trillion through illicit financial flows during the period 1970–2018.[96]

FIGURE 17: AGGREGATE CAPITAL FLIGHT FROM AFRICA (2008-2018)



	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Capital flight (in billion)	16.72886865	-19.26186722	60.44039121	51.08802673	100.1555803	79.99594961	50.64030765	129.1069509	116.3646854	109.2068542	64.51848297	98.47010125	86.22856449	65.93453488
Capital flight (% of GDP)	0.050581481	0.039383606	0.086920338	0.06669415	0.067091916	0.033467346	0.02291454	0.054398202	0.047373894	0.042896012	0.027802489	0.04479752	0.038775201	0.028261174

Source: Capital flight – Political Economy Research Institute, University of Massachusetts Amherst.
GDP – African Development Bank, African Statistical Yearbook.

As discussed in chapter 1 of the present report, illicit financial flows from Africa far outstrip the annual inflows of ODA ($48 billion) and FDI ($54 billion).

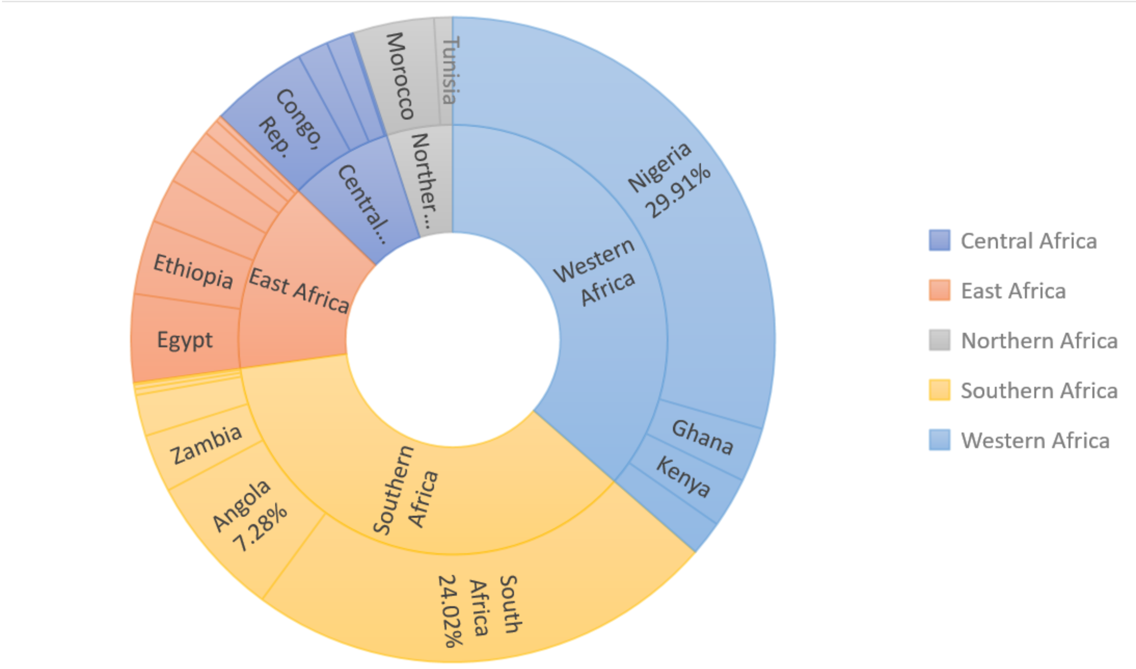
Illicit financial flows tend to be large for resource-rich African countries. The six largest illicit financial flow-remitting countries during the period 1970–2018 were Nigeria, South Africa, Mozambique, Algeria, Angola, Egypt and the Democratic Republic of the Congo. For example, during that period, Nigeria lost a total of $466 billion in illicit financial flows, followed by South Africa and Mozambique, with $330 billion and $135 billion in illicit financial flows, respectively.

There is considerable subregional variation in illicit financial flows (figure 18). West Africa and Southern Africa account for the largest shares of such flows, at 29.6 % and 28.5 %, respectively, followed by North Africa (19.8 %) and Eastern Africa (12.7 %). Central Africa has the lowest share at 9.4 %. The revenue loss associated with capital flight alone ranges from about 2 % of GDP in Southern Africa to 2.3 % in West Africa.[97]

96 This is based on the Capital Flight Database of the Political Economy and Research Institute of the University of Massachusetts Amherst, which calculates capital flight as trade misinvoicing plus balance of payments residual. See Léonce Ndikumana and James K. Boyce, "Capital flight from Africa 1970–2018: new estimates with updated trade misinvoicing methodology", PERI Research Report (May 2021).

97 Economic Development Report 2020: Tackling Illicit Financial Flows for Sustainable Development in Africa (Sales No. E.20.II.D.21). Data are median by subregion.

FIGURE 18: AGGREGATE CAPITAL FLIGHT (IN BILLION) FROM AFRICA, 2005-2018



Source: UNCTAD

4.3. TAXATION AND COMMERCIAL-RELATED ACTIVITIES

The Mbeki Panel identified commercial practices related to trade and tax abuse as the largest driver of illicit financial flows from Africa, accounting for 65 % (followed by criminal activities (30 %) and corruption (5 %)).[98] Given its sheer size, targeting this source of illicit financial flowswill be critical to strengthening domestic resource mobilization in Africa.[99] Furthermore, commercial activities contribute the most to employment, the production of critical goods and services and the payment of taxes. Therefore, addressing this is crucial to stemming the haemorrhaging effect of illicit financial flows on Africa. However, determining the illegal/illicit nature of commercial activities is a challenge.

In the context of Africa, the Mbeki Panel provided guidance on which tax and commercial practices/activities may be categorized as forms of illicit financial flows. They 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".[100]

In 2014, the taxation of multinational enterprises amounted to 88 % of the tax base of Nigeria. Rwanda similarly reported that up to 70 % of its tax revenue was realized from the taxation

98 African Union Commission and ECA, "Illicit financial flows: report of the High-level Panel on Illicit Financial Flows from Africa".
99 Office of the Special Adviser on Africa, Tackling Illicit Financial Flows Arising from Taxation and Illegal Commercial Practices in Africa (forthcoming).
100 African Union Commission and ECA, "Illicit financial flows: report of the High-level Panel on Illicit Financial Flows from Africa".

of multinational enterprises. In Burundi, one multinational enterprise alone is responsible for close to 20 % of the country's tax revenue. All this shows the significance of corporate taxes for African countries.

4.4. CAUSES AND DRIVERS OF ILLICIT FINANCIAL FLOWS OUT OF AFRICA

Illicit financial flows are generally influenced by a wide range of factors. In terms of the drivers of such flows, the literature shows that, in the context of Africa, illicit financial flows are influenced by structural factors as well as domestic policies. Capital account convertibility, debt, exchange rate regimes, interest rate differentials, corruption and political instability are key factors in driving illicit financial flows out of Africa. The report of the Mbeki Panel identifies corruption as a cross-cutting factor that drives illicit financial flows at every stage. While corruption is a worldwide problem, weak institutions and governance deficits make Africa vulnerable to corruption and abuse of power, which can fuel illicit financial flows.

The dependence of African countries on natural resource extraction, particularly fossil fuels, makes them particularly susceptible to illicit financial flows, and has also historically locked many African countries into patterns of primary product export specialization, leading to the so called "paradox of plenty", in which countries rich in resources do not actually benefit from their own natural wealth. Illicit financial flows are also enabled by several actors both in Africa and out, including financial institutions and professional service providers, such as accounting, auditing and legal service providers. In addition, illicit financial flows are facilitated by a global shadow financial system that includes tax havens, secrecy jurisdictions, disguised corporations, anonymous trust accounts and fake foundations, and uses trade mispricing and money-laundering techniques.

A study by the Brookings Institution grouped the drivers of illicit financial flows into categories: macroeconomic drivers and governance drivers.[101] Based on the correlation analysis conducted for the study, the findings revealed a positive and significant relationship between illicit financial flows and real GDP (aggregate) and inflation. These findings suggest that macroeconomic instability encourages people to send their capital abroad. The study also showed a positive and significant correlation between illicit financial flows and tax revenue as a share of GDP. Additional correlation analysis (figure 19) makes it clear that higher levels of corruption and conflict both contribute to capital flight. As is evident in the subsequent chapter of the present report, residents of countries where corruption is very high are unwilling to pay taxes because of the perception that such collected resources would be misused.

4.5. IMPACT OF ILLICIT FINANCIAL FLOWS ON AFRICA'S DEVELOPMENT

Illicit financial flows constitute a serious constraint to Africa's growth and sustainable development, as they deprive the region of vital resources for its development. Illicit financial flows also have a negative impact on domestic resource mobilization. This is manifested through reduced government funding for capital or development expenditure programmes such as education and health.[102] Indirectly, illicit financial flows affect development negatively through curtailing investment and saving.

101 Landry Signé, Mariama Sow and Payce Madden, "Illicit financial flows in Africa: drivers, destinations, and policy options", Policy Brief (Washington D.C., Brookings Institution, March 2020).

102 J. D. Nkurunziza, "Illicit financial flows: a constraint on poverty reduction in Africa", Association of Concerned Africa Scholars, Bulletin No. 87 (Fall 2012).