Economic Governance Report I

INSTITUTIONAL ARCHITECTURE TO ADDRESS ILLICIT FINANCIAL FLOWS

United Nations
Economic Commission for Africa

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Abbreviations

AAAA	Addis Ababa Action Agenda for financing sustainable development
ABC	Automatic exchange of tax information, Beneficial Owners registers, and Country by Country reporting
ABoC	Advisory Board on Corruption
ACC	Anti-Corruption Commission
ACI	Advanced Cargo Information
AEC	African Economic Community
AEOI	Automatic Exchange of Information
AEO	Authorized Economic Operator
AfCFTA	African Continental Free Trade Area
AGR	African Governance Report
AML	Anti-Money Laundering
AMU	Arab Maghreb Union
APRM	African Peer Review Mechanism
ARIN-EA	Asset Recovery Network -East Africa
ARIN-WA	Asset Recovery Network -West Africa
ARIN -SA	Asset Recovery Network -Southern Africa
ATA	ATA Carnet for the Temporary Admission of Goods [ATA Convention])
ATAF	African Tax Administration Forum
ATM	Automatic Teller Machines
AU	African Union
AUABC	African Union Advisory Board on Corruption
AUC	African Union Commission
ASYCUDA	Automated Systems for Customs Data
BCEAO	Banque Centrale des Etats de l'Afrique de l'Ouest
BEPS	Base Erosion and Profit Shifting
BPI	Bribe Payers Index
CbCR	Country-by-Country Reporting
CDD	Customer Due Diligence
CEMAC	Economic Community of Central African States
CENSAD	Community of Sahel-Saharan States
CENTIF	National Financial Information Processing Unit
CHRAJ	Commission on Human Rights and Administrative Justice
CoSP	Conference of State Parties
CPI	Corruption Perception Index
CPM	Country Partner Method
CTAF	Tunisian Financial Analysis Committee
CTF	Counter-Terrorism Financing
CTHI	Corporate Tax Haven Index
CIT	Corporate Income tax

COMEC	Economic and Commercial Cooperation of the Organization of Islamic Cooperation
COMESA	Common Market for Eastern and Southern Africa
CRS	Common Reporting Standards
DNFBP	Designated non-Financial Businesses and Professions
DRM	Domestic Resource Mobilization
DTAA	Double Taxation Avoidance Agreement
EAC	East African Community
ECCAS	Economic Community of Central African States
ECA	Economic Commission for Africa
ECOWAS	Economic Community of West African States
EGR	Economic Governance Report
EITI	Extractive Industries Transparency Initiative
EOCO	Economic and Organized Crime Office
EOI	Exchange of Information
EOIR	Exchange of Information Request
ESAAMLG	Eastern and Southern Africa Anti-Money Laundering Group
EU	European Union
EUROTRACE	Software for collection, compilation and dissemination of external trade data at national and regional level.
FATF	Financial Action Task Force
FDI	Foreign Direct Investment
FICs	Financial Intelligence Centers
FinCEN	Financial Crimes Enforcement Network
Fintech	Financial Technology
FIUs	Financial Intelligence Units
FSI	Financial Secrecy Index
FTAs	Free Trade Agreements
G20	Group of 20 Developed Countries
GABAC	Economic and Monetary Community of Central Africa
GCNet	part of the electronic Ghana TradeNet (GTN)
GDP	Gross Domestic Product
GFI	Global Financial Integrity
GFTrade	GFO's online tool to build customs capacity to detect mis-invoicing
GIABA	Inter-Governmental Action Group against Money Laundering in West Africa
GNC	Globally Networked Customs
GRA	Ghana Revenue Authority
GTN	Ghana TradeNet
HABG	High Authority for Good Governance
HS	the Harmonized System
IBFD	International Bureau of Fiscal Documentation

IBOGLUCC	Good Governance and Anti-Corruption Body
FAQ	Frequently asked questions
IFCs	International Financial Centers
IFFs	Illicit Financial Flows
IGAD	Inter-Governmental Authority on Development
IGG	Inspector General of Government
IM4DC	International mining for Development Centre
IMF	International Monetary Fund
INLCC	National Authority fo Combatting Corruption
IT	Information Technology
KPMG	Klynveld Peat Marwick Goerdeler
KYC	Know Your Customer
LTPU	Large Tax Payer's Unit
MAC	Convention on Mutual Administrative Assistance on Tax Matters (the Multilateral Convention)
MCAA	Multilateral Competent Authority Agreement
MENA	Middle East and North Africa
MENA-FATF	Middle East and North Africa Financial Action Task Force
MGD	Macroeconomics and Governance Division
MNCs	Multinational Corporations
MNEs	Multinational Entreprises
ML	Money Laundering
ML/TF	Monel Laundering/Terrorism Financing
MLI	Multi-lateral Instrument
MRA	Mutual Recognition Arrangements
NFIU	Nigeria Financial Intelligence Unit
NSW	Single Windows System
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
OSP	Office of Special Prosecutor
PCCB	Prevention and Combatting of Corruption Bureau
PEPs	Politically Exposed Persons
PLC	Public Limited Company

PML	Professional Money Laundering
PMLNs	Professional Money Laundering Networks
PMLOs	Professional Money Laundering Organizations
R&D	Research and Development
RADDEx	Revenue Authorities Digital Data Exchange
RAFIC	System of Rationalization of Tax and Accounting Action
RECs	Regional Economic Communities
RKC	Revised Kyoto Convention
SACU	Southern African Currency Union
SADC	Southern African Development Community
SCT	Single Customs Territory
SINDA	Automated Customs Information System (Tunisia)
STR	Suspicious Transactions Reporting
TIR	Convention on the International Transport of Goods under Cover of TIR Carnets
TIN	Tax Identification Number
TJN	Tax Justice Network
TJN-A	Tax Justice Network-Africa
TRA	Tanzania Revenue Authority
TTN	Tunisia TradeNet
UN	United Nations
UNCAC	United Nations Convention Against Corruption
UNCTAD	United Nations Trade and Development
UNECE	United Nations Economic Commission for Europe
UNESCO	United Nations Education, Scientific and Cultural Organization
UNODC	United Nations Office on Drugs and Crime
UNDP	United Nations Development Programme
VAT	Value Added Tax
WAEMU	West African Economic and Monetary Union
WCO	World Customs Organization
WTO	World Trade Organization
WTO-TFA	World Trade Organization Trae Facilitation Agreement

Foreword

At the dawn of the United Nations decade of action for meeting the Sustainable Development Goals (SDGs), Africa needs to mobilize additional resources to support the necessary development programmes. The amount needed is equivalent to more than a third of the continent's GDP.

Since 2010 the United Nations Economic Commission for Africa (ECA) has advocated for Africa to step up its domestic resource mobilization (DRM) for economic development. By harnessing this sustainable source of unconditional development financing, Africa would own the process and determine its own priorities. To mobilize those resources, ECA research established, Africa must improve its governance of public resources and curb their large illicit outflows.

A High Level Panel was commissioned in 2011 by the fourth joint African Union/ECA Conference of African Ministers of Finance, Planning and Economic Development and chaired by South Africa's former president, Thabo Mbeki. It established that Africa was losing $50 billion a year through illicit financial flows (IFFs), conservatively estimated. Stemming those outflows could shrink the continent's infrastructure financing gap considerably and strengthen its productive capacities, enhancing prospects for achieving the SDGs.

Although the value generated in Africa could lead to increased government revenue and so to the availability of development finance, unscrupulous economic agents use various mechanisms to deny this contribution to Africa's DRM. Moreover, those mechanisms damage African countries' governance structures, further dampening Africa's sustainable development prospects.

This premier edition of the **Economic Governance Report** (EGR) succeeds the **African Governance Report** (AGR), which was published in five biennial editions from 2005 to 2018. It builds on them and on other ECA research to address the economic governance issues in efforts needed by African countries to curb resource leakages. To study the requisite institutional architecture for addressing IFFs, it considers institutions broadly, including legal and regulatory frameworks, formal and informal practices and organizational structures that enable or curtail IFFs at the national, regional and international levels. The report takes a view of IFFs broader than the traditional definition as public abuse of office and encapsulates the complexity of motivations, manipulations and channels through which corrupt practices manifest locally and internationally to move wealth illicitly across borders.

The findings of this report, building from ongoing discourses in different forums around the world, support an emerging consensus that the highest leadership in each African country must view IFFs in the context of national security if they are to be curbed. That perspective will compel a determination to protect financial resources generated in the country and enhance efforts to mobilize them for sustainable development. A national strategy should back that determination with the legal and regulatory frameworks and, since IFF perpetrators are often powerful and compromised by varying degrees of criminality, with protection for those involved in anti-IFF activities.

To curtail IFFs, a country's institutions require a capacity that is currently outstripped in most places in Africa. African countries will have to undertake granular assessments of the institutions fighting IFFs to identify weaknesses and commit adequate resources to strengthen their capacities as required. The tax administration, customs authorities, judicial systems, financial intelligence units, anti-smuggling and anti-corruption organizations, anti-IFF coordination frameworks and overall policy formulation management all need upgrades. Given those, African countries can both tackle IFFs internally and engage foreign jurisdictions in auditing and investigating deviant transactions, as well as galvanize global support for addressing global IFF miscreants.

The mechanisms deployed to facilitate IFFs from Africa are growing in sophistication. They exploit African countries' institutional weaknesses, paucity of data and fragmented databases, and their lower place on the curve of the fourth industrial revolution. To dismantle the mechanisms, African countries must criminalize IFF activities, institute or strengthen anti-IFF institutional coordination, harness information technology for data collection and pursue a whole-of-government approach.

Since IFFs are transboundary, the African Union (AU) and its subregional economic communities must clearly criminalize IFFs at a regional level, explicitly include anti-IFF objectives in their anti-corruption conventions and protocols and establish reporting and accountability mechanisms. They should mainstream IFFs in the AU's African Peer Review Mechanism, clearly showing AU intolerance of the theft of Africa's resources to the world and to any member State struggling with state capture by IFF miscreants. And they should provide a framework supporting such member States.

> *"the highest leadership in each African country must view IFFs in the context of national security if they are to be curbed.*

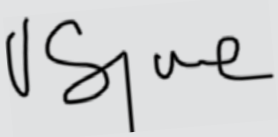
While the global community—particularly the UN and the Organisation for Economic Co-operation and Development/Group of 20—has undertaken the reform of global financial governance architecture, initiatives so far have fallen short. The failure mainly stems from slow implementation in developing countries, particularly in Africa, due to gaps in the capacities required, which leave ample space for well-financed and incentivized IFF miscreants to continue the plunder.

For instance, the Addis Ababa Action Agenda underscores the need for international tax cooperation to be universal in approach and scope and to fully consider the different needs and capacities of countries. But the global institutional architecture to address such IFFs as tax evasion and tax avoidance lacks a universal international convention. Such a convention would bring international tax cooperation matters under a single entity to oversee the spectrum of issues and provide international leadership and guidance like that of the United Nations Convention against Corruption and United Nations Convention against Transnational Organized Crime. Yet, the institutional environment of international tax cooperation is dominated by self-selected, regional or group forums (often with voluntary participation) and a proliferation of bilateral tax treaties and multilateral instruments.

Although individual AU member States may undertake various reforms, a global strategic directive would be more effective, given current capacity constraints and the imperative to meet the SDGs by 2030. It could be underpinned by lessening the burden on developing countries of auditing the activities of economic agents (individuals, multinational corporations, and so on), which they currently accomplish only partly if at all. The system would entail the global taxation of multinationals and other economic agents, allocating the taxes on their global profits or earnings proportionately to inputs from the jurisdictions that produced them. It could require a framework such as a universal tax body under the auspices of the United Nations with regional nodes around the UN's Regional Economic Commissions.

Meanwhile, African policymakers and their partners must hasten the economic governance reforms recommended in this report to strengthen African countries' institutional architecture to curb IFFs and enhance the prospects of achieving the SDGs.

African countries must, therefore, criminalize the practices that allow IFFs, establish national coordination mechanisms among the institutions responsible for curtailing IFFs, build the requisite capacities in those institutions, digitalize their procedures, coordinate with external jurisdictions and implement international initiatives and thus defend the economic security of the continent.



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Executive Summary

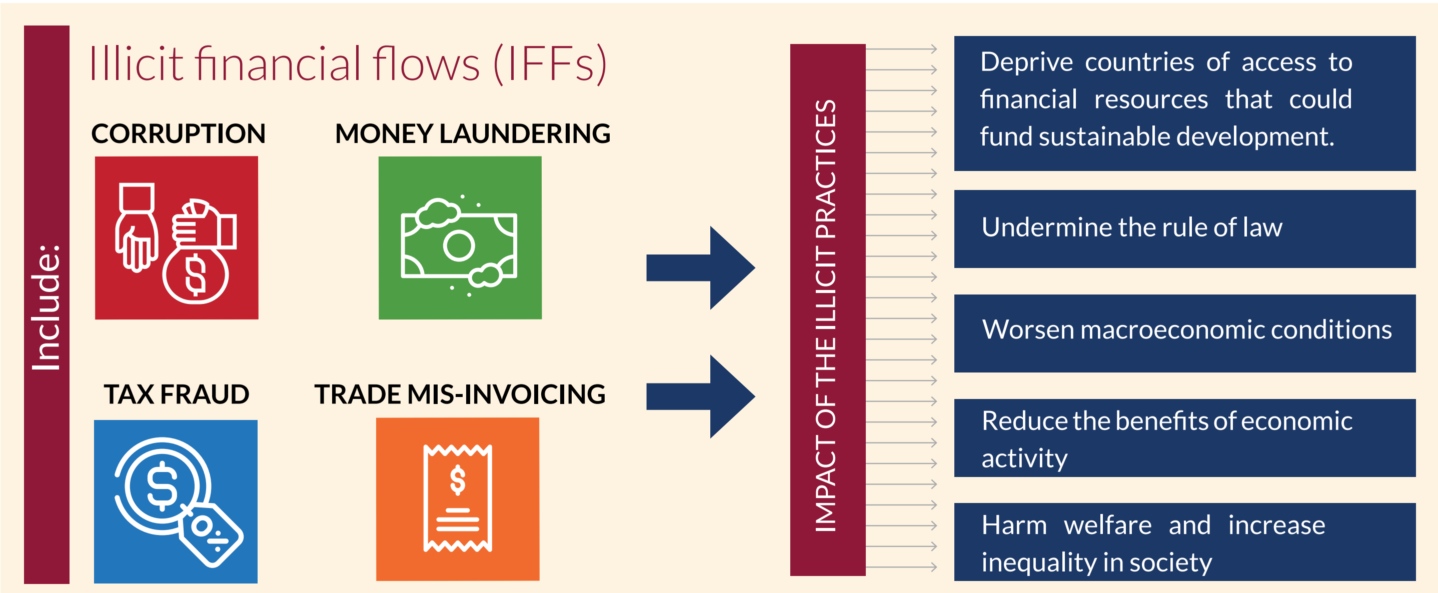
This premier **Economic Governance Report** (EGR I) assesses the institutional architecture pledged by African governments for blocking illicit financial flows (IFFs) and recommends initiatives to strengthen it. The report's findings indicate that IFFs continue to thrive, though African countries have tried to establish dedicated institutional frameworks for combatting them in the main channels of trade, investments and financial flows. The IFFs include corruption, money laundering, trade mis-invoicing to move money illicitly and tax fraud (including corporate tax dodging). The report encourages more inter-agency collaboration, coordinated reporting, the removal of duplicated and competing mandates, and consistent political support for institutional reforms to combat IFFs.

The African Union (AU)/Economic Commission for Africa (ECA) High Level Panel on Illicit Financial Flows (IFFs, 2015), chaired by Thabo Mbeki, the former president of South Africa, estimated that $50 billion leaves the continent annually in losses that cannot be attributed purely to capital flight. Later estimates (including those of this report) put the total even higher. The losses are largely due to the illicit practices of economic agents with such varied motivations as the desire to shift profits to low tax jurisdictions and to launder or conceal wealth, including that gained from illicit enrichment.

Those IFFs deprive countries of access to financial resources created within their jurisdiction that could fund sustainable development. And IFFs undermine the rule of law, worsen macroeconomic conditions, reduce the benefits of economic activity—particularly in the extractive sector—harm welfare and increase inequality in society.

The report examines how domestic governance institutions relate to the channels through which IFFs occur and the motivations for IFFs. Those institutions have individual roles, relations with other institutions and responsibilities to the international architecture combatting IFFs, given the essential character of IFFs as cross-border flows. The report adopts a whole of system approach to institutions, highlighting the increasing use by IFF perpetrators of sophisticated and complex financial and commercial arrangements to disguise the money trail.

A special declaration of the 24th AU Assembly, endorsing the Mbeki Panel report, called on African governments to institutionalize prudent legal and regulatory regimes, including fiscal policies that disallow financial secrecy, fight corruption, institute or strengthen African institutions, build African member state capacities for contract negotiation and tax administration and identify and return the resources lost through IFFs, which could greatly contribute to financing Africa's development.



Further, the 31st AU Summit meeting in July 2018 instituted an agenda for Africa on tax transparency and exchange of information to be led by the AU Commission. It called for stronger collaboration among countries and regions to address the root causes of IFFs and stronger tax cooperation to stem them and enhance domestic resource mobilization. The summit also called for establishing effective registers of beneficial ownership, country-by-country reporting of financial information, automatic exchange of information agreements and strengthening tax authorities through the work of the African Tax Administration Forum (ATAF). The summit also requested the AU Advisory Board on Corruption (AUABC), the AU Commission (AUC) and the United Nations Economic Commission for Africa (ECA), together with other stakeholders, to speed up implementation of the recommendations of the Mbeki Panel and to progressively abolish bank secrecy jurisdictions and tax havens on the continent.

A consortium of organizations tackling IFFs was later formed for coordinating African efforts and internationally advocating global financial governance architecture reforms to stop IFFs and recover lost assets. Research has been undertaken on global financial architecture and how it facilitates IFFs, the reforms required for improving the taxation of multinational enterprises to curb base erosion and profit shifting in Africa, and other topics.

Institutions and illicit financial flows

Institutions are the legal, regulatory and policy frameworks and practices (formal and informal) and the organizational structures that enable or curtail IFFs at the national, regional and international levels. The **Economic Governance Report**, in the spirit of the Mbeki Panel, defines IFFs as financial activities that are hidden—rather than necessarily illegal—where either the illicit origin of capital or the illicit nature of the transactions is deliberately obscured. Jurisdictions or intermediary organizations facilitate IFFs by providing secrecy (or concealment) to cross-border transactions to hide them from public view.

The report reiterates earlier ECA observations that the quality of institutions is a determinant of the whole economy, as well as of IFF prevalence. Viewed through a political economy approach, IFFs arise from decisions and non-decisions made by powerful individuals and corporate and public institutions pursuing their interests.

Corporate institutions exert influence to maximize returns and may exploit, in some cases, public sector corruption, loopholes in rules and laws or the weaknesses of regulatory entities to minimize tax obligations and to transfer wealth abroad illicitly. Strong public sector

IFFs arise from decisions and non-decisions made by powerful individuals and corporate and public institutions pursuing their interests.

institutions resist corruption, close regulatory loopholes and enforce laws. IFFs can weaken institutions by undermining the integrity of the rules and procedures these institutions practice or can deny them the resources necessary to invest in their own effectiveness. So, the relationship between IFFs and institutions goes in both directions, and a vicious cycle of IFFs and weak institutions can occur.

The institutions associated with IFFs are complex, with each type of IFF involving different local and international, public and private channels. To address IFFs, policy responses should examine how IFF sources, actors and channels interact. Similarly, the state institutions combatting IFFs are multiple. The **Economic Governance Report** concludes that only a whole-of-government approach can ensure the synergies needed for effectively combatting IFFs across all economic channels.

African countries should first establish comprehensive frameworks for tackling IFFs, based on comprehensive IFF policy, up-to-date laws and regulations that provide the legal basis for IFF-curbing efforts and governance frameworks to oversee and guide IFF-curbing programmes with collaboration and coordination. Given limited awareness about IFFs among policymakers, customs and tax officials and oversight bodies, familiarizing them is essential, and the media and civil society have roles to play.

National institutional frameworks are needed for the collaboration and coordination of agencies regulating tax- and trade-based IFF value chains—and the virtual paths that today convey more transactions than traditional cash, cheques and physical banks. Agencies include customs and revenue authorities, financial intelligence units, anti-smuggling units, anti-corruption units, financial institutions (banking and non-banking, formal and informal) and the central bank, as well as policy agencies such as the ministries of finance, trade and industry. The institutional framework will help establish coordinated reporting and harmonize the agencies' overlapping and competing mandates.

Tax-motivated illicit financial flows

The report examines the anatomy of tax avoidance and tax evasion that lead to IFFs, the adequacy or inadequacy of African institutions in tackling them, the state of international efforts to curb tax-motivated IFFs and the aims of various global initiatives and African countries' challenges in implementing remedies. The report highlights the lucrative industry supporting tax-motivated IFFs and the inability of various African governments to confront them and stem the resulting resource leaks.

Tax avoidance is perpetrated through strategies that exploit gaps and mismatches in tax rules and systems to make profits "disappear" for tax purposes (shrinking the tax base). Or they shift profits from the jurisdictions where the profits are made to places where the firm has little or no real activity but tax rates are low.

Tax avoidance and profit shifting also occur through trade mis-invoicing and the abuse of transfer pricing or barter trade to reduce a multinational enterprise's tax liabilities related to sales (value-added tax, or VAT, excise duties and so on). Multinationals may use intra-company loans or other intra-company financing instruments to increase a subsidiary's debt and thus thin the subsidiary's capitalization and reduce its tax obligations, illicitly shifting the amounts paid as interest on the loan. Multinationals may cherry-pick high-tax jurisdictions as the official location of intangible services such as patents, and research and development to increase expenses there and so to lower their overall tax liability. Or they may abuse tax incentives.

Like tax avoidance, tax evasion is pervasive. Tax evasion circumvents income taxation or tax obligations due to sales of goods and services through trade misreporting and mis-invoicing, VAT fraud, bribing tax officials, falsely claiming eligibility for tax incentives or not declaring personal income or corporate profits. These practices are followed by the illicit transfer of financial resources from an African country to some other jurisdiction.

Political leadership is the starting point in curbing tax-motivated IFFs by strengthening institutions and promulgating and implementing effective tax laws and policies. Clear laws and policies must determine the tax base and the taxes due, investigate the channels resources move through and manage mechanisms to recover illicitly transferred resources. The national revenue authorities, port authorities, investment regulatory bodies and the associated laws and regulations are at the centre of curtailing tax avoidance and tax evasion.

Governments must support their tax administrations in acquiring the technical and legal capabilities to assess the tax bases and determine tax due, investigate tax offences and bring defaulters to caution, arbitration and follow-up recovery of unpaid taxes. They need adequate capacity in tax-related auditing, assessment, investigation, prosecution and negotiation, as well as infrastructure for digitalization, cooperation arrangements, litigation or arbitration, and stakeholder dialogue. Audit units should be trained in international accounting standards so they can audit multinationals, deal with their aggressive tax planning and follow other tax jurisdictions' procedures and laws. Governments should provide tax authorities with the required legal capacity to decode and navigate the various loopholes tax avoiders and evaders could use.

Since tax-motivated IFFs involve more than one jurisdiction, tax administrations must be equipped to interact with other jurisdictions to follow and recover illicitly transferred funds. Their legal units should have the capacity to liaise with other units and institutions within the country and abroad to follow up on transboundary operations and to question insufficient prosecution and punishment of violators.

The United Nations and the Organisation for Economic Co-operation and Development (OECD) are the main forums for tackling international tax reforms by providing model conventions and commentaries, as well as codes of conduct and guidance. The greatest effort is the Group of 20/OECD action plan for an inclusive framework for base erosion and profit shifting (BEPS) to reduce the mis-alignment of profits with real economic activity. The action plan for BEPS permits thousands of bilateral tax treaties to be updated through a multilateral instrument (MLI), circumventing the need for renegotiation by individual affected parties. But few African countries have taken advantage of the MLI.

The Global Forum is supporting tax authorities in exchanging information on beneficial ownership, accounting and other types of information necessary for tackling cross-border tax avoidance and tax evasion. The Global Forum promotes the Common Reporting Standard (CRS), an information standard for tax authorities sharing bank and financial account details, which is used in the Automatic Exchange of Information (AEOI) Standard allowing jurisdictions to exchange financial account information with the home countries of non-citizen residents. It also supports the implementation of the exchange of information on request (EOIR) and AEOI standards. An initiative on transparency and the exchange of information across fiscal jurisdictions aims to facilitate access to multinationals' records regardless of where they domicile globally.

African countries have made progress in the exchange of information (EOI). African countries participating in the Global Forum on Transparency and Exchange of Information for Tax Purposes increased from 17 in 2014 to 29 in 2018, including 8 of the 15 oil exporters and 13 of the 26 mineral-rich countries. Only 9 have ratified the OECD Convention on Mutual Administrative Assistance in Tax Matters. Many more—18—made tax information requests by 2018. Five countries reported collecting more than $22 million in additional taxes by 2018 as a result of EOI, including Uganda ($9 million in 2015/2016), Togo ($1 million in 2016) and Tunisia ($2 million in 2018).

Some 31 African countries have established transfer pricing units to evaluate how companies account for sales between subsidiaries, affecting their tax liability. The units' effectiveness depends on the underlying legislation and how enforceable it is. African countries have an opportunity to play an active role in ongoing global discussions on replacing the current regime with one based on unitary taxation. Unitary taxation would consider a multinational corporation as a single unit. Profits declared by the corporation would be apportioned for taxing to each country where it creates value, using a formula that accounts for the unit's real economic activities in each country. The approach would eliminate the incentive for a multinational to shift profits to low tax jurisdictions.

For regional and international cooperation, African countries are urged to commit to the Addis Tax Initiative and to join complementary initiatives. The AU or its regional economic communities (RECs) may also consider establishing a technical dispute settlement and trade facilitation authority to promote regional efforts to curb corruption, tax-motivated and trade-based IFFs and money laundering. Such an authority would devise means for African government to share tax, finance and trade information among themselves.

Trade mis-invoicing

Trade mis-invoicing occurs when the prices of imports or exports on the invoices presented by importers or exporters to customs agencies and port authorities are falsified to move money illicitly across borders. IFFs through trade mis-invoicing pose the greatest threat to domestic revenue collection and foreign exchange earnings in many African countries, given the continent's overwhelming dependence on primary commodities, especially extracted commodities, for international trade.

ECA estimates that between 2000 and 2016 Africa lost, on average, $83 billion a year through trade mis-invoicing—comparable to the $93 billion needed to close the continent's infrastructure financing gap. Cumulatively over 2000–2016, the loss amounted to $1.4 trillion, equivalent to 5.3 per cent of Africa's GDP, or 11.4 per cent of the value of Africa's trade.

To curtail trade-related IFFs, national strategies must be strengthened. A national strategy for trade-related IFFs could include:

- Comprehensive legislative frameworks mandating customs and revenues bodies to tackle trade mis-invoicing of goods and services.
- Laws and regulations criminalizing trade mis-invoicing.
- Where such laws and regulations already exist, steps to strengthen enforcement and scale it up.

Rules governing trade data are central to the strategy. Laws addressing trade data should clearly provide for the following:

- Use, collection, storage, protection and sharing of data within and outside the country.
- Capacity-building in national tax and customs authorities to collect and share—and request from other customs/tax jurisdictions—trade and related data to facilitate the prevention and curbing of illicit trade, tax fraud and transnational crime.
- Risk analysis, mitigation and management.
- Compliance oversight and supervision.

Country-by-country reporting of companies' revenues and profits is crucial to curtailing trade-related IFFs. African countries should make it possible to share trade information among themselves, including through regional cooperation arrangements enabling customs authorities to share documents and copies through e-mail and other electronic channels and information technology systems.

Given the diversity of electronic customs administration systems and the varying valuation systems used in detecting trade mis-invoicing, African countries should establish interoperable regional information technology modules. Region-wide customs code and trade facilitation frameworks should require submission of invoices and certificates of origin. African countries should establish a regional mutual administrative assistance legal instrument, interoperable with national systems and with international mutual support standards, for the efficient settlement of disputes on trade mis-invoicing and other commercial fraud.

Illicit financial flows through the financial system

The report examines ways African financial systems are vulnerable to IFFs, including money laundering (ML). It discusses key mechanisms, actors and enablers of IFFs and ML and describes and evaluates key features of the institutional structures to combat them, drawing on global and regional frameworks. Banks serve as conduits and facilitators of IFFs, including money laundering, when they:

- Open multiple accounts for clients in multiple names in multiple jurisdictions, making it easier for clients to hide assets and illicit activities.
- Open accounts offshore to hold client assets in the name of shell corporations, thus facilitating the concealment of the assets and activities of beneficial owners.
- Open accounts for clients in the form of numbered accounts and coded names.
- Facilitate complex wire transfers from multiple accounts to multiple destinations in substantial amounts, enabling quick, complex movement of substantial funds across jurisdictional lines.
- Conduct client business through a single account that facilitates the processing and settlement of the transactions of multiple individual customers. The account can be a method of hiding the origin of funds.
- Maintain client records offshore and minimize or eliminate information in the country of residence, thereby impeding regulatory and law enforcement oversight.
- Conduct business in jurisdictions that promote secrecy as a service.

Money laundering often involves the complicity of agents in financial institutions who make deals happen and blur the origins and destination of funds and the identities of the individuals involved. As internet-based transactions by international merchants expand, payment processing services and virtual currency payment products and services also facilitate money laundering, posing severe IFF risks. Digital technology, including cryptocurrencies, presents special dangers because of its automation, speed and cross-border character; the anonymity it accords to users and the regulatory burden it imposes on regulators with weak technical capacity.

Successful anti-money laundering (AML) strategies need to include agencies to oversee and enforce risk assessment by banks, non-bank financial institutions and others. Institutions require adequate resources and capacity building for risk assessment. They must be able to invest in the technological infrastructure required to collect, track and store data necessary for AML activity. Financial intelligence units need to build the human capacities to enforce policies and laws aimed at detecting and stemming IFFs. Improved coordination of various overlapping agencies and comprehensive information exchange within and outside their jurisdictions are also needed.

Clear reporting mechanisms can be established to minimize inconsistencies across institutions in reporting and prosecuting money laundering and applying penalties for inadequate risk assessment and reporting. Customer due diligence is critical, as is suspicious transactions reporting. A strong AML framework must include ways to handle the transactions and assets of politically exposed persons and related social and business parties. Technology can be harnessed to aid all these functions.

Anti-corruption measures

Corruption, an important channel of IFFs, is complex and dynamic. The **Economic Governance Report** uses a broad definition of corruption: "the abuse of authority and the undermining of rules, systems and institutions that promote the public interest for the purpose of illicit acquisition, concealment and movement of wealth in the interest of oneself, kin or corporate legal personality or other overriding special interests." Corruption and IFFs are linked in tax abuse, market or regulatory abuse, abuse of political and administrative power and laundering the proceeds of crime.

Trade, foreign direct investments (FDI) and banking are the channels through which corruption facilitates IFFs. Trade is involved through over-pricing exports to exploit subsidy regimes or under-pricing them to shift undeclared profits abroad, evade tariffs, shift under-declared income or criminal proceeds out or even evade capital controls. Foreign direct investment works through under-pricing inward investments to hide political involvement or shift undeclared income out, or through portfolio flows using anonymity to conceal political interests. Technological advancement and financial globalization also provide an avenue for corporations and individuals to hide illicit criminal and non-criminal wealth.

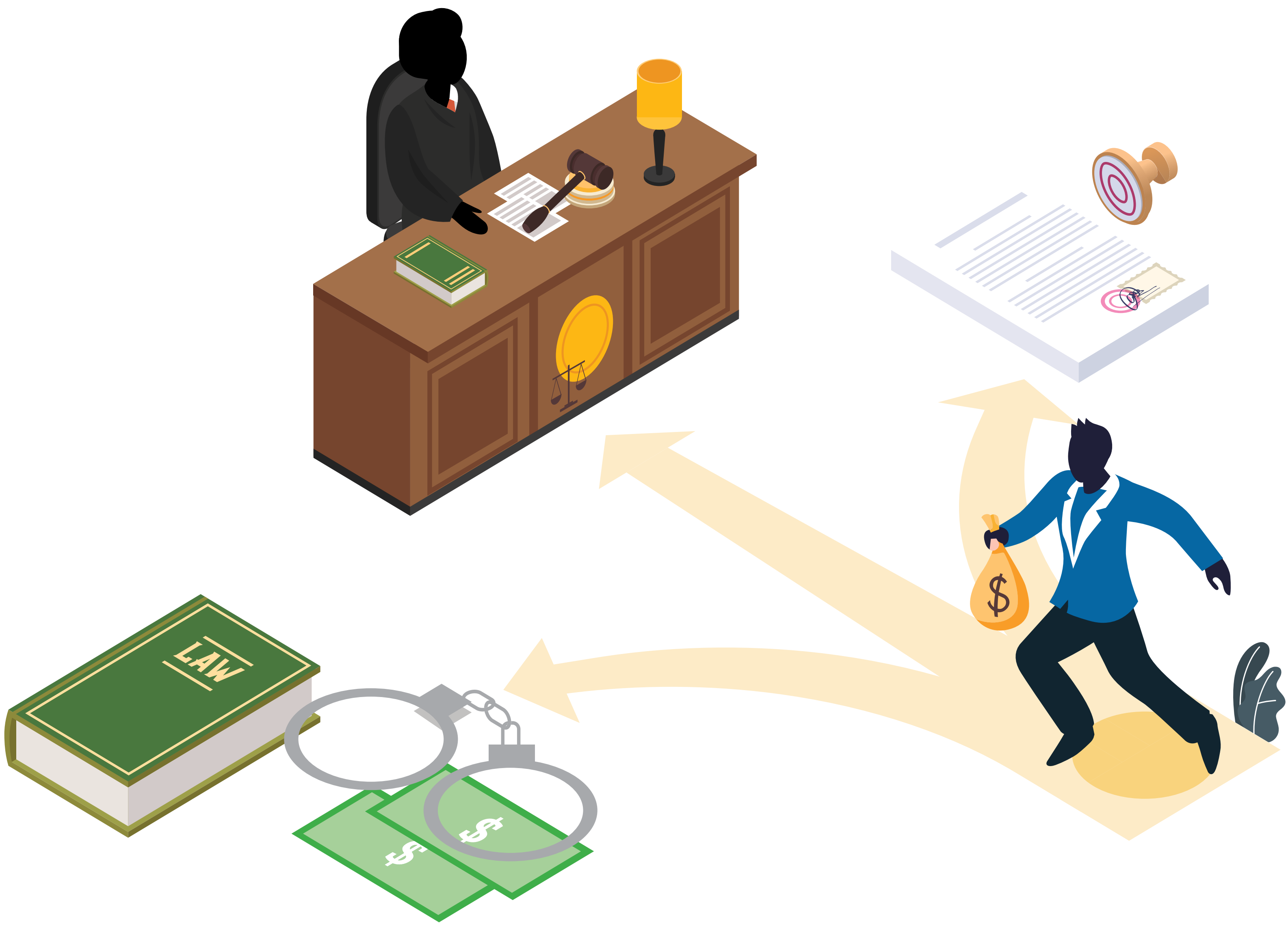
Secrecy or the lack of transparency is at the centre of the association between corruption and IFFs. Multiple tax havens and secrecy jurisdictions allow corporations and individuals to keep, move, hide and spend their money.

To tackle corruption effectively, African countries need to shine a spotlight on public sector institutions, particularly in public procurement, natural resource contracts and tax incentives, to eradicate state capture and grand corruption. African countries need to give the public access to procurement information and to develop an effective criminal justice system and strong anti–money laundering laws to curb the transfer abroad of illicit gains.

African countries that are parties to international conventions on corruption should fully implement and align all national laws governing anti-corruption agencies.

Tackling financial secrecy comprehensively would reveal the providers of secrecy services, thus taking the fight to the facilitators of corruption. The characteristics of financial secrecy will indicate the legal and regulatory measures required to tackle corruption in the context of IFFs. Monitoring corporate tax havens, focusing on how secrecy affects corporate taxation, should complement other efforts to tackle financial secrecy.

African countries that are parties to international conventions on corruption should fully implement and align all national laws governing anti-corruption agencies. Anti-corruption laws should expressly cover IFFs. African countries should also strengthen the powers and independence of anti-corruption agencies to effectively address corruption, money laundering, trade-related IFFs and tax-motivated IFFs. They should integrate data systems across all economic channels—central banks, customs authorities, other tax authorities, registries of companies, security exchange commissions and commercial and non-banking financial institutions—to support tracking of corrupt transactions and the movement of corrupt proceeds.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CHAPTER 1:

Illicit financial flows and Africa's institutional architecture: the conceptual framework

At the seventh joint annual meetings of the United Nations Economic Commission for Africa (ECA); the African Ministers of Finance, Planning and Economic Development and the African Union Conference of Ministers of Economy and Finance, the ministers pledged to take the necessary coordinated action nationally, regionally and continentally to strengthen our economic governance institutions and machinery, focusing especially on tax administration, contract negotiations, and trade-related financial leakages and to engage with the international community, in order to highlight our concerns regarding illicit transfers, including the question of tax havens.

The special declaration of the 24th Assembly of the African Union on Illicit Financial Flows (IFFs) from Africa also called on African governments to curtail those flows by institutionalizing prudent legal and regulatory regimes, including fiscal policies that prohibit financial secrecy, institute or strengthen institutions, build member state capacities for contract negotiation and tax administration and identify and return resources lost through IFFs. The declaration noted that although IFFs are global and complex, African governments have the power and the responsibility to curtail them in so far as they originate from the continent and should take that responsibility seriously.

This **Economic Governance Report** aims to assess how well the institutions tasked with implementing the state commitments to curtail IFFs have done, draw lessons from the experiences and propose measures to support the institutions in performing their responsibilities more effectively.

Context

The African Union/ECA High Level Panel on Illicit Financial Flows from Africa (the 2015 Mbeki Panel) was prompted by the realization that plugging resource leaks, particularly IFFs, was necessary to raise the needed financial resources to implement the African Union Agenda 2063 and the global 2030 Agenda.

Africa is losing significant resources through illicit financial flows (IFFs), conservatively estimated by the 2015 report of the High Level Panel on IFFs from Africa at $50 billion a year (AU and ECA, 2015). If this loss were expressed in terms of the resources needed for Africa to meet its Sustainable Development Goals (SDGs), this would be equivalent to:

- For the education budget: One and a quarter times the amount required a year over 2015–2030 to achieve SDG 4 on inclusive education, estimated by UNESCO at $39 billion a year (UNESCO, 2015).
- For the health budget: Three quarters of the estimated health financing gap of $66 billion per year for Africa to make significant progress on SDG 3 on good health and well-being (ECA, 2019a).
- For infrastructure: One third of the additional $130–170 billion Africa needs annually to fund infrastructure projects (African Development Bank, 2018).

AFRICA LOSES US$50
BILLION A YEAR IN
ILLICIT FINANCIAL FLOWS

The losses are equivalent to a proportion of:

3 GOOD HEALTH AND WELL-BEING

HEALTH BUDGET:
³/₄ the amount
needed to make progress on SDG 3

4 QUALITY EDUCATION

EDUCATION BUDGET:
1¼ the amount
needed to achieve SDG 4

9 INDUSTRY, INNOVATION AND INFRASTRUCTURE

INFRASTRUCTURE:
¹/₃ of the additional amount needed
annually to achieve SDG 9

This conservative estimate of the IFFs loss is also equivalent to a significant proportion of the following for Africa:

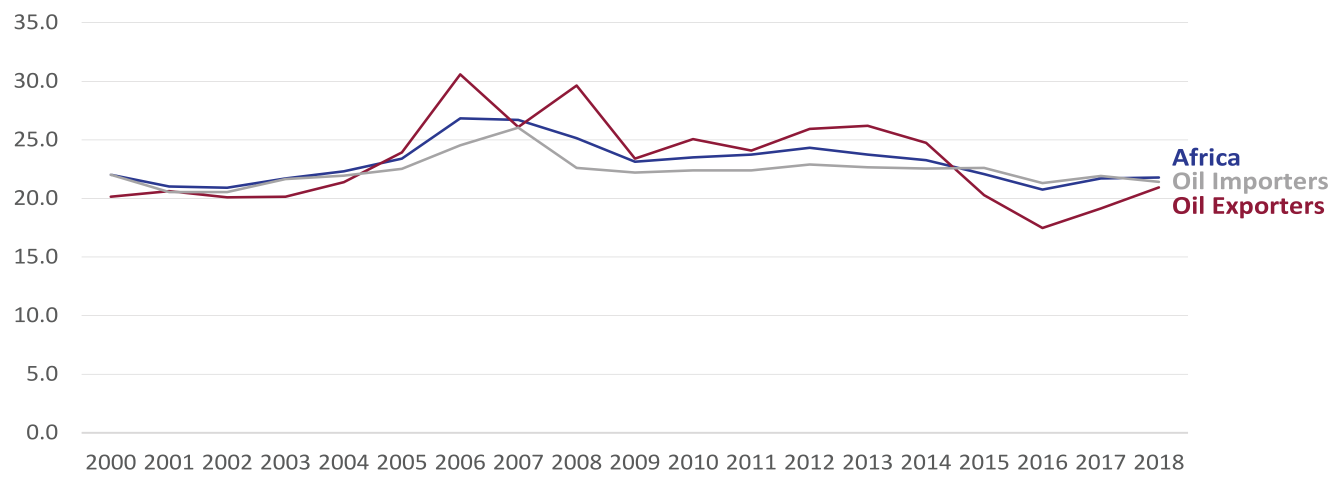
- Import bill: Between 10 per cent of the value of Africa's total annual exports and 9 per cent of the values of its imports.
- Gross domestic product: Almost 3 per cent of the continent's GDP.
- Annual debt service: About two-thirds of the $76.6 billion used in 2018 to service external debt.
- Official development assistance (ODA): Just over the $46.3 billion in ODA that Africa received in 2018.
- Remittances: Almost 60 per cent of the $84.4 billion in remittances Africa received in 2018.
- Foreign direct investment (FDI): About 1/16 of the $800 million in net FDI inflows to Africa from 2016–2018.

Africa's incremental financing need to meet sustainable development goals was recently estimated at $600–638 billion a year—about one-third the continent's GDP (Schmidt-Traub, 2015). Curtailing IFFs through trade mis-invoicing alone, according to recent ECA estimates, would have saved an average of $83 billion a year between 2000 and 2016 (ECA, 2019b)[1]. If other channels of illicit outflows are included, such as criminal activities and tax avoidance by multinational companies, the scale is even more staggering.

Curtailing IFFs to mobilize domestic resources is reliable, sustainable, empowering and essential for leveraging external resources, as both the Mbeki Panel's report and the subsequent Addis Ababa Action Agenda (AAAA) of the Third International Conference on Financing for Development argued (United Nations, General Assembly, 2015a). Doing so is urgent in an unstable development finance landscape, where traditional aid is declining, and external private capital remains concentrated in a few regions and countries. At the same time, most African economies face rising debt distress, shrinking fiscal space and unstable export revenues, largely due to volatile commodity prices.

African government revenues and commodity prices are correlated. Before recent declines in commodity prices, the ratios of total revenue to GDP were higher in oil exporting countries (figure 1.1). Declines in world oil prices led to a 5 percentage point fall in the revenue-to-GDP ratio for oil exporting countries between 2014 and 2017. And the heavy reliance on natural resources has exposed African countries to mounting IFFs, since natural resources provide the largest basis for IFFs through trade mis-invoicing, as this report will show.

Figure 1.1. Africa's total revenue as a share of GDP

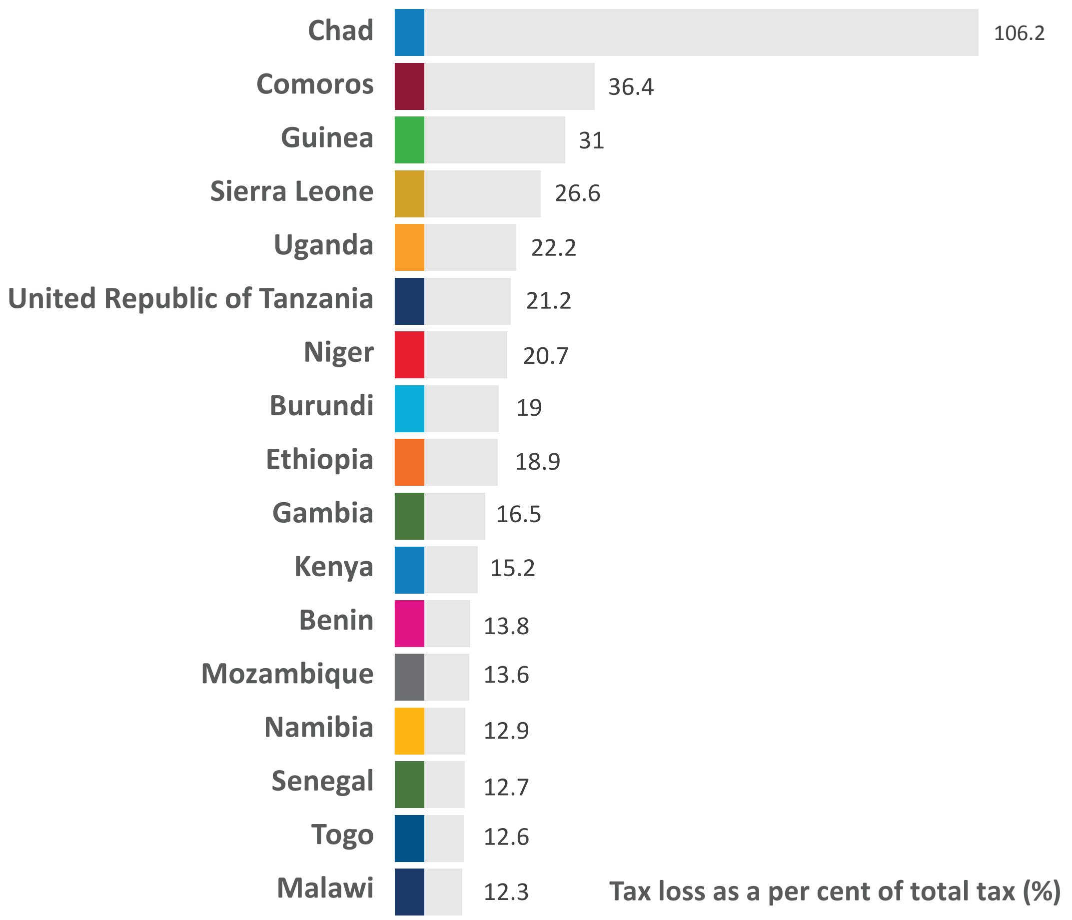


Source: ECA (2019b), based on IMF World Revenue Longitudinal Data (2019)

1 These estimates are within range of Ndikumana and Boyce's (2018) estimates of net trade mis-invoicing—about $93.5 billion—during 2000–2015. But that estimate is based on a sample of 30 African countries, while the ECA's sample includes 46 African countries.

The report of the Mbeki Panel recognized that IFFs reduce state revenues, sometimes significantly. IFFs subvert effective taxation, particularly direct taxation—thus undermining representative democracy, and ultimately eroding the quality of public services and exacerbating social inequalities (AU and ECA, 2015). The United Nations Conference on Trade and Development (UNCTAD) 2015 **World Investment Report** estimated developing countries lose $100 billion a year in taxes due only to routing of FDI investment through tax havens (UNCTAD, 2015). In several African countries these losses exceed 20 per cent of total revenues (figure 1.2). The scale of such losses is higher in natural resource–intensive countries than others.

Figure 1.2. Illicit financial flow–induced tax losses as a percentage of total tax



Source: Based on Cobham and Janský (2017) [2].

This report recognizes that IFFs are both outcomes and drivers of weak institutions. While weak institutions and corruption either facilitate IFFs or make it harder to combat them, IFFs in turn weaken institutions and exacerbate grand corruption in many ways. For example, illegal market IFFs, as in drug trafficking, are associated with a loss of state control and even state legitimacy as criminal actors become more powerful. Grand corruption moves a state along a continuum from a broad-based provider of public benefits to private capture, from transparency to opaqueness. Tax-related IFFs compound the issue.[3] The relationship between IFFs and institutions is at the core of this report.

The need to address the institutional architecture is based on the consensus that strong, effective and accountable institutions are key to sustainable development in general and central to curbing IFFs in particular (Acemoglu and Robinson, 2012; ECA, 2016a, 2018a, 2018b). The opposite is also the case, as weak institutions hamper efforts to curb IFFs and are indeed exploited to facilitate IFFs.

2 Please see https://taxjustice.net/2017/03/22/estimating-tax-avoidance-questions/
3 http://www.realinstitutoelcano.org/wps/portal/rielcano_en/contenido/!ut/p/a1/.

Previous work

The **Economic Governance Report** draws on previous work, including the Mbeki Panel report. The definitions and concepts used derive from that report and subsequent work on specifics such as base erosion and profit shifting and the global governance architecture that sustains IFFs but could curtail them (ECA, 2018a, 2018b).

This chapter outlines the conceptual framework linking IFFs to domestic governance institutions and describes specific concepts subsequent chapters use to explore the institutional dimensions more concretely. All chapters, while focusing on domestic institutions, also explore regional and global dimensions. Recommendations for capacity building, while focusing predominantly on the domestic, also consider the place of domestic institutions in the international cooperation needed to address the cross-border dimensions of IFFs.

Objectives of the economic governance report

Although no systematic reporting and evaluation of African governments' progress implementing the recommendations of the Mbeki Panel has yet been undertaken, ECA's recent reports noted major weaknesses in the institutional framework for blocking IFFs at national, regional and global levels (AU and ECA, 2015; ECA, 2018a, 2018b). These include:

- **The lack of a coordinated response across individual governments at the national level.** Governments lack national action plans to guide the work of the various agencies, such as police, customs agencies, revenue authorities, anti-corruption agencies and financial intelligence units, required to block IFFs. Information sharing between agencies is often limited (ECA, 2018a, 2018b).
- **Limited capacity.** Agencies often lack the capacity to fully implement their mandates for blocking IFFs. For example, the high level of IFFs through trade mis-invoicing is partly due to customs authorities' inability to detect and prevent such flows, including by recognizing and combatting abusive transfer pricing. The agencies tend to be underfunded (ECA, 2018b, for details). Laws, norms and regulations to block IFFs have also been found deficient, particularly for the taxation of multinational corporations, or inadequately implemented, as in anti–money laundering regulations (AU and ECA, 2015; ECA, 2018a, 2018b).
- **Limited or overlapping and uncoordinated mandates at the international level.** Although many ongoing initiatives aim to block IFFs, they are pursued by different organizations with mandates often limited to only a subset of IFFs or with overlapping mandates but limited coordination. No global mechanism coordinates action on illicit financial flows, nor does any comprehensive global agreement address all its aspects.
- **Complex procedures underpinning international cooperation.** International cooperation in prosecuting IFF cases remains difficult and lengthy. It lacks a comprehensive legal framework bringing together all affected countries and all aspects of the problem requiring mutual legal assistance. A simplified approach under an international agreement requiring parties to assist each other in IFF cases would be beneficial. Some provisions are already in the Convention against Corruption and the Convention against Transnational Organized Crime but do not cover some aspects of IFFs, particularly those related to tax evasion. And African countries tend to be under-represented in the international institutions through which states agree on IFF policies.
- **Absence of an enforceable regional agreement on IFFs.** At the African regional level, the Consortium to Stem IFFs from Africa exists to coordinate the efforts of various organizations. But as at the international level, no comprehensive legal agreement addresses all aspects of IFFs, and information sharing by African countries on blocking IFFs is limited (ECA, 2018b).

This report seeks to address these issues and to fill knowledge gaps concerning:

- How to properly structure institutions to perform their priority roles.
- How exactly they can block IFFs.
- How they should relate to one another.

The report will also address capacity building based on previous ECA Reports on relevant government agencies. It will address the specific needs of institutions in the IFF architecture: staff skills, technology, reforms in organizational procedures and knowledge of emerging tools such as public beneficial ownership registries and new customs risk assessment tools, as well as infrastructure and attitudes about public information access.

The report will also build on previous reports that sought solutions to specific loopholes. For example, ECA (2018a) made specific recommendations for tackling tax base erosion and profit shifting. And although previous reports highlighted the importance of an overarching national framework, they fell short of addressing the governance structures to oversee the framework's implementation or how national action plans for blocking illicit financial flows should be formulated.

ECA research at the international level has called for greater coordination of efforts, a comprehensive legal framework and greater information sharing and collaboration for blocking IFFs (for instance, ECA, 2018b). This report will explore implementing those recommendations.

So, the main purpose of the **Economic Governance Report** is to fill important knowledge gaps, especially concerning the regulatory, institutional and policy frameworks needed to effectively curb IFFs. The report will illuminate the strengths and weaknesses of the institutions central to IFFs and those central to curtailing them. It will draw both best practice and worst practice lessons to inform policies and practices for curtailing IFFs.

Methodology

The report uses a combination of research methods. A review of secondary literature concentrates on the role of institutions in tackling illicit financial flows. Primary data sources include key informant interviews and national institution data gathered in field missions to five African countries: Côte d'Ivoire, Ghana, Namibia, United Republic of Tanzania and Tunisia.

The case studies on the five countries focus on the role of institutions and policies in curtailing IFFs, drawing lessons about the effectiveness of particular institutions. For each country, they briefly summarize inducements for IFFs in the country and the national and international regulatory and institutional frameworks to best curb IFFs. The report also describes practical measures for more effective national institutions to fight IFFs, better cooperation with countries that IFFs flow to and greater certainty that the proceeds of these resources are spent on improving the lives of the African people.

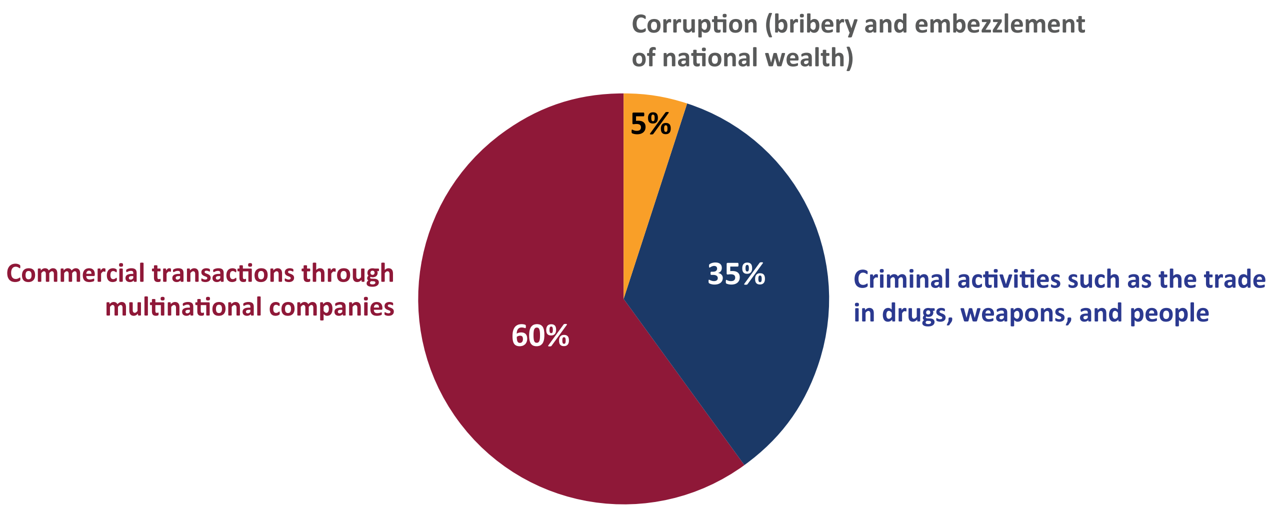
Taxonomy of illicit financial flows and the institutional architecture

The Mbeki Panel report and other previous work addressed definitions and conceptual issues on the key themes of IFFs, institutions and corruption, and this report will not dwell on them. The report employs the following understandings of the key concepts.

Illicit financial flows

In the Mbeki Panel report and subsequent ECA work, IFFs are defined as financial resources crossing borders that are illegally or illegitimately earned, transferred or harboured abroad. “Illegitimate” refers to transactions that transfer wealth abroad in non-transparent ways and are driven by motivations that undermine the public good. This definition incorporates the most widely used categorization based on legality (figure 1.3). It also covers morally questionable practices such as aggressive tax avoidance practiced by multinational enterprises (MNEs) and their facilitators, including the secrecy services some countries offer. The common factor is opacity. International consensus is lacking on the definition of IFFs, as is demonstrated by the ongoing debate on Sustainable Development Goal Target 16.4. But since profit shifting by multinational companies that take advantage of Africa’s wealth constitutes a major financial loss to Africa, a definition based strictly on legality would fail to fully identify wealth that should be retained for Africa’s development.

Figure 1.3. Elements contributing to global illicit financial outflows



Source: Adapted from Baker (2005).

IFFs are sometimes conflated with capital flight, but they differ both conceptually and in policy terms. The defining factor of IFFs is that the resources transferred abroad are hidden and require players at all stages—origin, transit and destination—to make the flows happen. But conventional models of capital flight place the burden solely on developing countries, since the flows are motivated by their unfavourable business environment.

The capital flight approach, generally referred to as “portfolio choice”, follows standard neoclassical models of utility and profit maximization in which capital flight represents portfolio diversification by rational economic agents seeking higher foreign returns on assets than they could get domestically (Blankenburg and Khan, 2012). The prevalent literature on capital flight underscores such domestic risks as unstable macroeconomic policies as the predominant drivers (Collier, Hoeffler and Pattillo, 2004; Kant, 2002). In contrast, the main drivers of IFFs are both domestic and international, and the need to curtail IFFs highlights the need for a better regulatory environment at both levels.

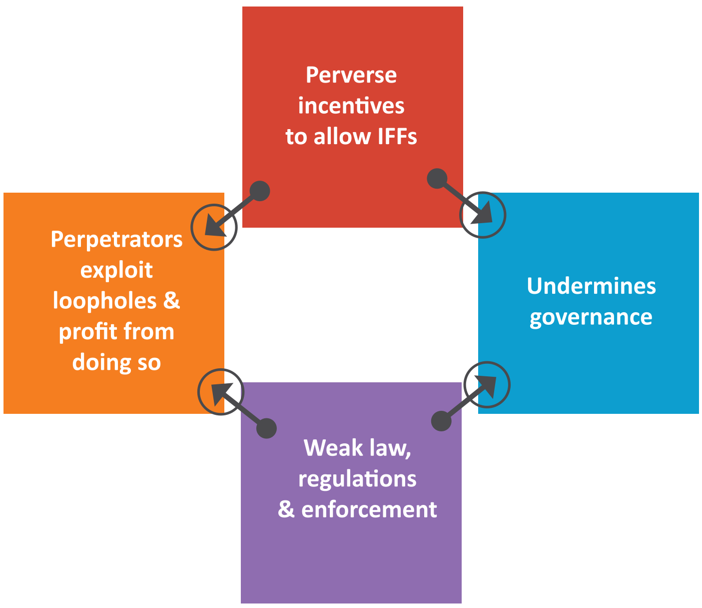
Some studies suggest, for example, that rapid inflation does not seem to induce capital flight from African states (Ndikumana and Boyce, 2008; Lensink, Hermes and Murinde, 1998). Dissatisfaction with the neoliberal approach and its emphasis on macroeconomic instability as the driver of capital flight highlights the need for a more institutional approach to IFFs recognizing the interrelations among macroeconomic stability, governance and institutions. Kar (2011) identifies structural and governance aspects as the leading drivers of IFFs from developing countries, though individual cases may differ.

Structural drivers of IFFs in African countries have received little empirical study. They include rising income inequality, faster (non-inclusive) economic growth and increasing trade openness without adequate regulatory oversight. Non-inclusive economic growth leads to rising income inequality and perhaps to more widespread avoidance of domestic taxes. So, this report regards IFFs as distinct from conventional capital flight.

Institutions and institutional architecture

There is a consensus that the quality of institutions has a major impact on development, including capital outflows (Acemoglu and Johnson, 2005). Institutions directly bear on the management of a country's economy. They influence illicit financial outflows as both enablers and curtailers. On the flip side, IFFs can weaken institutions by undermining the integrity of their rules and processes or by depriving them of resources necessary to invest in effective rules and processes. So, the relationship between IFFs and institutions is bi-directional, and a vicious cycle of weak institutions and IFFs is possible (figure 1.4).

Figure 1.4. The vicious cycle of illicit financial flows and weak institutions



There is far less consensus on what institutions are or are not. The mainstream conception of institutions and their role in development follows North (1991, p. 97) who defines institutions as "the humanly devised constraints that structure political, economic and social interaction. They consist of both informal constraints (sanctions, taboos, customs, traditions, and codes of conduct) and formal rules (constitutions, laws and property rights)." To North, the organization–institution distinction stems from the basic difference between ends and means. While ends define the organization, means include—besides material and technological resources—paradigms and conventions or, in short, institutions.

Source: ECA staff.

The organization–institution demarcation is not clear-cut. As Hodgson (2006, p. 10) highlights, "organizations involve structures or networks, and these cannot function without rules of communication, membership, or sovereignty. The unavoidable existence of rules within organizations means that, even by North's own definition, organizations must be regarded as a type of institution."

The literature on public finance also contrasts market-enhancing governance, emphasizing costs, property rights and other means that enhance the role of markets and downplaying structural rigidities in the economy, with growth-enhancing governance, focusing more on building productive capacities for economic growth and structural transformation (Khan, 2012). The market-enhancing governance approach clearly distinguishes between formal and informal institutions, but in practice the dividing line between them is very thin. Formal rules generally become effective when incorporated in custom and habit since they depend on non-legal rules and inexplicit norms to operate (Hodgson, 2006). The distinction elucidates the institutional architecture that should govern IFFs: formal institutions will only be effective if they are socially embedded.

This report adopts a whole system approach to institutions. It highlights the increasing use by IFF perpetrators of sophisticated and complex financial and commercial arrangements to disguise the money trail. The whole system approach uses the mainstream view of institutions as laws, rules, norms and organizations situated in a political economy with clearly defined actors, interests and an environment that allows for the pursuit of illicit activities. In this application, government organizations such as customs and financial intelligence units (FIUs), as well as other organizations such as firms, will be considered subsets of overall institutions.

Based on the whole system approach, the evidence presented in this report indicates that although African countries have tried to establish institutional frameworks for combatting IFFs in the channels of trade, investments, financial systems and corruption, illicit motivations such as corporate tax dodging and money laundering continue to thrive, aided in some cases by public sector corruption. It suggests the need for more inter-agency collaboration, coordinated reporting and removal of duplicated and competing mandates, as well as consistent political support for institutional reforms to combat IFFs.

Figure 1.5 outlines the key organizational players in combatting IFFs through trade, the financial system, investments and the motivations behind IFFs—tax avoidance and tax evasion, money laundering and the laundering of the proceeds of corruption and illegal wealth.

Figure 1.5. The institutional architecture for illicit financial flows

Legal and regulatory framework, culture and practices			
Roles	**State bodies/agencies**	**Market**	**Civil society**
Implementors	Revenue/tax Trade and investment Ministry of finance Justice	Financial institutions Private equity Stock brokers Companies (international business) Importers/exporters	Trade unions Non-profit companies and trusts
Regulators/ facilitators	Law enforcement Financial intelligence units Central bank Securities Regulation Company registers International rules	Auditing firms Law firms National and international law	Non-profit and trust laws Membership organizations
Oversight	Anti-corruption agencies Anti-money laundering Prosecution agencies	Business and professional associations International compacts	Research and advocacy organizations

Source: ECA staff.

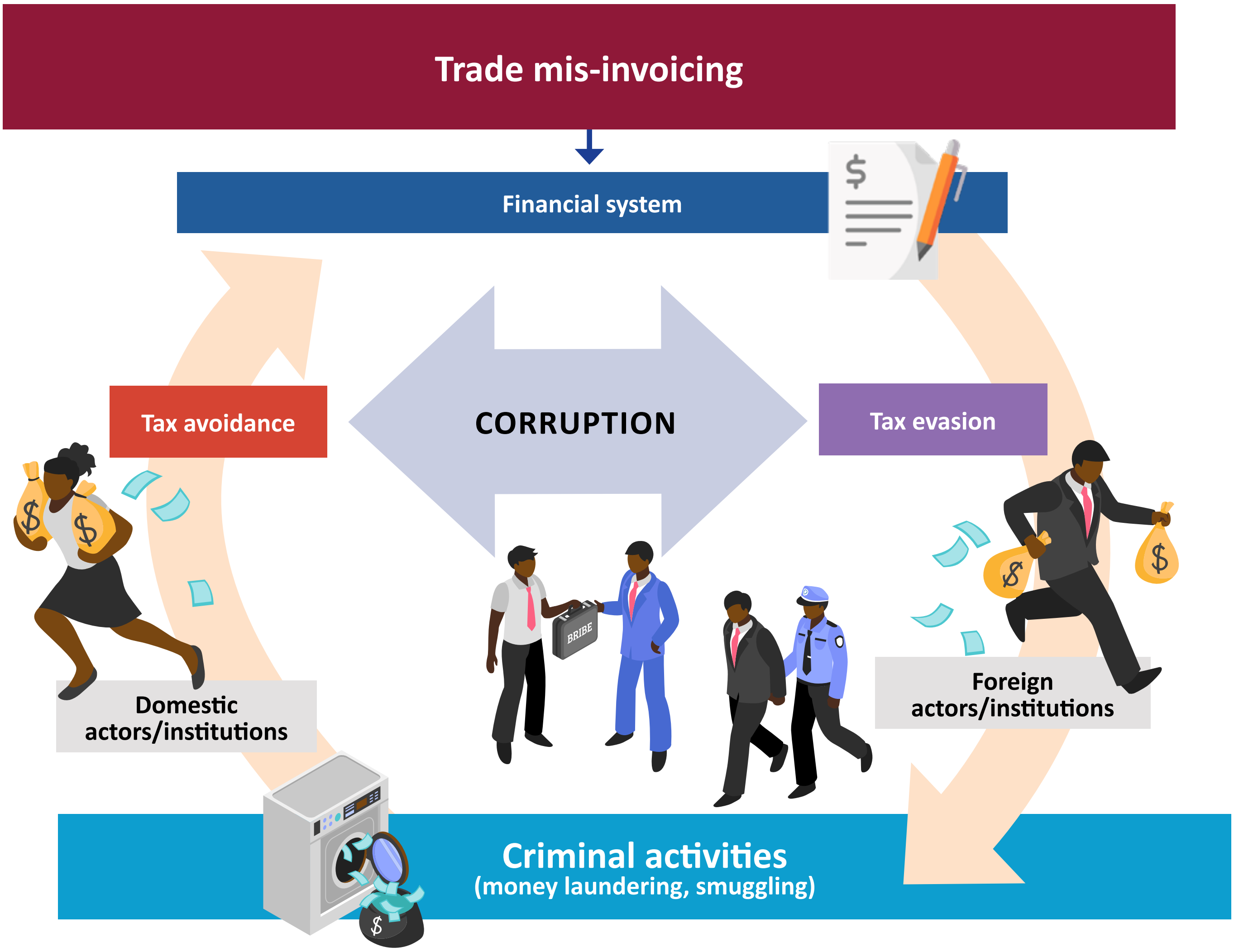
Political economy of illicit financial flows

IFFs arise from decisions and non-decisions by powerful individuals and corporate and public institutions in the context of an established global architecture. The powerful entities include diverse political, corporate, criminal and intellectual leaders and influencers. They affect the character, level, motivations and directions of flow of IFFs from countries, organizations and corporations (ECA, 2018b). They heavily damage income, revenues, societal cohesion and institutional integrity and resilience, among others (AU and ECA, 2015).

Each type of IFF involves a different and complex network of actors—domestic and foreign state institutions, domestic and foreign public officials and foreign financial institutions. The actors, influenced by various factors in moving money abroad, use channels such as poaching, car smuggling, bulk cash smuggling, shell corporations, informal value transfer systems and trade-based money laundering. Policy responses, to effectively address IFFs, should examine the interactions between IFF sources and actors (figure 1.6).

Table 1.1 presents a more detailed framework for the full range of interactions that constitute IFFs—the economic channels in which they occur, the mechanisms of manipulation used and the illicit motivations behind them, as well as the impact on state funds and state effectiveness. The mechanisms used for IFFs substantially overlap, regardless of motivation, in the four main channels of IFFs outflows: trade related, investment related, finance related, and corruption related. The opportunity to hide, where it exists, is likely to be exploited for multiple purposes—so that identifying illicit flows in a particular mechanism will tend to be insufficient to specify the type of IFF in action.

Figure 1.6. Interactions between the sources and actors of illicit financial flows



Source: ECA staff.

Table 1.1. Illicit financial flows: Motivations, manipulations and channels

Economic channel/ dataset	Manipulation	Illicit motivation	IFF type[a]	Impact on state funds	Impact on state effectiveness
Trade (exports)	Over-pricing	Exploit subsidy regime	2	↓	↓
		(Re)patriate undeclared capital	1	↓	↓
	Under-pricing	Shift undeclared (licit) income/profit	2	↓	↓
		Shift criminal proceeds out	4	↓	↓
		Evade capital controls (including on profit repatriation)	1	↓	↓
Trade (imports)	Under-pricing	Evade tariffs	2	↓	↓
		(Re)patriate undeclared capital	1	?	↓
	Over-pricing	Shift undeclared (licit) income/profit	2	↓	↓
		Shift criminal proceeds out	4	?	↓
		Evade capital controls (including on profit repatriation)	1	↓	↓
		Shift undeclared (licit) income/profit	2	↓	↓
Foreign direct investment (inward)	Under-pricing	Shift undeclared (licit) income/profit	2	↓	↓
		Shift criminal proceeds out	4	?	↓
		Evade capital controls (including on profit repatriation)	1	↓	↓
	Over-pricing	(Re)patriate undeclared capital	1	?	↓
	Anonymity	Hide market dominance	1	↓	↓
	Anonymity	Hide political involvement	3	↓	↓
Foreign direct investment (outward)	Under-pricing	Evade capital controls (including on profit repatriation)	1	↓	↓
	Over-pricing	Shift undeclared (licit) income/profit	2	?	↓
		Shift criminal proceeds out	4	↓	↓
	Anonymity	Hide political involvement	3	↓	↓
Portfolio assets (outward)	Anonymity	Tax evasion	2	↓	↓
	Anonymity	Shift criminal proceeds out, financing of terrorism	4	↓	↓
	Anonymity	Paying kickbacks, corruption	3	↓	↓
Portfolio liabilities (inward)	Anonymity	Money laundering	1	↓	↓
	Anonymity	Round tripping	1	↓	↓
	Anonymity	Tax evasion	2	↓	↓
	Anonymity	Shift criminal proceeds out, financing terrorism	4	↓	↓
	Anonymity	Paying kickbacks, corruption	3	↓	↓
Banking liabilities (inward)	Anonymity	Money laundering	1	?	↓
	Anonymity	Round tripping	1	↓	↓

a. IFF types: 1: market/regulatory abuse; 2: tax abuse; 3: abuse of power, including theft of state funds; 4: proceeds of crime.

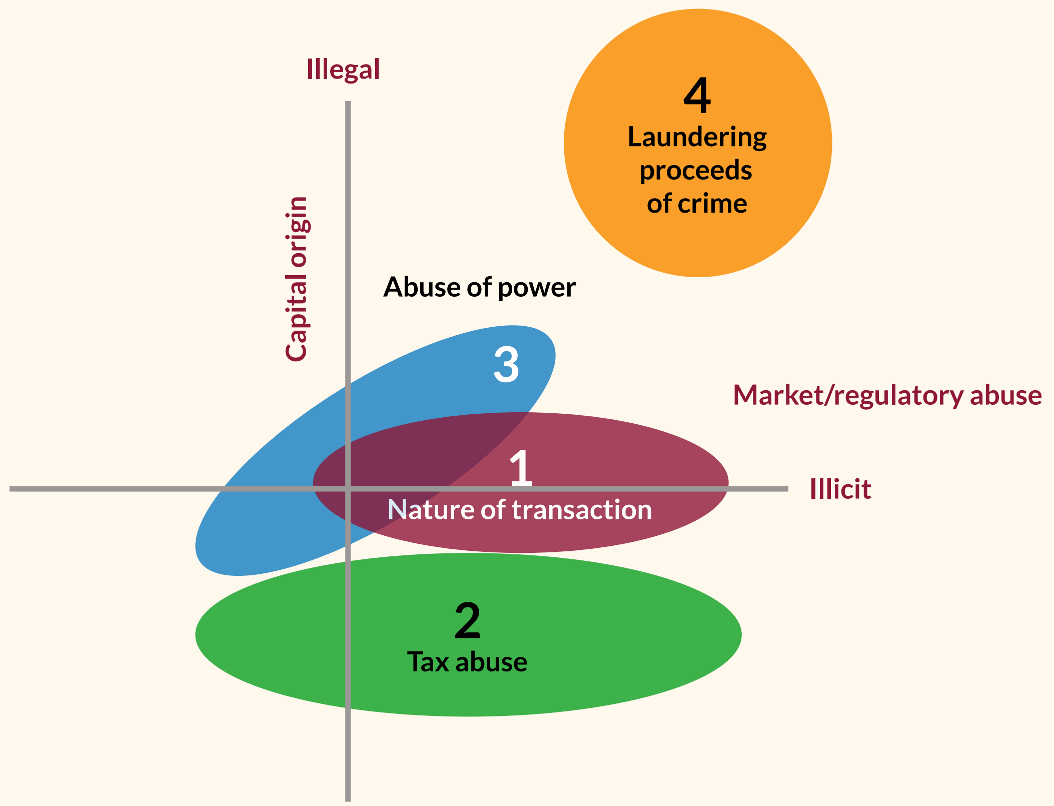
Source: Abugre et al. (2019), based on Cobham (2014).

Clear clusters are captured in the column "IFF Type" in table 1.1, which shows the main illicit motivations: market/regulatory abuse, tax abuse, abuse of power, including the theft of state funds and assets, and proceeds of crime. As the final two columns indicate, all four IFF types are likely to reduce both state funds and institutional strength.

Figure 1.7 provides a broader overview of the transaction types, though it is not exhaustive since any transaction has the potential to engineer an illicit flow, and the range of potential illicit motivations is wide. Even so, the figure illustrates the breadth of IFF phenomena. Note that IFFs can use capital anywhere on a continuum of legality. At one end are criminal proceeds and stolen public funds, and at the other are legitimate income and company profits.

A cross-continuum covers not the capital, but the transactions themselves. At one end are clearly illegal transactions, such as the bribery of public officials by commercial interests; at the other end, transactions that are probably illicit but legal—at least in the sense of not having been challenged successfully in a court. That category would contain, for example, some of the more aggressive transfer pricing behaviours of multinational companies.

Figure 1.7. Illicit financial flow typology



Source: Cobham, 2014.

Historically, international development efforts have paid more attention to illegal capital IFFs (numbers 3 and 4 in figure 1.7) than legal capital IFFs (numbers 1 and 2). So, until recently, policy initiatives have focused on countering corrupt behaviour in lower income countries and in the public sector, not on large corporations and the higher income countries where those companies originate, or on the countries and professional firms and banks that provide tax havens and financial secrecy incentives that are the main drivers of IFFs.

Analytical framework for illicit financial flows in an institutional context

Tracking trade related illicit financial flows

Trade can be a channel of tax dodging, money laundering or corruption-related transfers (table 1.2).

Table 1.2. Tracking illicit financial flows through trade

Relationship of transaction partners	Manipulation	Illicit motivation	Details/scheme for possible illicit activities (non-exhaustive)
Independent party trade, related party trade, intra group trade	**Pricing, quantity, quality of traded goods in customs declaration forms**	Tax	Manipulations of price, quantity, quality can take the form of re-invoicing (routing trade on paper through third jurisdictions, resulting in two different invoices for one trade transaction), same invoice mis-pricing, fake transactions (an extreme case of no trade taking place), and transfer mis-pricing (or abusive transfer pricing; intra-group trade)
		Money laundering	Trade-based money laundering schemes
		Corruption	Corruption by or of (multinational) companies by mis-pricing trade, staff of companies creating and controlling slush funds for bribery or conspicuous consumption (embezzlement)
Independent party trade, related party trade, intra group trade	**Bribing or putting pressure on custom officials.**	Corruption, money laundering	Bribery of custom officials or extortion, for instance through drone surveillance in port areas by criminals to identify customs officials opening containers with illegal goods

Source: Abugre et al. (2019).

Table 1.3 maps trade-related manipulation—mis-invoicing of exports and imports. The second column of the table shows that to identify a country's imports or exports that might have been mis-invoiced, a value gap analysis examines a country's trade with its partners to find four major types of trade mis-invoicing: import over-invoicing, export under-invoicing, import under-invoicing and export over-invoicing (GFI, 2019).

Table 1.3. Main types and common purposes of trade mis-invoicing

IFF outflows	Import over-invoicing	• To shift money abroad (evade capital controls, shift wealth into a hard currency, and so on) • To reduce income tax liability, overstate the cost of imported inputs • To avoid anti-dumping duties
	Export under-invoicing	• To shift money abroad (evade capital controls, shift wealth into a hard currency, and so on) • To evade income taxes (lowering taxable income levels) • To evade export taxes
IFF inflows	Import under-invoicing	• To evade customs duties or VAT taxes • To avoid regulatory requirements for imports over a certain value
	Export over-invoicing	• To exploit subsidies for exports • To exploit drawbacks (rebates) on exports

Trade mis-invoicing includes two ways of illicitly sending funds into a country (IFF inflows) and two ways of illicitly sending funds out of a country (IFF outflows). In the case of both inflows and outflows, either way could be used—manipulating the stated prices for goods on invoices of either imports or exports. Several methods estimate the scale of losses from trade mis-invoicing, including the Price Filter Method (Pak, 2006) and the Country Partner Method (CPM) using the value gap (see chapter 3).

Exposure of the banking sector to illicit financial flows

In the absence of adequate and efficient financial regulatory infrastructure, financial institutions and markets may facilitate IFFs purposefully or inadvertently (see chapter 4 on the financial systems as a channel of IFFs). IFFs provide pecuniary benefits and protection from prosecution to the perpetrators while providing returns to the financial intermediaries, so the operation incentivizes both parties. The functions of financial institutions, inadequacies in regulation and financial innovations produce features in the financial system that make it susceptible to facilitating IFFs. The US Senate's Permanent Subcommittee on Investigations has provided a good survey of these features (table 1.4).

Table 1.4. Examples of banking features used for illicit transfer of funds

Features	How they can facilitate illicit activity
Multiple accounts Banker opens multiple accounts in multiple names in multiple jurisdictions for clients	Impede monitoring and tracing client activity and assets and allow quick, confidential movement of funds. May hide or facilitate illicit activity
Offshore accounts Shell corporations or trusts are formed to hold client assets offshore. Banker opens accounts in name of offshore entities	Impede monitoring and tracing client activity and assets. May hide or facilitate illicit activity
Special name or numbered accounts Banker opens an account in code name	Impede monitoring and tracing client activity and assets. May hide or facilitate illicit activity
Wire transfers Banker facilitates complex wire transfers from multiple accounts to multiple destinations with substantial amounts	Allow quick, complex movement of substantial funds across jurisdictional lines
Concentration accounts Banker conducts client business through one single account that facilitates the processing and settlement of multiple individual customers' transactions. The account that mixes the funds is used for the internal purposes of the bank, but it can also be a method of hiding the origin of funds	Impede monitoring and tracing of client activity and assets. May hide or facilitate illicit activity
Offshore recordkeeping Bank maintains client records offshore and minimizes or eliminates information in the country of residence	Impedes bank, regulatory and law enforcement oversight
Secrecy jurisdictions Bank conducts business in a jurisdiction that criminalizes the disclosure of bank information and bars bank regulators from some other countries	Impede bank, regulatory and law enforcement oversight

Source: Heggstad and Fjeldstad, 2010.

For African economies, the features that deserve close examination are multiple accounts, offshore accounts, concentration accounts, and offshore recording and secrecy (see chapter 4 for detailed discussion). **Multiple accounts** enable operators to dissociate funds from the beneficial owners and break or blur the link between the source of the funds (or predicate activity) and the funds themselves as domiciled in the banking institutions. The more open the capital account, the higher the risk. The holding of **offshore accounts** makes it possible to disguise the identity of beneficial owners of assets and transactions that may be associated with funds that were acquired or transferred illegally. **Concentration accounts**, operated by financial institutions to settle multiple individual customer transactions, expand the scope of the settlement system, facilitating trade and financial transactions, but can be abused to disguise illicit transactions. **Offshore record-keeping and secrecy** in financial systems facilitate money laundering.

Risks associated with IFFs through the banking system can be monitored, barring data limitations, through measuring the vulnerability and exposure of a country's banking liabilities and claims to financial secrecy with respect to partner country relationships (Abugre et al., 2019). Similar risk monitoring is possible for portfolio capital flows and foreign direct investments.

Corruption-related illicit financial flows

This report challenges as too narrow the traditional notion of corruption as the abuse of public office for private gain. That definition over-emphasizes public office and the ostensible legality of the act, neglecting corrupt tendencies prevalent in the private and non-state sectors and the international dimension of corruption (ECA, 2016).

The traditional definition of corruption focuses on bureaucratic or administrative corruption, which occurs when public officials misuse their authority for private gain. The definition overlooks private sector actors in IFFs and the supply side of corruption, an important element of ECA's programme on policy, research and advocacy (ECA, 2013; ECA et al., 2012). IFFs often result from the deliberate intentions and actions of private operators willing to evade the monitoring and regulation of their wealth and to take advantage of the opacity of financial systems abroad.

The strict classification of IFF components also takes a narrow operational view of corruption and IFFs. To the extent that these flows are illicit or illegal, they are facilitated, if not driven, by corruption. So, disentangling corruption from other sources of funds, such as tax evasion and criminal activities, is difficult. For example, exporters and importers manipulate invoices to channel money abroad or launder money by paying off regulators and inspectors. As Chaikin and Sharman (2009, p. 27) note, "corruption and money laundering are symbiotic: not only do they tend to co-occur, but more importantly the presence of one tends to create and reciprocally reinforce the incidence of the other." In addition, corruption facilitates transfer pricing, since multinational corporations (MNCs) can buy off the relevant national authorities or even lobby for low taxes, lax regulations and weak oversight.

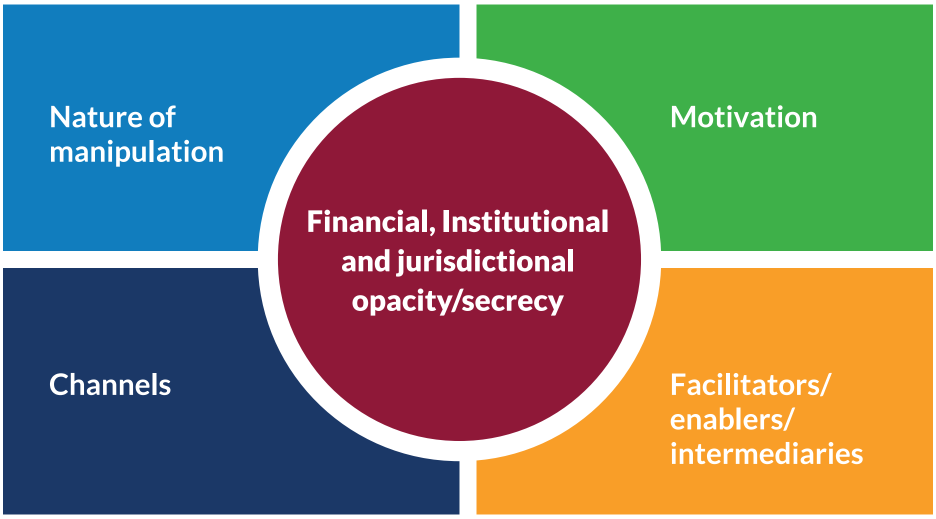
Those factors make it difficult to gauge the contribution of corruption to IFFs. This difficulty contributes substantially to the risk of minimizing corruption as an enabler of IFFs. Due to the challenges in tracking corruption and the lack of credible official data, most empirical studies have relied primarily on perceived corruption (ECA, 2016).

In this report, corruption is defined as the abuse of authority and the undermining of rules, systems and institutions that promote the public interest for the purpose of illicit acquisition, concealment and movement of wealth in the interest of oneself, kin or corporate legal personality or other overriding special interests. The broader definition highlights the full range of corrupt acts that undermine the integrity of institutions and the public good and of motivations driven not so much by accumulation as by concealment.

As in trade-related IFFs or in using the banking sector as IFF channel, opacity and secrecy underlie all corruption, whether state driven, or private-sector driven (figure 1.8). Note that institutional actors may use corrupt acts to acquire wealth illegally and illegitimately, or to conceal and transfer such wealth abroad.

With technological advancement and financial globalization, corruption takes new and more frightening forms. Instant wire transfers remove the constraints of weight and distance, while a network of shell companies (trusts and foundations) with an army of willing lawyers and accountants conceal the beneficial owners of companies and financial accounts. Secrecy jurisdictions, which also tend to be tax havens, provide perfect hiding places for illicit criminal and non-criminal wealth and drive global tax competition, while wealthy countries with plush real estate, yachts and other conspicuous consumption opportunities provide other ways to spend IFFs.

Figure 1.8. Corruption–illicit financial flows interactions



Source: ECA staff.

This architecture allows locally intractable grand corruption, including kleptocracy, to be unleashed globally, making a transnational network of corruption. It also facilitates tax-avoidance and tax evasion, provides havens for the proceeds of organized crime (for which anti–money laundering measures are needed) and facilitates capital flight and "pirate banking." Pirate banking is the practice of hiding and managing offshore assets for the world's elite (Henry, 2012). To tackle corruption in the context of IFFs requires substituting transparency for secrecy. See chapter 5 for discussion of the institutional architecture to fight corruption.

Financial secrecy, the driver of corruption and illicit financial flows

IFFs are hidden, resulting from opaque transactions from origin to destination, occurring in all economic channels—trade, finance (including investments) and government procurement (including public sector corruption).

Indicators of financial secrecy are classified into four groups: ownership registration, legal entity transparency, integrity of tax and financial regulation and compliance with international standards and regulations (table 1.5). The indicators measure the ability to hide transactions from the public and from regulators, including but not only tax authorities, and suggest the areas that need to be addressed to curtail IFFs. They can be used for institutional assessments of countries' transparency in comparison with other countries' (Cobham, Janský and Meinzer, 2015). Assessed on this basis, countries fall onto a secrecy continuum rather than into a binary division of havens and non-havens.

Table 1.5. Financial secrecy indicators

Ownership registration	Legal entity transparency	Integrity of tax and financial regulation	International standards and regulations
Banking secrecy	Public company ownership	Tax administration capacity	Anti–money laundering
Trusts and foundations register	Public company accounts	Consistent personal income tax	Automatic information exchange
Recorded company ownership	Country-by-country reporting	Avoids promoting tax evasion	Bilateral treaties
Other wealth ownership	Corporate tax disclosure	Tax court secrecy	International legal cooperation
Limited partnership transparency	Legal entity identifier	Harmful structures	
		Public statistics	

Source: www.taxjustice.net.

The Financial Secrecy Index (FSI) generated from these indicators can help against IFFs in many ways[4]. First, by spotlighting the providers of secrecy services it should help direct the fight against the facilitators of IFFs. Second, the indicators can guide the scope of legal and regulatory measures to block IFFs, including corruption-related IFFs.

The FSI shows that the main providers of secrecy services are mainly outside Africa. Of 133 countries ranked (17 in Africa), only 5 in Africa are among the 50 most secretive: Algeria (23), Kenya (24), Nigeria (34), Angola (35) and Egypt (46) (TJN, 2020a). Liberia, though ranked 111, serves as America's outpost of financial secrecy, having totally outsourced its corporate and shipping registries to the United States. Liberia thus permits the establishment of some of the most powerful secrecy instruments in the world, as is reflected in its secrecy score of 80 (TJN, 2020b).

The Corporate Tax Haven Index (CTHI) complements the FSI[5]. It focuses on how secrecy affects corporate taxation by measuring how intensely a jurisdiction abuses its autonomy over corporate income tax (CIT) rules to enable and incite tax spillovers. The spillovers reduce other jurisdictions' autonomy in rule setting and deciding its tax mix. And the CTHI measures how "successful" a jurisdiction is in pursuing this corporate tax haven strategy[6]. The index ranks countries according to tax loopholes and gaps, the nature of corporate transparency, tax avoidance practices and double taxation treaties.

Of the 8 African countries rated by the index[7], Mauritius ranks on corporate tax policies as the most corrosive in Africa and 14 of 64 countries in the world. Mauritius offers one of the lowest corporate tax rates for foreign direct investment, the lowest capital gains tax rate and a range of sectoral tax exemptions. It provides total secrecy in the areas of public company accounts, country-by-country reporting, reporting on tax avoidance and court secrecy, among others. Mauritius is followed by South Africa (42), Seychelles (44), Liberia (54), Kenya (58), Ghana (60), United Republic of Tanzania (62) and Gambia (63). So, although African countries are relatively minor players in providing secrecy to serve corporate interests, they need considerable internal reforms to contribute to curtailing tax avoidance.

...although African countries are relatively minor players in providing secrecy to serve corporate interests, they need considerable internal reforms to contribute to curtailing tax avoidance.

4 https://www.financialsecrecyindex.com/en/.
5 A corporate tax haven is a jurisdiction that seeks to attract multinational companies by offering facilities that enable them to escape or undermine the tax laws, rules and regulations of other jurisdictions, reducing their tax payments in those jurisdictions. The tax payment reduction results from tax base spillovers (shifting profits for tax avoidance) or strategic spillovers (races to the bottom in which jurisdictions competitively lower their tax rates or tax base in response to each other).
6 https://www.corporatetaxhavenindex.org/PDF/CTHI-Methodology.pdf.
7 The countries are: Botswana, Gambia, Ghana, Kenya, Mauritius, Seychelles, South Africa and United Republic of Tanzania.

Curbing tax avoidance and illicit financial flows in a single integrated global process

The inability of United States and other member states at the 2015 Addis Ababa Conference on Financing for Development to agree on a global body to deal with tax and IFFs has led to parallel global processes: one on base erosion and profit shifting (BEPS) led by the OECD, and one on IFFs as part of implementing the Sustainable Development Goals. This report argues BEPS and other IFFs should be addressed together because of the following:

- The definition of illicit—not sanctioned by law, rule, or custom—is broader than the simply illegal. And such illicit practices are harmful, depriving countries of important tax revenues. Cobham and Jánsky (2018) estimated global revenue losses due to international tax avoidance strategies at $500 billion a year.
- BEPS often go against the spirit of the law. For example, they may abuse exemptions in double taxation treaties that did not anticipate current business structures, or abuse intra-multinational-group transfers to shift profits from a tax jurisdiction where the "true" profits were. Where tax practices are harmful or undermine the spirit of the law, they should be considered wrong and therefore illicit (ECA, 2018b).
- A thin line often divides tax evasion and tax avoidance, and trying to distinguish them in advance when planning interventions can be fraught with difficulty. A practical or methodological argument also supports including legal tax avoidance under illicit financial flows for the purposes of measurement. It is often difficult, particularly in common law systems, for an analyst to tell whether particular tax avoidance schemes are legal or not. But techniques for quantifying multinational profit shifting, including through abusive transfer pricing and thin capitalization, look at the amount of profits shifted, not whether the schemes used were legal or not. There is a consensus that illegal tax-related IFFs (such as unlawful profit shifting techniques that will be struck down in court) should be part of IFFs. But if they should be included, so should legal profit shifting, since the data and estimation techniques do not permit separating the two.
- Finally, treating BEPS separately from other IFFs perpetuates the view that BEPS are not illicit and so reduces the political pressure on those responsible for them. It is important to call BEPS illicit so those responsible for the flows receive the censure they deserve, given the harm that the flows cause, and so that appropriate political pressure leads to changes to stop the flows associated with BEPS.

There are important practical reasons to consider abusive tax practices as part of IFFs. First, political momentum, funds and initiatives to achieve the SDGs should be leveraged to tackle aggressive tax avoidance, like other aspects of IFFs. Second, there are synergies in addressing BEPS and other IFFs together, since they face common areas of action, such as improved customs administration and tax policy administration. So, efforts to curtail BEPS and other IFFs could benefit from economies of scope if coordinated through a single process. Currently there is no global coordinating mechanism, though for Africa the Consortium to Stem Illicit Financial Flows from Africa is trying to coordinate efforts among nongovernmental organizations and international organizations to tackle BEPS and IFFs.

Structure of the report

Each chapter of the **Economic Governance Report** investigates the institutional architecture needed to address IFFs and highlights the institutional factors supporting the IFFs in Africa.

Chapter 2 examines the anatomy of tax avoidance and tax evasion. It describes progress in addressing them and highlights underlying weaknesses to be addressed in a comprehensive institutional framework for addressing IFFs. The discussion raises current international ideas to stem tax avoidance such as unitary taxation and Africa's institutional readiness for them.

Chapter 3 investigates trade mis-invoicing and addresses the institutional mechanisms for trade-based IFFs. Using the five case study countries, the chapter analyses the policy, regulatory and institutional frameworks and the mechanisms countries have put in place to address trade mis-invoicing. Subregional and continental efforts, including those within the context of the African Continental Free Trade Agreement, are also examined.

Chapter 4 examines vulnerabilities to IFFs and money laundering. It focuses on the key mechanisms, actors and enablers; describes the main features of the institutional structures designed to combat IFFs and money laundering, drawing on global and regional frameworks; and assesses these structures and the challenges African countries face as illustrated by the five country case studies.

Chapter 5 assesses corruption and the extent to which the measures and institutional architecture established by African governments to fight it are adequate to tackle IFFs. It covers the actions, actors, motivations and machinations involved in the internationalization of corruption. The chapter adopts a broad conception of corruption and corrupt acts to capture the full range of motivations and mechanisms associated with cross-border flows of illicit wealth and their impact on society.

Chapter 6 summarizes the arguments, findings and recommendations required to strengthen the institutional architecture in Africa for addressing IFFs.

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TAX

CHAPTER 2:

Tax avoidance and tax evasion by multinational enterprises

Key messages

- Recent reforms of the international tax systems have not produced the intended benefits for developing countries, particularly in Africa, where countries' capacity to effectively implement the reforms was inadequate.
- The transfer pricing system for assessing the value of intra-company transfers for taxation has failed due to obstacles inherent in the arm's length principle, such as the absence of comparables for setting transfer prices and tax administrations' lack of access to comprehensive multinational enterprise subsidiary records.
- African countries, to effectively curb tax-motivated illicit finance flows, need to remedy their capacity weaknesses in: human capacity; knowledge of the international tax system and its taxonomy; drivers and channels of tax-motivated illicit financial flows; the infrastructure required, including digitalization; updated legislation addressing emerging loopholes and international collaboration; and the political will to oppose powerful multinational enterprise lobby groups.
- Simplified taxation of multinational enterprises through, for instance, unitary taxation would expunge the need for burdensome information gathering and verification and for the expensive tax expert auditors and lawyers employed by both multinational enterprises and tax administrations. More tax revenues for developing countries and more profits for multinational enterprises would result.

Tax-motivated illicit financial flows (IFFs) by multinational enterprises (MNEs) are perpetuated through tax avoidance and tax evasion practices in which value created in one country is not presented for taxation there, but illicitly transferred by the MNE to another tax jurisdiction where the value faces a much lower tax rate or even no tax.

This chapter assesses the institutional architecture in African countries that MNEs use to create IFFs motivated by tax avoidance and tax evasion. Chapter 3 will treat trade mis-invoicing under transboundary trade-based IFFs, even though that also falls under the subject of chapter 2, tax-motivated IFFs (mis-invoicing is a form of customs or tax fraud in which exporters and importers deliberately misreport the value, quantity or nature of goods or services in a commercial transaction).

This chapter will explore the taxonomy of tax-motivated IFFs and current regional and international institutional arrangements for addressing MNEs' non-trade tax motivated IFFs. It will assess the performance of those institutional arrangements. And the chapter will identify gaps in effectively curbing IFFs and present conclusions and policy recommendations.

Taxonomy of tax-motivated illicit financial flows in Africa

Tax avoidance by MNEs refers to activities that run counter to the purpose and spirit of tax law or code—though they may be legal—to reduce their tax liabilities. Tax avoidance exploits the structure of the tax system and its ambiguities and loopholes. Such practices can be prevented through statutory anti-avoidance rules, but where such rules do not exist or are ineffective, the practices can be a major component of IFFs.

Tax evasion by MNEs is the illegal practice not paying due taxes or minimizing tax liability by VAT (value-added tax) fraud; bribing tax officials; misrepresenting the amount or source of income; not declaring financial assets in offshore accounts; deliberately overstating tax credits, deductions and exemptions or concealing taxable income, taxable activities, profits liable to taxation and so on.

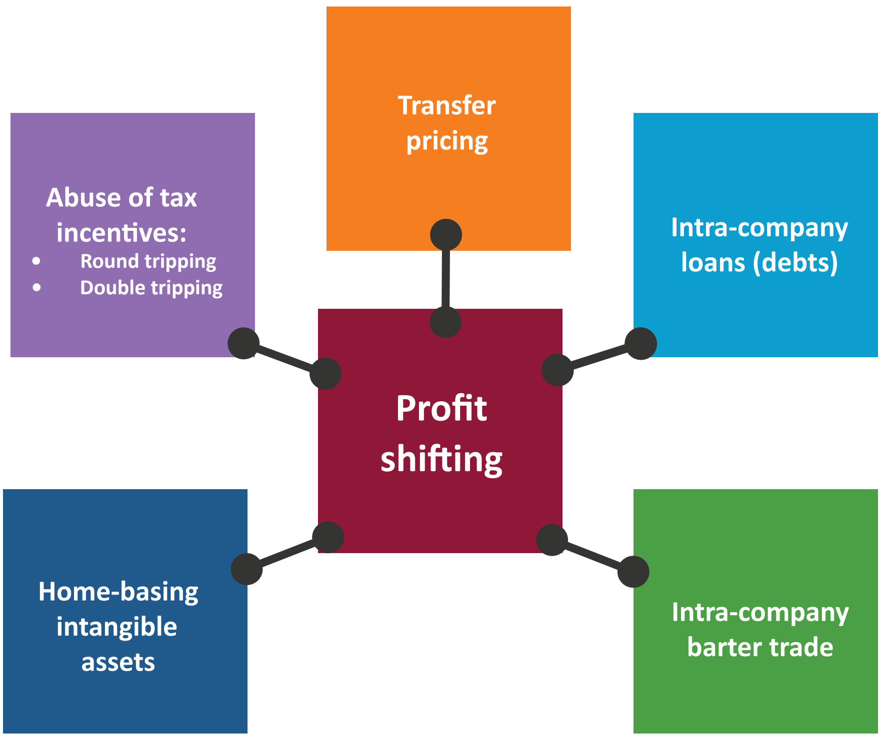
The anatomy of tax avoidance

Tax avoidance is commonly perpetrated through base erosion and profit shifting (BEPS), which legally exploit loopholes in the tax code's allowance for discretion on the formation of the tax base or the level of taxable income or mis-exploits tax incentives granted to attract investment in priority sectors. BEPS refers to "tax planning strategies that exploit gaps and mismatches in tax rules to make profits "disappear" for tax purposes or to shift profits from jurisdictions where they are made to locations where there is little or no real activity but the tax rates are low, resulting in little or no overall corporate tax being paid" (OECD, 2013). They erode the tax base by shifting value created in one jurisdiction to others, depriving the creating jurisdiction from taxing that value or from having the economic liquidity of that value available to support development.

MNEs minimize or eliminate tax liabilities by shifting profits from the jurisdictions where the profits are made to jurisdictions where they will face lower tax rates or no taxes at all. Underpinning this system is tax authorities' treatment of the MNE subsidiaries as separate entities to avoid taxing them in the country where they operate and reside. The purpose is to avoid double taxation, so that the MNE profits are taxed only once—in the country where the subsidiary resides. But MNEs use that same principle to minimize their overall tax burden through tax planning that shifts the profits of the MNE subsidiary from one tax jurisdiction to another subsidiary in a lower tax or no-tax jurisdiction. The profits are shifted through mechanisms manipulating transfer prices—the prices of goods and services traded within the group. The mechanisms exploit intra-group loans and deliberately choose the beneficial allocation of profitable tangible or intangible assets to avoid taxes on the profits made in one jurisdiction by illicitly moving the profits across borders to jurisdictions of lower or no tax—hence illicit financial flows (figure 2.1).

Transfer prices are intra-group prices for (cross-border or cross-jurisdictional) transactions of goods, services, tangible or intangible assets and financial assets traded between affiliated companies. They constitute a necessary and legitimate tool for a corporate group with intra-group transactions to assigning profits correctly to the relevant affiliate. That practice allows the group to identify profitable subsidiaries and to avoid double taxation. But MNEs can distort transfer prices to reduce the group's overall tax burden by manipulating the allocation of profits in particular high and low tax jurisdictions. In an effort to purge this practice, an international tax system reform recommended the use of the arm's length principle, by which MNE subsidiaries transact with each other as if they were transacting with non-related enterprises (OECD, 2001).

Figure 2.1. Anatomy of tax avoidance



But limitations and difficulties in applying the arm's length principle make transfer pricing particularly prone to abuse for illegal tax avoidance and tax evasion purposes, for example through fake transactions or artificially under- and over-billing in intra-group cross-border sales. The possibility of manipulating transfer prices arises because there are usually no commonly observable market prices (comparables)—normally seen in market transactions among independent economic agents—to which the intra-group prices the group uses could be compared. The nature of intra-group transactions offers an MNE considerable discretion in setting transfer prices, violating the arm's length principle. The MNE sets higher transfer prices for products and services transferred as inputs to subsidiaries in high tax countries, overstating input costs and artificially minimizing taxable profits. It sets low transfer prices for transactions in low tax countries, illicitly moving taxable value (resources or profits) generated in high tax jurisdictions to low tax jurisdictions.

Profit shifting can similarly be achieved through barter, when goods and services are directly bartered between subsidiaries of an MNE, instead of being sold and bought in the market. The parties in the exchange are interested in receiving subjective fair value in return for their barter goods and services, with prices only fixed for purposes of taxation. But eagerness to reduce an MNE's tax liabilities related to sales (VAT, excise duties and so on) can lead subsidiaries to artificially alter the book value of goods and services bartered in the transaction, thereby illicitly transferring value from subsidiaries based in high tax jurisdictions to those in low tax jurisdictions.

Another mechanism for profit shifting is the use of intra-company loans or other instruments of intra-company financing, thereby increasing an MNE subsidiary's debt, leading to its thin capitalization. A business is said to be thinly capitalized when its level of debt is much greater than its equity capital, meaning that the company is mostly funded by debt (or "over-geared"), has a high potential to be paying excessive interest and poses an insolvency risk to creditors. The tax deductibility of interest paid on loans offers the MNE an incentive to make intra-company loans to subsidiaries in high tax countries, thereby substantially lowering their tax obligations. Not paying tax on the interest illicitly shifts that value from that tax jurisdiction to the other MNE affiliate in a lower tax or no-tax jurisdiction. Seen through a country's domestic resource mobilization (DRM) perspective, the borrowing subsidiary's higher interest payments on the debt result in tax avoidance.

Yet another mechanism of profit shifting for MNEs lies in choosing where to locate assets to optimize their overall tax liability within the legal framework. The MNE would assign intangible assets such as patents, trademarks and copyrights that generate substantial profits from licence payments to subsidiaries in low tax countries. The MNE would locate cost-intensive units, such as research and development (R&D) or central services, in high tax countries to reduce taxable profits and thus illicitly transfer the taxable value of profits from the high tax to the low tax jurisdiction.

The pressure to attract investment in African and developing countries leads many to offer tax incentives to foreign investors. Countries thereby reduce their fiscal space by forgoing tax revenue.

Often, tax incentives/expenditures/exemptions or subsidies are used by African governments to pursue a specific economic, social or political goal. They constitute intentional exceptions from the general rules guiding the tax code to promote certain activities by lowering tax rates, postponing tax liabilities, exempting activities from taxation or offering some other kind of favourable tax treatment (ECA, 2019; Fuest and Riedel, 2009).

But not all tax exemptions are implemented for some legitimate societal goal. Under certain circumstances, nepotism, corruption, and opaqueness have used exemptions to put an official stamp on tax evasion (European Parliament, 2015). In these cases, individuals, firms or groups receive favourable tax treatment, often due to lobbying. Although this treatment is formally legal, it is illegitimate and causes major harm to governance.

In African countries, tax incentives to attract foreign direct investment (FDI) often result from lobbying by MNEs that possess high bargaining power with government officials. Increased global competition for mobile capital has led to a race to the bottom as countries outdo each other in offering tax incentives (see TJN-A and ActionAid International, 2012).

The incentives for foreign investment have spawned illegal tax evasion. For instance, it has been reported that in China and Mauritius domestic company investments have been relabelled as FDI ("round-tripping"—box 2.1; Aykut, Sanghi and Kosmidou, 2017; Zebregs and Tseng, 2002). Or older businesses may be sold to subsidiaries disguised as new investors to become eligible for tax holidays exclusively granted to new investors ("double dipping").

Box 2.1. Foreign direct investment round-tripping in India and Mauritius

Low tax jurisdictions present opportunities for round-tripping to savvy entrepreneurs. From 2000 through 2014, two small countries—Mauritius and Singapore—accounted for half of India's FDI inflows (Aykut, Sanghi and Kosmidou, 2017). Although not all flows from Mauritius constituted round-tripped Indian capital, about 10 per cent of FDI inflows to India were attributed to round-tripping through Mauritius (Rao and Dhar, 2011). Indian companies used the strategy for tax evasion and, in some cases, money laundering.

This situation was facilitated by the 1983 Double Taxation Avoidance Agreement (DTAA) between India and Mauritius, which gave only Mauritius the right to tax capital gains arising from sales of shares of an Indian company by a resident of Mauritius. But Mauritius does not tax capital gains, so Indian companies based in Mauritius fully avoided taxation in both jurisdictions. For many years, the small island was the top country of origin for FDI in India.

The Indian Finance Ministry estimated Indian tax revenue lost due to round-tripping of FDI to India at about $600 million a year (Taylor, 2014). In 2016, India and Mauritius signed an amendment to the DTAA (effective 1 April 2017), hoping to curb tax evasion and the accompanying welfare loss. Critics pointed out that changing the preferential investment policies or placing too high a burden of proof identifying the ultimate investment beneficiary would divert legitimate investments from India. The amendment proved ineffective, since India had granted exclusive taxing rights for capital gains to several other countries—Cyprus, Mauritius and Singapore (see the 2005 CECA). The mere announcement that the amendment had been signed with Mauritius led to a diversion of Indian companies from Mauritius to Singapore (Shreesh, 2016).

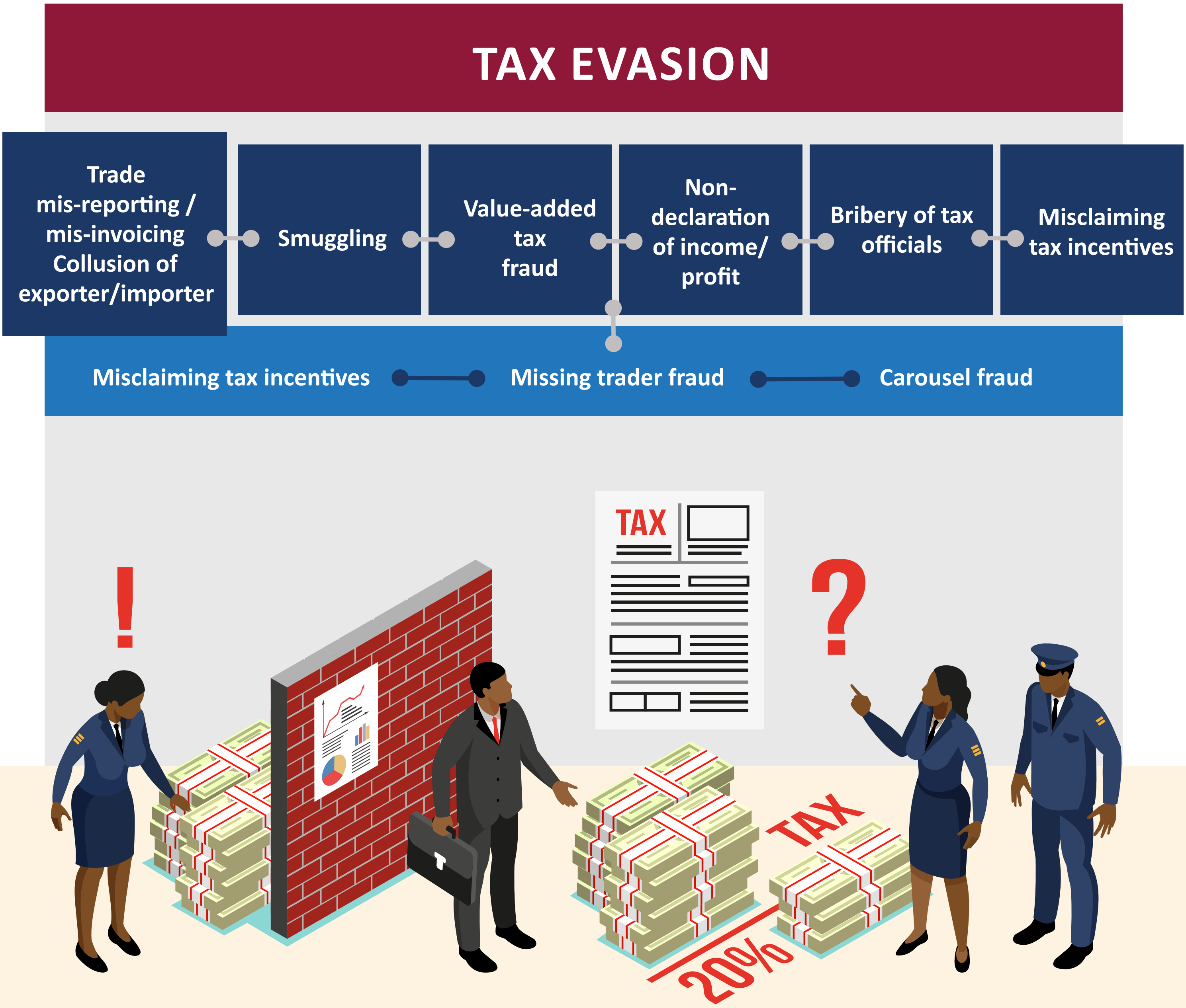
Source: Adapted from Aykut, Sanghi and Kosmidou (2017).

Simplifying the tax code is a natural way to reduce tax avoidance opportunities. Simplification should reduce the number of special tax treatments. Since special tax treatment most often takes the form of tax preferences—investment incentives, tax deductions, credits, and exclusions from income—the corresponding expansion of the tax base allows reducing rates and may have a beneficial side-effect for the treasury of further reducing incentives to avoid taxes.

Tax evasion

Tax evasion includes several misdeeds that violate national tax laws to evade tax obligations, including trade misreporting and mis-invoicing, VAT fraud, bribing tax officials, falsely claiming eligibility for tax incentives, and non-declaration of personal income or corporate profits to circumvent direct income taxation or tax obligations resulting from sales of goods and services (figure 2.2). In Africa these practices lead to the illicit transfer of financial resources from/to external jurisdictions.

Figure 2.2. Anatomy of tax evasion



Source: ECA staff.

Under trade misreporting (to be covered in chapter 3), invoices are faked between colluding exporters and importers, leading to illegal money transfer from an African country to the financial accounts of companies or of oneself abroad, usually to evade taxes (GFI, 2010). In Africa, countries such as Côte d'Ivoire and Nigeria fell prey to substantial illegal capital outflows based on deliberate over-invoicing of imports or under-invoicing of exports (TJN, 2006).

ECA underscored the size of the VAT gap afflicting African countries and the potential for stepping up tax revenue collection through efficient VAT collection systems, which would require plugging policy gaps and remedying compliance deficiencies (ECA, 2019). Fraudulent exploitation of the VAT system appears in various domestic and cross-border forms. The forms all rely on the principle that all registered businesses are expected to be able to credit VAT expenses from purchasing input goods against VAT due on their sales. In the simplest case, missing trader fraud under-reports sales by falsifying records and accounts, allowing the fraudster to collect taxes without remitting them to the tax authority. Or conversely, overstating purchases and forging invoices to increase VAT refunds are especially applied by new businesses where corresponding levels of sales are not expected immediately (Keen and Smith, 2007).

Internationally, carousel fraud takes advantage of the zero-rating of exports between multi-country trade operations, exploiting the cross-border nature of transactions in different tax authorities. It entails the collection of VAT payments without remitting them to the corresponding tax authority (missing trader fraud), and often the illegitimate claim of tax refunds for the goods that were exported (Reuters, 2009).

The misclassification of commodities normally subject to different VAT rates to reduce tax liabilities or increase tax refund claims is another avenue of tax evasion. So is smuggling goods across borders, which evades VAT liabilities, along with other indirect taxes such as customs and excise duties, creating revenue losses for the treasury that are then illicitly transferred out of the country. Moreover, bribery by non-compliant economic agents to facilitate other tax evasion mechanisms is facilitated by African countries' inefficient tax administration and enforcement.

Finally, economic agents, particularly multinational enterprises, engage in non-declaration of personal income or corporate profits to circumvent direct income taxation or tax obligations resulting from sales of goods and services. These agents often hold incomes in offshore financial accounts to conceal taxable income from tax authorities in their country of residence, exploiting bank secrecy and poor financial regulation abroad and benefitting from low or no taxes abroad.

These modes of tax evasion are not mutually exclusive. They can be concurrent, and some can follow from others. For instance, illicit financial flows directed to offshore accounts may have resulted from criminal activities such as smuggling goods, fraudulent manipulation of VAT records or even bribery.

African countries therefore face a daunting task to reign in tax avoidance and tax evasion. Such efforts may entail building tax administration capacity or establishing special units or institutions with clear mandates to combat these phenomena.

Box 2.2. Tanzania's tussle with asset recovery

For asset recovery, Tanzania's Prevention and Combating of Corruption Bureau has a memorandum of understanding with the ministry of finance, Directorate of Planning, Policy and Resource Mobilization, revenue authority, Business Registration and Licensing Authority (responsible for domestication of foreign companies) and Office of the Director of Public Prosecutions asset forfeiture and recovery unit for asset tracing and recovery. The bureau investigates, then links to the director of public prosecutions for criminal prosecution, conviction and forfeiture of assets.

Through this collaborative system, more than half a billion dollars in tax revenue was recovered between 2015 and 2018 from various companies. Recoveries included $1,520,540 from Mangunya Minerals Ltd, $112,273,183 from North Mara Gold Mine and $416,109,000 from Bulyanhulu Gold Mine—all three being subsidiaries of Acacia Mining PLC (see also box 2.3). In 2010, more than $1,522,111 was recovered from the Tanzania Telecommunication Company Limited from its investments in the property market in Dubai.

Source: Mukungu (2019).

Institutional arrangements for addressing tax avoidance and tax evasion

To combat tax-motivated IFFs, African countries must improve the weaknesses in their tax management systems that inhibit detecting, arresting, prosecuting and preventing tax avoidance and tax evasion. Improvement requires appropriate legislation, organization and practices to ensure that the tax code is well known and implemented, that defaulters are apprehended and arbitrated or prosecuted and that lost resources are recovered (box 2.2; table 2.1).

Table 2.1. Institutional architecture for combatting tax-motivated illicit financial flows

Institutional architecture	Focus
National strategy	• Tax policy (ministry of finance/treasury) • Medium- to long-term vision on combatting tax-motivated IFFs • Link to legal and law enforcement system (parliament) • Inter-agency task force • Resource allocation (ministry of finance) • Oversight and reporting
Legal framework	• Criminalization of tax avoidance and tax evasion • Rules, laws and regulations to govern/oversee and regulate multinational enterprise activities, including transfer pricing, beneficial ownership and observance of the arm's length standard[a] • Whistleblower system and protection legislation • Dedicated and legally empowered entities (courts, anti-smuggling units, financial intelligence units, illicit financial flow prosecutors, etc.)

Operational procedures	• Office for large taxpayers equipped with
	  ▪ Audit units
	  ▪ Transfer pricing unit
	  ▪ Investigative units, and control and verification units
	  ▪ Fourth industrial revolution (technology) unit
	  ▪ Data collection and management unit
	• Anti-corruption campaigns or agencies
	• Tax arbitration unit
	• Asset recovery unit

Special operational arrangements	• Inter-agency task force on illicit financial flows • Financial intelligence units • Special prosecutor office and courts for tax-motivated illicit financial flow cases • International liaison with other tax jurisdictions' competent authority liaison office • Anti-smuggling units

Institutional architecture	Focus

Regional and international cooperation	• Global Forum on Transparency and Exchange of Information for Tax Purposes
	  ◦ Exchange of information
	  ◦ Exchange of information on request
	  ◦ Standard for automatic exchange of financial account information in tax matters
	  ◦ Common reporting standards
	  ◦ Information sharing bureaus
	• Campaign against tax havens and bank secrecy jurisdictions
	• Base erosion and profit shifting (BEPS) project
	  ◦ Beneficial ownership registry
	  ◦ Country-by-country reporting, including local and master files
	  ◦ Multilateral instrument for rebalancing double taxation agreements
	• Addis tax initiative
	• Convention on mutual administrative assistance on tax matters
	• Anti-smuggling collaboration

a. The arm's length standard spells out the arm's length principle, which requires the treatment of transactions between related parties as if they were transacting with unrelated parties on the open market.

The starting point in curbing tax-motivated IFFs is the promulgation of tax law and policy by parliament and the ministry responsible for finance, which develop the relevant tax code and publish it for economic agents to follow. The law and policy, and therefore the tax code, must be clear and fit for curbing tax-motivated IFFs by addressing how to clearly determine the tax base and the taxes due, investigate the channels through which resources are moved and recover illicitly transferred resources.

In this tax management cycle, tax administration is key. It must possess capabilities to assess the tax bases and determine due tax, investigate tax malfeasance and reprimand it, submit it to arbitration and follow up to recover unpaid taxes. Since tax-motivated IFFs involve more than one tax jurisdiction, the tax administration must be equipped to interact productively with other jurisdictions to follow illicitly transferred funds and recover them. These duties require the capacity to undertake tax-related auditing, assessment, investigation, prosecution and negotiation to reside within the tax administration, as well as infrastructure to facilitate the processes—digitalization, cooperation arrangements, beneficial ownership registry, judiciary and arbitration, stakeholders' dialogues and so on.

The investigation capacity can be outside the tax administration organization. Even so, it requires knowledge of the tax code and the procedures for calculating taxes from the tax base, equipment to carry out investigations and modalities for collaborating with the tax administration (particularly the auditing units, arbitrators and the prosecution services) both within and outside the tax jurisdiction. Between 2015 and 2018 United Republic of Tanzania recovered more than half a billion dollars in tax revenue from three subsidiaries of a multinational enterprise registered in the country (box 2.3).

Arbitration services, precursors to turning to the judiciary, entail the prosecutors approaching offenders to discuss the merits of claims in the presence of the arbitrators. Prosecutors and arbitrators must be knowledgeable about the tax code and tax-motivated IFFs to work effectively with multinational enterprises on tax avoidance and tax evasion. Failure to resolve cases leads towards the judiciary system.

The judiciary needs special tax courts to adjudicate tax-motivated IFF cases, with specialized knowledge of tax-motivated IFF anatomy, drivers, channels and weaknesses in existing domestic, regional and international arrangements, including the regional and global protocols for transboundary tax cooperation.

Recovering illicitly transferred assets is complicated since it requires the tax administration to have cooperation arrangements, and perhaps agreements, with the relevant international jurisdictions, to gather evidence and to get court judgement directing the repayment of illicitly transferred resources.

Box 2.3. Tanzania's experience with multinational enterprise illicit financial flows

In United Republic of Tanzania, tax policy is formulated by the ministry of finance, with the minister of finance presenting the tax code to parliament. There a parliamentary committee considers the tax code and presents it to parliament for passing into legislation to be followed by all economic agents in the country. The tax law guides the Tanzania Revenue Authority in assessing and collecting taxes, reporting defaulters to investigators, taking them to arbitration or court and recovering unpaid taxes decided through successful prosecution. Within the revenue authority, the Large Tax Payers' Unit (LTPU) deals with large taxpayers, mostly multinational enterprises. Since tax evasion and tax avoidance cases are often underpinned by corruption, the revenue authority collaborates with the Prevention and Combatting of Corruption Bureau, a semi-autonomous branch of the judiciary that investigates corruption cases in collaboration with the finance ministry's financial intelligence unit. Tanzania established an interagency task force to coordinate efforts against IFFs—its members represent the central bank, ministry of finance, revenue authority, financial intelligence unit, judiciary, Prevention and Combatting of Corruption Bureau and a parliamentary committee that oversees the activities of the task force.

In an investigation of the multinational enterprise Acacia Mining PLC, a subsidiary of Barrick Gold, the task force estimated that Tanzania had lost up to $84 billion through IFFs between 1998 and 2017, equivalent to five years of the country's roughly $15 billion budget (based on the budget proposed for 2017/2018). Further, the investigations found that Acacia Mining had engaged in dubious practices contributing to IFFs including:

- Base erosion and profit shifting, in which Acacia Mining would include ineligible costs when computing its costs of production to erode its tax obligations in Tanzania. Then, through a network of subsidiaries, Acacia would export the gold concentrate—now with a lower book value—from Tanzania and sell it to third parties at a much higher value through its treasury department in South Africa.
- Trade mis-invoicing, in which Acacia Mining would misreport the nature, amount and value of mineral ore being exported.
- Transfer pricing, in which Acacia Mining would collude with other companies to sell gold and mineral ore at prices that did not reflect the actual market value. The manipulation of the sale price aimed to avoid or reduce the company's tax obligation.

Source: Kinyunyu (2017), with collaboration by other interlocutors from Tanzania Revenue Authority and Prevention and Combatting of Corruption Bureau. See also Mukungu (2019).

Regional and international cooperation for addressing tax-motivated illicit financial flows

Globally, the United Nations and the Organisation for Economic Co-operation and Development (OECD) are the two main platforms for international tax reforms, providing countries with model conventions and commentaries, as well as codes of conduct and guidance. The building blocks of reform include domestic legislation, international agreements, administrative and information technology capacity in the jurisdictions and confidentiality and data safeguards. They have a legal basis that permits automatic exchange of information and legal protections, for example, for using data, found in the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters, Article 26 of the Double Taxation Convention and Tax Information Exchange Agreement. They require exchange details, such as what is to be exchanged and under what timing framework, specified in the Multilateral Competent Authority Agreement and the Bilateral Competent Authority Agreements.

Recent initiatives address weaknesses in the global financial architecture, particularly loopholes addressing tax avoidance and tax evasion in the tax rules. Two are the G20/OECD Action Plan on BEPS, which aims to reduce the misalignment of profits with real economic activity, and the efforts of the Global Forum on Transparency and Exchange of Information for Tax Purposes. The Action Plan on BEPS is by far the larger effort, requiring thousands of bilateral tax treaties to be updated through the Multilateral Instrument (MLI), circumventing the need for the affected parties to renegotiate individually. The OECD initiative on Transparency and Exchange of Information across fiscal jurisdictions aims to facilitate access to multinational enterprise records regardless of where they domicile globally.

The African Union (AU), in its concern to step up domestic resource mobilization, called at its 31st summit meeting in July 2018 for a tax transparency and exchange of information agenda for Africa, to be led by the AU Commission. The statement called for stronger collaboration to tackle the root causes of IFFs and for stronger tax cooperation to stem them and enhance domestic resource mobilization. The summit also called for establishing effective beneficial ownership registers, country-by-country reporting of financial information, participation in automatic exchange of information agreements and strengthening tax authorities through the African Tax Administration Forum. It also asked the AU Advisory Board on Corruption, the AU Commission, the United Nations Economic Commission for Africa and other stakeholders to speed implementation of the recommendations of the High Level Panel on IFFs from Africa (Mbeki Panel) and to attempt to progressively abolish bank secrecy jurisdictions and tax havens on the continent.

The OECD Action Plan on Base Erosion and Profit Shifting

In 2013, the G20 countries endorsed the OECD action plan to address base erosion and profit shifting (BEPS). In BEPS a company employs international tax planning strategies exploiting gaps and mismatches in tax rules to artificially shift profits to low tax or no-tax jurisdictions, even though the company has little or no economic activity there, resulting in tax avoidance.

The action plan identified 15 actions based on three pillars: introducing coherence in the domestic rules that affect cross-border activities, reinforcing substance requirements in existing international standards and improving transparency and certainty (IBFD, 2018).[8] The action plan provided domestic and international tools governments need to combat base erosion and profit shifting. It recognized that greater transparency and improved data are needed to evaluate and stop the growing disconnect between where profits are made and where they are reported for tax purposes. The BEPS package should provide a good basis for countries in Africa to deal with abusive transfer pricing.

8 These measures include further guidance on the application of existing international tax standards (such as the arm's length principle), as well as concrete recommendations that countries can implement by amending their domestic tax laws and tax treaties. The package also contains minimum standards, which are key priority measures where action is considered urgent: combatting harmful tax competition (Action 5); preventing tax treaty abuse, including treaty shopping (Action 6); improving transparency, which covers both country-by-country reporting (CbCR) (Action 13) and the exchange of certain favourable tax rulings (Action 5) and enhancing the effectiveness of tax treaty dispute resolution (Action 14).

Country-by-country reporting (CbCR) can also be used to flag discrepancies between where economic activity takes place and where taxes are paid by multinational enterprises (ECA, 2019).

The Multilateral Instrument, though it considerably simplifies updating tax treaties, is complex. With a mix-and-match set of articles and options for countries to choose from, it only works if both treaty partners select the same options. There has been some progress in uptake of the MLI globally. Some 75 countries implemented the CbCR requirements by end of 2018, including 3 from Africa (Gabon, Nigeria and South Africa); 4 countries had draft bills, including 1 from Africa (Kenya) and 8 expressed intent to implement BEPS Action 13 promoting CbCR, including 4 from Africa (Botswana, Namibia, Rwanda and Uganda) (table 2.2).

Table 2.2. Implementation of Base Erosion and Profit Shifting Action 13, by country, end-2018

Country	Reporting requirements			
	Country-by-country reporting (CbCR)	**Master file**	**Local file**	**Signed the Multilateral Competent Authority Agreement (MCAA) on CbCR**
Botswana	Intention to implement			
Côte d'Ivoire	Final legislation			
Gabon	Final legislation	Final legislation	Final legislation	Yes
Kenya	Draft bill for public discussion	Intention	Draft bill for public discussion	
Mauritius	Final legislation	Intention to implement	Intention to implement	Yes
Namibia	Intention to implement	Intention to implement	Intention to implement	
Nigeria	Final legislation	Draft bill	Draft bill	Yes
Rwanda	Intention to implement	Intention to implement	Intention to implement	
Senegal				Yes
South Africa	Final legislation	Final legislation	Final legislation	Yes
Uganda	Intention to implement	Intention to implement	Intention to implement	
Zambia		Final legislation	Final legislation	

Source: KPMG (2018)
Note: No information on Botswana and Côte d'Ivoire on master file, local file or MCAA on CbCR; and no information on Senegal on CbCR, master file or local file.

Most articles in the MLI offer benefits for developing countries. But the "corresponding adjustments" articles give away too much power by allowing treaty partners to effectively set transfer prices and stipulate binding arbitration. And although MLI allows comprehensive and coherent implementation of the BEPS actions, its value for developing countries largely depends on the options selected by their treaty partners, such as Ireland, the Netherlands, Switzerland, the United Kingdom and the United States, of which only the United Kingdom had finalized its options by end of 2018. The United States is implementing the BEPS actions without using the MLI (Oguttu, 2018).

The selective or partial adoption of MLI provisions by developed countries is of particular concern to developing countries. Gaps and mismatches could create opportunities for tax arbitrage, and so tax avoidance and tax evasion. Further, the intricate processes for setting transfer prices and pursuing binding arbitration often require capacities beyond those of African countries.

Tax transparency and information exchange

Information asymmetry between taxpayers and tax authorities creates opportunities for abuse of the tax system. It allows taxpayers to hide wealth abroad with little risk of being caught, thereby increasing inequality, diminishing public morale and lowering voluntary compliance with tax laws. Countering tax avoidance and tax evasion requires greater transparency, more effective intelligence gathering and analysis, and improved cooperation and information sharing between a country's government agencies and between countries.

The second main global initiative to tackle tax avoidance and tax evasion relates to promoting of fiscal transparency. The International Monetary Fund (2018) called internal transparency between government agencies "critical for effective fiscal management." Civil society has advocated transparency in the Effective Industries Transparency Initiative and Publish What You Pay, while the US Dodd-Frank Act has been influential internationally. International exchange of information (EOI) between tax authorities is a powerful enforcement tool that allows tax authorities to reach out to offshore information sources. It deters tax evasion by raising the costs of evasion, and it boosts public belief in the fairness of the tax system, thereby motivating greater tax compliance.

Lukewarm or non-existent political will slows the uptake of these initiatives. But a concerted move towards greater transparency in tax matters began with the exchange of information on request (EOIR), spearheaded by the Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum). EOIR was updated to facilitate the detection of formerly undetected aggressive tax planning through a single global standard, the Automatic Exchange of Information for Tax Purposes (AEOI), endorsed by the OECD in 2014.

The number of African countries participating in the Global Forum increased from 17 in 2014 to 29 in 2018[9], including 8 of the 15 oil exporters[10] and 13 of the 26 mineral-rich African countries, thanks to the advocacy by the Global Forum and its observers, such as the African Tax Administration Forum through its African Initiative[11]. Member countries benefit from the Global Forum's support in countering tax avoidance and tax evasion by taking advantage of increasing global tax transparency, growing international cooperation and increased transparency of corporate bodies, arrangements and financial information (OECD, 2019).

With assistance of the OECD's African Initiative, some African countries have broadened their EOI network and can now avoid long, complex and sometimes resistant negotiations of taxing rights by becoming parties to the Convention on Mutual Administrative Assistance in Tax Matters (the Multilateral Convention—MAC). Nine African countries have ratified the MAC[12], while 6 have signed it[13] and 4 are in the process of signing[14] (table 2.3). The MAC will increase considerably their EOI relationships. It enables all forms of tax cooperation, including the automatic exchange of CbCR and the mandatory spontaneous exchange of tax rulings—key elements of the BEPS action agenda that are particularly relevant for African countries. The countries' opportunities to send and receive information for tax purposes under agreements signed with foreign jurisdictions are thus multiplied. Although the number of bilateral agreements made by African countries has increased slowly, their EOI networks have expanded substantially due to their participation in the MAC.

9 Benin, Botswana, Burkina Faso, Cameroon, Cabo Verde, Chad, Côte d'Ivoire, Djibouti, Egypt, Eswatini, Gabon, Ghana, Kenya, Lesotho, Liberia, Madagascar, Mauritania, Mauritius, Morocco, Niger, Nigeria, Rwanda, Senegal, Seychelles, South Africa, United Republic of Tanzania, Togo, Tunisia and Uganda.

10 Algeria, Angola, Republic of Congo, Democratic Republic of the Congo, Equatorial Guinea, Libya and Sudan are not members of the African initiative.

11 It is aimed at helping unlock the potential for tax transparency and exchange of information in support of African countries pursuit of the Sustainable Development Goals of domestic resource mobilization and the fight against illicit financial flows.

12 Cameroon, Ghana, Mauritius, Nigeria, Senegal, Seychelles, South Africa, Tunisia and Uganda.

13 Burkina Faso, Gabon, Kenya, Liberia, Mauritania and Morocco.

14 Angola (not a member of the Global Forum, however), Benin, Madagascar and Togo.

Table 2.3. African countries' progress in joining the Multilateral Convention, February 2019

Ratified (9)	Signed (6)	In the process of signing (4)
Cameroon, Ghana, Mauritius, Nigeria, Senegal, Seychelles, South Africa, Tunisia, Uganda	Burkina Faso, Gabon, Kenya, Liberia, Mauritania, Morocco	Angola, Benin, Madagascar, Togo

Source: OECD, 2019.
Note: Angola, a major oil exporter, is not a member of the Global Forum and has not yet participated in the OECD African Initiative

The real power of international tax cooperation comes from using improved transparency to identify evaded income and assets. That depends on the capacity of tax administrations to send EOI requests to their treaty partners and receive the information from them. Although African countries have not readily made these requests, the number of countries increased from 5 in 2014 to more than 18 in 2018. The slow progress was due, in part, to the limited capacities of the tax administrations including the lack of EOI infrastructure, a narrow network of EOI partners and the lack of awareness and skills regarding EOI and its benefits. Converting information obtained through EOI into revenues takes time and skills. The upshot is demonstrated in the report that in 2018 five countries reported collecting additional taxes of more than $22 million as a result of EOI, including Uganda collecting $9 million in 2015/2016, Togo $1 million in 2016 and Tunisia $2 million in 2018 (OECD, 2019).

The AEOI aims to "strengthen international efforts to increase transparency, cooperation, and accountability among financial institutions and tax administrations, and enable governments to recover tax revenues lost to non-compliant taxpayers." It requires jurisdictions to obtain information from their financial institutions and automatically exchange that information with other jurisdictions annually. It is supplemented by the Common Reporting Standard (CRS). The CRS requires financial institutions to report to signatory country tax administrations financial account information that is then exchanged with other signatory country tax administrations to clamp down on tax evaders hiding or withholding information about undeclared offshore funds. The move towards public and centralized registers of ultimate beneficial owners, which reveal the ultimate owners of trusts, foundations and other opaque vehicles, is expected to improve transparency, particularly in the natural resources sector.

Table 2.4. Commitments of African countries towards Automatic Exchange of Information (AEOI), January 2020

Jurisdictions committed to undertake first exchanges	Jurisdictions yet to set a date for the first exchanges
Ghana (by 2019), Mauritius (by 2018), Nigeria (by 2020), Seychelles (by 2017), South Africa (by 2017)	Benin, Botswana, Burkina Faso, Cabo Verde, Cameroon, Chad, Côte d'Ivoire, Djibouti, Egypt, Eswatini, Gabon, Guinea, Kenya, Lesotho, Liberia, Madagascar, Mauritania, Morocco, Namibia, Niger, Rwanda, Senegal, United Republic of Tanzania, Togo, Tunisia and Uganda

Source: OECD, 2020.
Note: Ghana and Nigeria are among developing countries that do not host a financial centre and so are not required to commit to a specific date to exchange information, but did so voluntarily.

Only 5 African countries have so far committed to their first automatic exchange of information, while 26 were yet to set a date as of January 2020 (table 2.4). Yet Nigeria, following a commitment to implement AEOI, recovered $82.6 million through the voluntary assets and income disclosure scheme between July 2017 and September 2018 and registered an additional 5 million new taxpayers. South Africa recovered $225 million in tax revenues from October 2016 to March 2017 through the special voluntary disclosure programme.

Critical challenges persist for countries following up on multinationals suspected of avoiding and evading taxes, including complications in identifying the beneficial owners. Of 27 countries that returned survey questionnaires on beneficial ownership legislation to the Library of Congress Global Legal Research Center in 2017, only 3 were from Africa (Namibia,[15] South Africa[16] and United Republic of Tanzania[17]). The survey found that most countries with public beneficial ownership registration laws viewed registration as an anti–money laundering tool that worked in coordination with other legal mechanisms, such as access to company information, risk assessment, government monitoring and law enforcement (Law Library of Congress, 2017). The implementation of international standards for the exchange of information for tax purposes could help African countries fight tax-motivated IFFs (Owens and McDonell, 2018).

The implementation of international standards for the exchange of information for tax purposes could help African countries fight tax-motivated IFFs.

Transfer pricing legislation

Tax administrations' ability to identify and address transfer pricing risks depends on their tax laws containing well-articulated and enforceable transfer pricing provisions and related regulations. Sophisticated transfer pricing legislation should be consistent with the generally accepted international standard of the arm's length principle for pricing transactions within a multinational enterprise, as set out in Article 9 (associated enterprises) of the UN Model Tax Convention and Article 9 (associated enterprises) of the OECD Model Tax Convention. The two models, the basis for nearly all bilateral treaties for avoiding double taxation, endorse the arm's length principle.

The amended OECD (2010) Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, with its predecessors, has provided consistent policies and practices applied by tax administrations for transactions between related parties in developed economies for more than three decades. Attempts to implement these guidelines to Africa, or even to adapt them, have proved slow, costly and often ineffective, with a few exceptions (such as Article 7 on business profits) (Guj et al., 2017).

Although in many African countries basic provisions were in place for transfer pricing by 2013, they often lacked appropriate documentation requirements or had not yet been complemented by the necessary regulations and guidance for implementation (Guj et al., 2017). African countries have since stepped up: 31 have explicit legislation on transfer pricing and 8 have legislation mentioning tax avoidance that could address some aspects of transfer pricing. And 37 countries have large taxpayer units responsible for the transfer pricing practices of large corporations (table 2.5). But there are gaps in transfer pricing legislation and in the competence of the large taxpayer units to handle the specifics of tax avoidance and tax evasion in the natural resources sector, particularly the mineral subsector.

15 Financial Intelligence Act 13 of 2012, Government Gazette of the Republic of Namibia §§ 1, 4, 5, 9 & 70 (Dec. 14, 2012), archived at https://perma.cc/7PFKBXGN; Financial Intelligence Regulations, Government Notice Bo. 3 of 2015, §§ 2 & 3(Jan. 28, 2015), archived at https://perma.cc/8KFX3YU7.

16 Financial Intelligence Centre Act 38 of 2001, §§ 1, 21B, 21C-E, 40 & 45C, archived at https://perma.cc/SBE7- 3QRG; Financial Intelligence Centre Amendment Act 1 of 2017, Government Gazette, No. 40841 (May 2, 2017), archived at https://perma.cc/9U4LZGLK. Note that the provision extending application of Act to beneficial owners has yet to take effect. Commencement of Financial Intelligence Centre Amendment Act, Government Notice (GN) No. 563 (June 13, 2017), archived at https://perma.cc/BBH6 -7ASV.

17 Financial Intelligence Unit, Anti-Money Laundering Guidelines to CMSA Licensees §§ 1.2, 2.4.1, 9.0 & 11.4 (Guidelines No. 5, Feb. 1, 2012), archived at https://perma.cc/3YR4- WVDF; Anti-Money Laundering Act No. 12 of 2006, § 17 (Jan. 5, 2007), archived at https://perma.cc/3W-JA-PCLY; Anti-Money Laundering Act Regulations § 32, 93(36) Subsidiary Legislation to the Gazette of the United Republic of Tanzania (Sept. 7, 2012), archived at https://perma.cc/2PC6- AB2X.

Table 2.5 Transfer pricing legislation and large taxpayer units in African countries, December 2019

Countries with transfer pricing legislation (31)	Countries with some form of transfer pricing provisions (8)	Countries with large tax payers units (37)
Algeria, Angola, Benin, Botswana, Burkina Faso, Cameroon, Cabo Verde, Chad, Democratic Republic of the Congo, Republic of Congo, Côte d'Ivoire, Egypt, Ethiopia, Gabon, Ghana, Kenya, Liberia, Madagascar, Malawi, Mali, Mozambique, Namibia, Nigeria, Rwanda, Senegal, South Africa, United Republic of Tanzania, Togo, Tunisia, Uganda, Zambia	Burundi, Djibouti, Gambia, Guinea, Lesotho, Libya, Mauritania, Morocco	Angola, Benin, Burkina Faso, Burundi, Cameroon, Cabo Verde, Central African Republic, Chad, Comoros, Democratic Republic of the Congo, Republic of Congo, Côte d'Ivoire, Djibouti, Egypt, Eritrea, Eswatini, Ethiopia, Gambia, Ghana, Guinea, Kenya, Lesotho, Liberia, Malawi, Mali, Mozambique, Niger, Nigeria, Rwanda, São Tomé and Príncipe, Senegal, Seychelles, South Africa, Tanzania, Uganda, Zambia, Zimbabwe

Source: ECA staff compilation from various sources

A survey on transfer pricing of senior tax and mine department officials from some 40 African countries represented at the International Mining for Development Centre (IM4DC)/World Bank Group mining tax administration workshops provided the most comprehensive single source of information so far on transfer pricing in Africa, particularly on the mineral sector. The survey provided insights into legislative evolution on transfer pricing, as well as the extent to which transfer pricing audits were being carried out in various countries. The survey established that 21 countries had legislation providing for the arm's length principle, 14 were implementing regulations or guidance, 14 had effective documentation requirements with penalty or burden of proof provisions but only 7 had annual disclosure requirements for related-party transactions (Guj et al, 2017; Shongwe 2019). So, the comprehensiveness of legislation varies across countries.

Half the countries surveyed had specific transfer pricing legislation or rules, one-fourth referred to the arm's length principle in their general tax laws and many of the rest were either developing transfer pricing provisions or were considering doing so. The survey generally confirmed that, even though many jurisdictions had adequate specific transfer pricing legislation in place, only a few enforced it noticeably. Transfer pricing audits were rarely carried out, including those of mining companies.

About three-fourths of respondents reported high levels of borrowing by the mining industry—leading to thinned capitalization. The lenders were largely related overseas parties with remittance of the related interest expenses subject to various levels of withholding tax. In many instances, the rate of withholding tax may have been reduced or the tax even waived in line with stability agreements or double taxation agreements. Moreover, about two-thirds of respondent countries reported that borrowing in the mining industry had thin capitalization rules in place, but some were unable to enforce them.

Only a few jurisdictions had specific transfer pricing units in their tax administrations. They had between 2 and 20 officers with varying levels of experience. Audits of transfer pricing issues were rarely carried out as part of general audits. A very few jurisdictions had officers with specialized skills in transfer pricing within the general ranks of their tax inspectors. But many tax administrations were training officers in transfer pricing.

Although appropriate legislation on transfer pricing is basic to dealing with its risks, the lack of commensurate administrative capacity, limited access to reliable comparable databases or a dearth of reliable domestic comparable data renders such legislation largely ineffective. With a few exceptions, the current state of affairs is due to the complexity of transfer pricing legislation, tax administrations' limited technical capacity and industry knowledge and the high cost of implementing a transfer pricing audit function. The survey clearly highlights a need throughout Africa to strengthen tax authorities' capacity in transfer pricing and enhance their knowledge of the mining industry's processes and of the key value drivers in its supply chain, particularly in fast-developing mineral-rich countries.

Unitary taxation

Taxing multinational enterprises around the world is based on individual subsidiaries, though the profits reported in each jurisdiction are determined centrally by the MNE by manipulating records kept secretly in multiple jurisdictions and cumulatively inaccessible to the authorities in any of them. Unpacking MNE records has required the complicated processes described above—such as those for transparency and information exchange, OECD's BEPS actions (there are 15 of them) and the promulgation of laws on transfer pricing specific to various sectors—all burdening developing countries' capacity and leading to low levels of implementation.

Implementing the unitary taxation approach, currently being led by the European Union and the OECD, would require global agreement.

Global tax reforms so far have adopted the use of the arm's length principle, which assumes that intra-company trades are genuine and fair. The practice of developing country tax authorities examining only the records of an MNE affiliate operating in its jurisdiction misses the central MNE records that would show the true profitability of its business in that country.

To effectively police the arm's length principle, tax authorities must review thousands of individual transactions. In many cases no effective arm's length comparables exist, producing numerous competing methods of determining acceptable prices for intra-company transactions. The range of prices within a corridor leads to disagreements, persistent conflicts and sometimes to double taxation, in which two countries claim to tax the same portion of the base. Countries fight over the prices within corridors since they determine the share of MNE tax base or profits each country can tax. The number of unresolved double taxation conflicts has grown for many years. Developing countries are consistently disadvantaged in the secretive, arm-twisting negotiations in those resource-intense distributional conflicts (Turner and Meinzer, 2017).

To avoid the weaknesses of the arm's length principle, tax authorities should consider the MNE as a whole, not just the subsidiary operating in a single country. The profits of the entire MNE should then be apportioned to each country where the MNE operates, using a formula for the MNE's real economic activities in each country generating profits.

This approach is already used, for example, by the United States of America for the taxes of companies operating across states. It benefits both the businesses and the tax authorities in each state. It is easy to calculate, eschews deductions and loopholes, gives businesses greater certainty in reducing spending on tax consultants and advisors and allows businesses to concentrate on their core business while maximizing the revenues for tax authorities. Introducing this unitary taxation approach would boost tax revenues, reduce the burden of administration on tax authorities and eliminate the incentive for an MNE to shift profits to low-tax jurisdictions.

Unitary taxation would need to find the formula for apportioning profits that most accurately reflects real productive activity in each tax jurisdiction. The European Commission has been considering the approach under the common consolidated corporate tax base proposal, which gives equal weight to capital, labour and sales. Canada uses another approach that weights sales revenue and the number of employees equally, thereby avoiding capital considerations, which can be subjective and are vulnerable to manipulation and profit shifting (Turner and Meinzer, 2017).

Implementing the unitary taxation approach, currently being led by the European Union and the OECD, would require global agreement. The transparency of the model could be beneficial even if adopted unilaterally, since every MNE would know up front the basis on which it would be taxed, rather than having to enter closed-door negotiations over appropriate transfer prices. But African countries would have to develop the capacity to determine whether an MNE's accounting was above board, particularly in valuing the capital invested in subsidiaries and in reporting global profits.

Conclusion and policy recommendations

This chapter has examined tax-motivated IFFs (briefly highlighting trade mis-invoicing, which is covered in chapter 3). It described related laws and agencies and how these interact formally and informally, as well as international efforts (see table A2.1 in the annex for a summary of African countries' legal frameworks for curbing tax avoidance and tax evasion). It examined the anatomy of tax avoidance and tax evasion, showing how they lead to IFFs, and the state of African governments' economic governance structures and their (in)adequacy in curbing tax-motivated IFFs. The chapter reviewed the state of international efforts to address tax-motivated IFFs, the aims of various global initiatives and the challenges to African countries in implementing them. The chapter raises the possibility of more practical approaches. It highlights the lucrative industry that supports tax-motivated IFFs and the incapacity of various African governments to confront misconduct and stem the resulting resource leakages.

The following recommendations describe institutional steps for African governments to effectively curb tax-motivated IFFs and for the international community to complement African government efforts.

National strategy

To block tax-motivated IFFs, African countries need a comprehensive, unambiguous tax policy. Their strategy should derive from a medium- to long-term vision of combatting tax-motivated IFFs through the legal and law enforcement system. The strategy should bring together the national agencies essential to blocking IFFs, provide them clear mandates and establish an interagency task force to coordinate and oversee their activities addressing tax-motivated IFFs.

Legislation

Complex and frequently changing tax laws confuse and cause uncertainty among tax officials and taxpayers, sometimes resulting in unintended tax avoidance and tax evasion. So, tax reforms should enhance the user-friendliness and transparency of procedures and minimize their bureaucratic burden and the complexity of the tax system. African countries should:

- Clearly outlaw the misconduct of tax avoidance and tax evasion and empower the tax administration system to go after tax avoiders and evaders. Where such legislation and regulations already exist, governments should strengthen and scale up enforcement.
- Ensure that the mandates of the institutions combatting tax-motivated illicit financial flows have a legal basis for activities curbing tax avoidance and tax evasion.
- Revise tax codes to require economic entities to truthfully declare their beneficial owners.
- Simplify tax codes. One way of doing this is to reduce the number of special tax treatments.
- Equip their legal systems with laws and regulations enabling governance and oversight of multinational enterprise activities, including transfer pricing, beneficial ownership, and the arm's length standards for intra-company trade.
- Enact effective laws and governance structures protecting whistle blowers to support a risk-free intelligence harvest. The anonymity of the whistle blower must be maintained at all levels.
- Legally establish dedicated agencies to curb tax-motivated illicit financial flows, such as anti-smuggling units, anti-corruption units, illicit financial flow arbitrators, illicit financial flow courts and prosecutors and financial intelligence units to monitor the anomalous movement of financial resources.

Operations

To block tax-motivated IFFs requires establishing specialized institutions and operational arrangements in African countries' tax-management systems. Many African countries have already moved towards creating semi-autonomous revenue collection authorities and units for large taxpayers, to cover large sources of revenue more efficiently. They have developed capacity by providing training and offering courses on selected topics such as detecting tax fraud and illegitimate profit shifting. They have also restructured the wage schedule of revenue authorities to offer sufficient incentives to recruit capable staff and minimize the risk of corruption.

African countries need to establish or strengthen various capacities within their tax administrations, with greater support from politicians, particularly for investigators, courts and judges, including:

- Audit units conversant with international accounting standards able to audit multinational enterprises and follow other jurisdictions' tax administration laws and procedures.
- Transfer pricing units to deal with multinationals' transfer pricing practices and aggressive tax planning activities. Countries should establish registers of comparables for the most common commodities, services and skills.
- Legal capacity to decode and navigate loopholes that tax avoiders and evaders could use, hidden, for instance, in bilateral tax treaties.
- Investigative units with accounting, financial and legal capacities to pursue the crooked practices of multinational enterprises, often supported by high-powered accountants, lawyers and financial analysts. The investigative units should liaise with other units and institutions within the country and abroad to follow up on transboundary operations and address insufficient prosecution and punishment of violators so tax criminals face stricter penalties effectively executed by courts.
- Divisions on taxation's interface with the fourth industrial revolution to undertake efficient ways of governance of MNE tax compliance and to anticipate rogue MNEs' use of technology to facilitate tax-motivated IFFs
- Data collection, maintenance and dissemination divisions' capacity to ensure data availability and data quality and to share data with external collaborators within and outside the country—activities required to detect and prosecute violators and so to enforce the social contract.
- Training capacity to update employee skills to curb emerging offences, such as those using evolving digital platforms.
- Automation of tax collection through online tax assessment, payment and monitoring—efficient ways to reduce the scope for tax avoidance and tax evasion.

Regional and international cooperation

To mesh with international institutions and efforts, national governments in Africa should undertake the following initiatives for combatting tax-motivated IFFs and so curtailing revenues losses:

- Adopting national legislation that addresses beneficial ownership—requiring that the true owners of companies be identified—and encouraging all other governments to establish public registries of beneficial ownership information on all legal entities. All gatekeepers to the financial system should be able to know the true beneficial owner of any account or client relationship they open.
- Adopting country-by-country reporting (CbCR) and encouraging all other governments to require multinational enterprises to publicly disclose their revenues, profits, losses, sales, taxes paid, subsidiaries and staff levels country by country.
- Adopting automatic exchange of information (AEOI) for tax information with all other partner countries and encouraging all other governments to actively participate in the worldwide movement towards the automatic exchange of tax information, as endorsed by both the OECD and the G20.
- Officially signing on to support the Addis Tax Initiative and encouraging all other governments to do so as well, to further support efforts to curb tax-motivated illicit financial flows as a key component of the development agenda.[18]

For its part, the global community should:

- Adopt unitary taxation of multinational enterprises with formulary apportionment based on labour used and sales in particular jurisdictions to tax the profits generated from the different jurisdictions and aggregated globally for the multinational's shareholders.

18 See current signatories to the Addis Tax Initiative: https://www.addistaxinitiative.net/#slider-4.

ANNEX

Table A2.1. African countries' institutional arrangements and legal frameworks for curbing tax avoidance and tax evasion

Countries	Policy organ	Tax administration	Large taxpayer unit	Transfer pricing unit	Supreme audit institutions	Global Forum on Transparency and Exchange of Information for Tax Purpose[a]	Automatic exchange of information (AEOI)
Algeria	Yes	Administration fiscale algérienne	Yes	Yes	Cour des Comptes		
Angola	Yes	Administração Tributária Angolana	Yes	Yes	Tribunal de Contas de Angola		
Benin	Yes	Benin Revenue Authority	Yes	Yes	Chambre des Comptes de la Cour Suprême	Yes	Yes
Botswana	Yes	Botswana Unified Revenue Service		Yes	Office of the Auditor General	Yes	Yes
Burkina Faso	Yes	Direction Générale des Impôts	Yes	Yes	Cour des Comptes	Yes	Yes
Burundi	Yes	Office Burundais des Recettes	Yes		Inspection Générale de l'Etat		
Cameroon	Yes	Cameroon Revenue Authority	Yes	Yes	Contrôle Supérieur de l'État	Yes	Yes
Cabo Verde	Yes	National Revenue Authority	Yes	Yes	Tribunal de Contas	Yes	Yes
Central African Republic	Yes	Direction générale des impôts et des domaines	Yes		Inspection Général d'État		
Chad	Yes	Direction Générale des Impôts	Yes	Yes	Chambre des Comptes de la Cour Suprême	Yes	Yes
Comoros	Yes	General Tax Authority (AGID)	Yes				
Republic of Congo	Yes	Direction Générale des Impôts	Yes	Yes	Cour des Comptes et de Discipline Budgétaire		
Democratic Republic of the Congo	Yes	Direction Générale des Impôts	Yes	Yes	Cour des Comptes		
Côte d'Ivoire	Yes	Direction générale des Impôts	Yes	Yes	Cour des Comptes de Côte d'Ivoire	Yes	Yes
Djibouti	Yes	Direction Générale des Impôts	Yes		Cour des Comptes	Yes	Yes
Egypt	Yes	Egyptian Tax Authority	Yes	Yes	Accountability State Authority (ASA)	Yes	Yes
Equatorial Guinea	Yes				Direccion General de Control Financiero		

Countries	Beneficial owners law	Country-by-country reporting law in place and 1st ultimate parent entity filing[b]	Convention on Mutual Administrative Assistance in Tax matters (MAC)[c]	Transfer pricing legislationd	BEPS Multilateral Instrument (MLI)e	Common Reporting Standards (CRS)	Multilaterals Competent Authority Agreement (MCAA)[f]
Algeria				Yes			
Angola				Yes			
Benin	Yes		27 November 2019	Yes			
Botswana	Yes			Yes			
Burkina Faso	Yes		25 August 2016	Yes	7 June 2017		
Burundi				Yes[d]			
Cameroon	Yes		25 June 2014	Yes	11 July 2017		
Cabo Verde	Yes		26 November 2019	Yes			
Central African Republic							
Chad	Yes			Yes			
Comoros							
Republic of Congo			Yes				
Democratic Republic of the Congo				Yes			
Côte d'Ivoire		1 January 2018		Yes	24 January 2018		
Djibouti				Yes[d]			
Egypt	Yes	1 January 2019		Yes	7 June 2017		
Equatorial Guinea							

Countries	Policy organ	Tax administration	Large taxpayer unit	Transfer pricing unit	Supreme audit institutions	Global Forum on Transparency and Exchange of Information for Tax Purpose[a]	Automatic exchange of information (AEOI)
Eritrea	Yes		Yes		Office of the Auditor General (OAG)		
Eswatini	Yes	Eswatini Revenue Authority	Yes		Office of the Auditor General	Yes	Yes
Ethiopia	Yes	Ethiopian Revenues and Customs Authority	Yes	Yes	Office of the Federal Auditor General		
Gabon	Yes	Direction Générale des Impôts		Yes	Cour des Comptes	Yes	Yes
Gambia	Yes	Gambia Revenue Authority	Yes		National Audit Office		
Ghana	Yes	Ghana Revenue Authority	Yes	Yes	Ghana Audit Service	Yes	Yes
Guinea	Yes	Direction générale des Impôts	Yes		Cour des Comptes	Yes	Yes
Guinea-Bissau	Yes				Tribunal de Contas—Gabinete do Presidente		
Kenya	Yes	Kenya Revenue Authority	Yes	Yes	Office of the Auditor-General	Yes	Yes
Lesotho	Yes	Lesotho Revenue Authority	Yes		Office of the Auditor General	Yes	Yes
Liberia	Yes	Liberia Revenue Authority	Yes	Yes	General Auditing Commission (GAC)	Yes	Yes
Libya	Yes				Libyan Audit Bureau		
Madagascar	Yes	Tax General Directorate		Yes	Cour des Comptes	Yes	Yes
Malawi	Yes	Malawi Revenue Authority	Yes	Yes	National Audit Office		
Mali	Yes		Yes	Yes	Contrôle Général des Services Publics	Yes	
Mauritania	Yes				Cour des Comptes de la République Islamique de Mauritanie	Yes	Yes
Mauritius	Yes	Mauritius Revenue Authority			National Audit Office	Yes	Yes
Morocco	Yes	General Tax Administration (DGI)			Cour des Comptes	Yes	Yes
Mozambique	Yes	Mozambique Revenue Authority	Yes	Yes	Tribunal Administrativo		

Countries	Beneficial owners law	Country-by-country reporting law in place and 1st ultimate parent entity filing[b]	Convention on Mutual Administrative Assistance in Tax matters (MAC)[c]	Transfer pricing legislationd	BEPS Multilateral Instrument (MLI)e	Common Reporting Standards (CRS)	Multilaterals Competent Authority Agreement (MCAA)[f]
Eritrea							
Eswatini							
Ethiopia				Yes			
Gabon		1 January 2017	3 July 2014	Yes	7 June 2017		26 January 2017
Gambia				Yes[d]			
Ghana			10 July 2012	Yes		2019	
Guinea				Yes[d]			
Guinea-Bissau							
Kenya			8 February 2016	Yes	26 November 2019		
Lesotho				Yes[d]			
Liberia			11 June 2018	Yes		2020	
Libya				Yes[d]			
Madagascar				Yes			
Malawi				Yes			
Mali				Yes			
Mauritania			12 February 2019	Yes[d]			
Mauritius		1 July 2018	23 June 2015		5 July 2017	2018	26 January 2017
Morocco			21 May 2013	Yes[d]	25 June 2019		26 June 2019
Mozambique				Yes			

Countries	Policy organ	Tax administration	Large taxpayer unit	Transfer pricing unit	Supreme audit institutions	Global Forum on Transparency and Exchange of Information for Tax Purpose[a]	Automatic exchange of information (AEOI)
Namibia	Yes	Namibia Inland Revenue Authority		Yes	Office of the Auditor-General	Yes	Yes
Niger	Yes		Yes		Cour des comptes	Yes	Yes
Nigeria	Yes	Federal Inland Revenue Service	Yes	Yes	Office of the Auditor-General for the Federation	Yes	Yes
Rwanda	Yes	Rwanda Revenue Authority	Yes	Yes	Office of the Auditor General	Yes	Yes
São Tomé and Príncipe	Yes	Department of Taxation	Yes		Tribunal de Contas		
Senegal	Yes		Yes	Yes	Cour des Comptes	Yes	Yes
Seychelles	Yes	Seychelles Revenue Commission	Yes		Office of the Auditor General	Yes	Yes
Sierra Leone	Yes	National Revenue Authority			Audit Service Sierra Leone		
Somalia	Yes	Inland Revenue Department			Office of the Auditor General		
South Africa	Yes	South African Revenue Service	Yes	Yes	Auditor-General of South Africa	Yes	Yes
South Sudan	Yes	National Revenue Authority			National Audit Chamber		
Sudan	Yes	Sudan Customs Authority			National Audit Chamber		
United Republic of Tanzania	Yes	Tanzania Revenue Authority	Yes	Yes	National Audit Office	Yes	Yes
Togo	Yes	Togolese Revenue Authority		Yes	Cour des Comptes	Yes	Yes
Tunisia	Yes	Direction Générale des Impôts		Yes	Cour des Comptes	Yes	Yes
Uganda	Yes	Uganda Revenue Authority	Yes	Yes	Office of the Auditor General	Yes	Yes
Zimbabwe	Yes	Zimbabwe Revenue Authority	Yes		Office of the Auditor General		

Countries	Beneficial owners law	Country-by-country reporting law in place and 1st ultimate parent entity filing[b]	Convention on Mutual Administrative Assistance in Tax matters (MAC)[c]	Transfer pricing legislationd	BEPS Multilateral Instrument (MLI)e	Common Reporting Standards (CRS)	Multilaterals Competent Authority Agreement (MCAA)[f]
Namibia				Yes			
Niger							
Nigeria	Yes	1 January 2018	29 May 2013	Yes	17 August 2017	2019	27 January 2016
Rwanda				Yes			
São Tomé and Príncipe	Yes						
Senegal	Yes	1 January 2018	4 February 2016	Yes	7 June 2017		4 February 2016
Seychelles	Yes	1 January 2020	24 February 2015		7 June 2017	2017	9 July 2019
Sierra Leone							
Somalia							
South Africa		1 January 2016	3 November 2011	Yes	7 June 2017	2017	27 January 2016
South Sudan							
Sudan							
United Republic of Tanzania	Yes						
Togo			30 January 2020	Yes			
Tunisia	Yes	1 January 2020	16 July 2012	Yes	24 January 2018		26 November 2019
Uganda	Yes		4 November 2015	Yes			
Zimbabwe				Yes			

a. EOI as of February 2020 at https://www.oecd.org/tax/transparency/who-we-are/members/.

b. CbCR status accessed 21 August 2020 at https://www.oecd.org/tax/automatic-exchange/country-specific-information-on-country-by-country-reporting-implementation.htm.

c. MAC signatories accessed at https://www.oecd.org/tax/exchange-of-tax-information/Status_of_convention.pdf.

d. Yes, some form of transfer pricing legislation.

e. MLI as of 22 July 2020 at https://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf.

f. MCAA as of 23 July 2020 at https://www.oecd.org/ctp/exchange-of-tax-information/CbC-MCAA-Signatories.pdf.

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CHAPTER 3:

Institutional architecture for addressing trade mis-invoicing

Key messages

- Trade mis-invoicing is growing. It is the most significant form of illicit financial flows, threatening domestic revenue collection and foreign exchange earnings in many African countries, thus stifling growth and sustainable development.
- Between 2000 and 2016, Africa lost, on average, $83 billion a year in trade mis-invoicing, slightly less than the $93 billion needed to close the infrastructure financing gap.
- To effectively address trade mis-invoicing, governments must invest in transparency measures that enable access to information, particularly up-to-date world market pricing information at a detailed commodity level, among agencies relevant to the trade-based IFF value chain monitoring.
- Governments must bolster the capacity of their customs administration and financial intelligence institutions by equipping and training officers to better detect and prevent mis-invoicing through modern technological tools and systems.

Between 2000 and 2016, Africa lost, on average, $83 billion a year in trade mis-invoicing, slightly less than the $93 billion needed to close the infrastructure financing gap.

This chapter assesses the readiness of national, regional and international institutions in Africa to combat trade-based illicit financial flows (IFFs), particularly trade mis-invoicing. Trade mis-invoicing is a form of tax evasion (covered broadly in chapter 2) that moves money illicitly across borders by falsifying the stated price, volume or value of imports or exports on invoices or customs declarations submitted by importers and exporters, respectively, to customs agencies and port authorities. IFFs, including trade mis-invoicing, harm the governance of African economies.

Trade mis-invoicing involves criminality through customs fraud, where false trade documentation is submitted to the authorities, or smuggling, where goods are hidden and no documents are submitted at all. By under-pricing or over-pricing the value of shipments, illicit flows are hidden within the legitimate flows of commercial trade, thereby illicitly transferring money across borders.

Trade mis-invoicing should be studied through three subjects: **gross outflows** to depict how institutions fail to prevent the loss of resources generated in a country; **illicit inflows** to depict the weaknesses of the institutions safeguarding against criminal behaviour from outside the country; and **total flows** depicting both kinds of governance institutions. The Report of the High Level Panel on Illicit Financial Flows (Mbeki Panel) recommended that governance at the origin, in transit and at the destination be scrutinized to combat IFFs (AU and ECA, 2015).

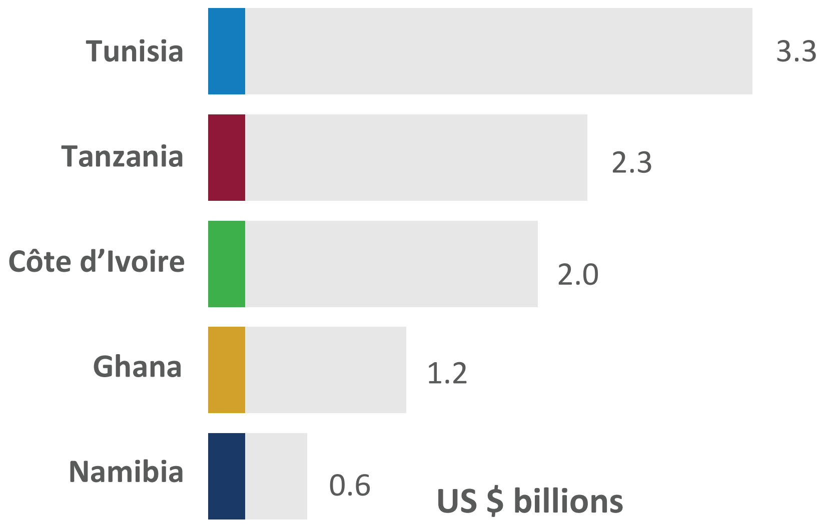
This chapter explores the role of African governments, the typology and effectiveness of institutional arrangements among African countries and at the region, as well as trade-focused regional and international cooperation arrangements, for addressing IFFs, particularly through trade mis-invoicing.

Incidence of trade-based illicit financial flows in Africa

IFFs through trade mis-invoicing in African countries are large and growing. Estimates for the period 2000–2016 averaged at $83 billion a year, a total of $1.4 trillion, equivalent to 5.3 per cent of Africa's GDP or 11.4 per cent of Africa's total trade for the period (ECA, 2019a). North Africa has 35 per cent of the trade-based IFFs, West Africa 20 per cent, East Africa 19 per cent, Southern Africa 18 per cent and Central Africa 8 per cent.

Average annual trade-based IFFs were estimated for the five countries that served as case studies for the **Economic Governance Report:** Côte d'Ivoire, Ghana, Namibia, United Republic of Tanzania and Tunisia (see chapter 1). Some $3.3 billion a year was transferred from Tunisia, followed by $2.3 billion from Tanzania, $2.0 billion from Côte d'Ivoire, $1.1 billion from Ghana and $0.6 billion from Namibia (figure 3.1) (ECA, 2019b). These figures mirror the regional share of outflow patterns. Uganda lost the equivalent of a staggering 33 per cent of its trade, while both Burundi and Niger lost 24 per cent of their total trade, through trade-based IFFs. For Africa's low-income countries the amount is half what they need annually to meet their needs for financing basic infrastructure, food security, health and education. Trade mis-invoicing pushes low-income countries further towards the tail end of sustainable development performance owing to their additional financing needs.

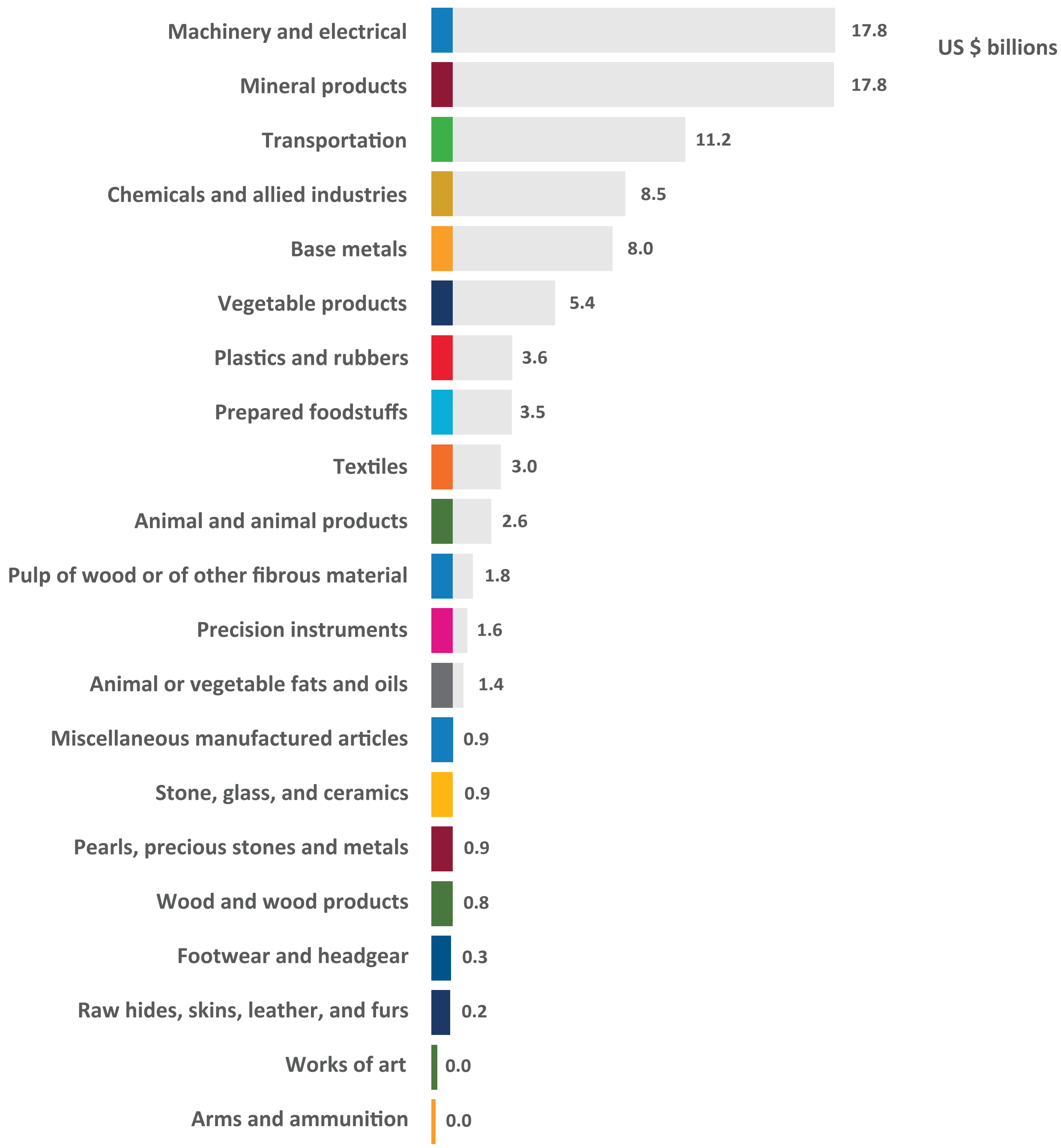
Figure 3.1. Average annual illicit outflows through trade mis-invoicing from selected African countries, 2000–2016



Source: ECA, 2019b.
Note: Gross outflows, high estimates.

The minerals machinery and electrical sectors have the highest mis-invoicing in Africa (figure 3.2). High-value electronics and components have the highest outflows through mis-invoicing. In Tanzania, the mineral sector has the highest. Trade mis-invoicing is heavily concentrated in the commodity exports of the countries studied, particularly mineral products. This is not surprising, since most African countries largely depend on mineral resources for their exports and for a major share of tax revenue.

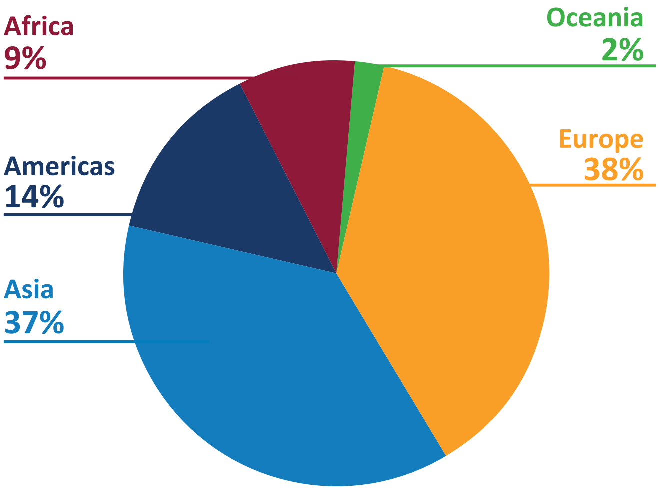
Figure 3.2. Average annual outflows by sector in Africa, 2000–2016



Source: ECA, 2019b.

A high concentration of illicit outflows goes to Asia (37 per cent) and Europe (38 per cent), since emerging countries feature significantly among Africa's trading partners (figure 3.3) (Mevel, Ofa and Karingi, 2015). China, for instance, receives 62 per cent of South Africa's exports of iron ore (UNCTAD, 2016). ECA (2019b) suggests China as the leading destination country of mis-invoiced commodities, followed by the United States. Most outflows go to high-income and upper-middle income countries, with Europe and Asia as the other destination regions.

Figure 3.3. Top destinations of outflows from African countries with average annual outflows, 2000–2016



Source: ECA, 2019b.

Taxonomy of trade-based illicit financial flows in Africa

Trade mis-invoicing dates to development discourses of the 1960s (Bhagwati 1964, 1967, cited in UNCTAD, 2016). Trade mis-invoicing can take place at either the export or import side of a transboundary commercial transaction. Trade mis-invoicing includes two ways of illicitly sending funds out of a country into other countries (IFF outflows) and two ways of illicitly receiving funds from another country (IFF inflows). In each case, either method could be used by manipulating the stated prices, volumes or quality of goods on invoices of either imports or exports, so there are four standard types of trade mis-invoicing: under-invoicing and over-invoicing of both exports and imports (box 3.1). Two of these types result in illicit outflows, and two result in illicit inflows. The effect of all of them is to reduce customs revenues and illicitly move money across borders (see chapter 1).

Box 3.1. Anatomy of the four pathways of trade mis-invoicing

Import over-invoicing aims to shift money abroad. For example, instead of paying $100 per unit for goods, an importer can submit a falsified invoice to read $120 per unit. Upon receiving $120 in payment, the exporter transfers the extra $20 into a foreign bank account controlled by the importer. So, while the importer pays $100 per unit for the goods, the falsified invoice enables the outflow of $20 per unit into an offshore account. Import over-invoicing is a common method of illegally moving money out of developing countries and is a form of illicit outflow of funds. There are many reasons why people seek to move money out of developing countries. The most common is to shift wealth from countries with weak currencies (whose value often fluctuates and depreciates on world markets) into hard currencies such as US dollars, British pounds or EU euros (whose value is more steadily retained). Another major reason is tax evasion.

Box table 1. Motives behind trade-based illicit financial flows through trade mis-invoicing

IFF outflows	Import over-invoicing	• To shift money abroad (evade capital controls, shift wealth into a hard currency and so on) • To overstate the cost of imported inputs to reduce income tax liability • To avoid anti-dumping duties
	Export under-invoicing	• To shift money abroad (evade capital controls, shift wealth into a hard currency and so on) • To evade income taxes (lower taxable income levels) • To evade export taxes
IFF Inflows	Import under-invoicing	• To evade customs duties or VAT • To avoid regulatory requirements for imports over a certain value
	Export over-invoicing	• To exploit subsidies for exports • To exploit drawbacks (rebates) on exports

Source: GFI, 2016

Similarly, export under-invoicing can be used for shifting money abroad. In this method, the invoice is falsified to show that the price of goods being exported is lower than the actual price being paid by an importer abroad. This type of trade mis-invoicing is done by exporters who are attempting to pay a lower tax on exports, or it is used by companies as an accounting manoeuvre to officially lower apparent profits and so to pay a lower corporate income tax rate. This practice plagues high-value natural resource exports from African countries. Export under-invoicing often creates illicit outflows of money from developing countries while also denying export and income taxes owed to the developing country government. Other reasons for export under-invoicing include evading the payment of export taxes and lowering a company's taxable income.

Trade mis-invoicing is also used to bring illicit funds into countries. Import under-invoicing is a key method of illicit inflows. It is often used for evading the payment of customs duties and of value-added taxes (VAT) on imports. For example, instead of reading $100 per unit, the importer can arrange for the invoice to read $50 per unit and save on the duties and VAT that would have been payable at the higher unit price. Upon paying the invoice at $50, the importer still owes the remaining $50 to the original producer abroad and therefore must also have a separate means of shifting money abroad to complete the transaction. In other words, import under-invoicing sometimes has an additional mechanism for shifting un-taxed money out of the country to meet the actual balance due. Import under-invoicing is also a common method for evading capital controls—legal limits on how much money can be brought into or taken out of a country. Since more wealth is being imported than is being declared, import under-invoicing results in illicit inflow of funds into a country.

Finally, export over-invoicing is also used to bring illicit funds into countries. In this type of trade mis-invoicing, the prices listed on export invoices are falsified to show exports as priced at higher levels than importers abroad have invoiced as being paid. While this may result in exporters paying more export taxes than are actually due, such tactics are used to benefit companies that are seeking to abuse various government export incentive programmes, such as customs duty and VAT drawbacks (rebates). Many countries have special government programmes to encourage exports by offering rebates on the duty and VAT for the costs of imported materials used in the local production of goods before they are exported. Export prices can also be inflated to receive larger export subsidies from the government. Although these government programmes are intended to promote exports, they can create incentives for companies to falsify the price of their exports to maximize the size of rebates or take advantage of export subsidies. In such cases, companies can earn more through receiving such government rebates and subsidies than they pay in additional (inflated) export taxes. Since this results in more money coming into an economy than would have if exports had been priced accurately, export over-invoicing also results in illicit inflows.

Source: ECA staff.

Trade mis-invoicing tends to receive far less attention from the media and international institutions than profit shifting and abusive transfer pricing (see chapter 2), though both result in massive loss of tax revenues for developing countries. Evidence suggests that trade mis-invoicing is the bigger problem in scale and scope, particularly in estimated revenue losses. Global Financial Integrity estimates losses of more than $800 billion in trade mis-invoicing from developing countries each year, while the International Monetary Fund (IMF) recently estimated revenue losses to developing country governments of about $200 billion a year from profit shifting and abusive transfer pricing (Kar and Spanjers, 2015).

Since Africa's public investment is largely financed through taxes, trade mis-invoicing cripples economies by shrinking import and export duties, eroding the domestic tax base, creating persistent balance of payment problems and re-directing much needed resources away from investment. It ultimately undermines socioeconomic development, income redistribution and poverty reduction efforts. By creating shortfalls in government revenue, it incites regressive taxation measures, which affect the vulnerable most, including women, thereby exacerbating pre-existing inequalities (Muchhala, 2018). With about 10 years left to the 2030 timeline for meeting the Sustainable Development Goals, African governments cannot afford to lose more revenue to illicit activities.

Institutions for addressing trade-based illicit financial flows

Key institutions for addressing trade mis-invoicing at national and regional levels include national policies, laws, instruments of cooperation and administrative structures along with mechanisms and arrangements for customs cooperation and exchange of information among the African Union Regional Economic Communities and within the African Continental Free Trade Area (AfCFTA). The **Economic Governance Report's** case studies of Côte d'Ivoire, Ghana, Namibia, United Republic of Tanzania and Tunisia allow comparative analysis with other countries. Key questions are whether:

- National legislation provides a proper mandate for customs to deal with illicit financial flows, including trade mis-invoicing and customs fraud.
- Transparency measures are in place, including exchange of information at national and subregional levels and cooperation in customs administration.
- Institutions have the capacity, including national electronic customs systems and other information technology (IT) solutions, to detect and prevent trade mis-invoicing.
- Countries have adopted international customs administration and management standards and have joined regional and global institutions concerned with customs and tax authorities.

National legislation and trade-based illicit financial flows

Complex and obscure, trade mis-invoicing requires robust institutions with clear mandates and adequate technical and financial resources to effectively be addressed. Tax authorities, customs administrations and financial intelligence units are central to curbing IFFs. Traditionally customs agencies were limited to collecting duties and tariffs from exports and imports. But since the early 1990s customs administrations globally have changed tremendously, their roles going beyond primarily collecting taxes towards facilitating cross-border trade.

In most of Africa customs agency changes and reforms were largely driven by domestic, regional, and international demands. Domestically the needs to address administrative inefficiencies, close national budget deficits and finance poverty reduction strategies were key considerations. At the regional and international levels, the growth of trade agreements provided the stimulus (Zake, 2011). Legislative reforms largely led to expanding the mandate of customs administrations to tackle tax fraud and smuggling.

Despite these reforms, customs agencies are still mainly engaged in tax collection and have yet to play a more active role in cross-border trade facilitation in the changing global landscape. A survey by the World Customs Organizations (WCO) found that 62 per cent of customs administrations, world over, still had limited mandates—a major impediment in addressing trade-based IFFs (Han and Ireland, 2016)[20]. Trade-based IFFs, particularly trade mis-invoicing, remains unfamiliar and underexplored for most customs administrations, particularly in Africa.

...trade mis-invoicing requires robust institutions with clear mandates and adequate technical and financial resources to effectively be addressed.

Of the country cases studied for this report, Ghana has a strong legal basis for curbing trade mis-invoicing. While its laws do not explicitly mention IFFs or trade mis-invoicing, the legal framework can support addressing them. The Ghana Revenue Authority (GRA) is mandated to combat tax fraud and tax evasion, as well as to prevent illicit trade and transnational crime[21]. The law provides for the tax authority to cooperate with other agencies in Ghana and other countries to realize this mandate.

As in Ghana, United Republic of Tanzania's legal framework does not clearly address the challenge of IFFs and its various forms but indirectly alludes to them. The law mandates the Tanzania Revenue Authority (TRA) to determine the actions needed to counteract fraud and other forms of tax and fiscal evasions, including initiating investigations into suspicious transactions (Section 5, TRA Act Chapter 399). Notably, any fraudulent activities, including false or misleading documents in relation to customs declarations, are criminalized (S. 84 The Tax Administration Act, 2015). And the Tax Administration (General) Regulations, 2016, provide powers to the Commissioner General of the TRA to conduct investigations and tax audits as and when necessary.

Namibia, as a member of the Southern African Customs Union (SACU), has customs administration laws largely determined by the SACU's frameworks. New tax legislation in 2017—the Namibia Revenue Agency Act 12—emboldened the country to address growing global challenges, including illicit transactions. This law makes a fair attempt to define "illicit" in relation to imported or excisable goods, surcharge goods or fuel levy goods to mean "any such goods in respect of which any duty, surcharge or levy is due and payable, but which has not been paid." This provision seems to cover trade mis-invoicing fairly well, including its different ways of understating or overstating the value or volume of imports or exports to avoid duties. The new law also gives the Namibia Revenue Agency the mandate to protect Namibian borders from illegal imports and exports of goods. That provision of the law defining "illicit" or the provision about illegal imports and exports was not extended to services, leaving a huge loophole.

Countries have made remarkable efforts in working towards broadening the mandate of their tax and customs agencies to address trade mis-invoicing. But the customs and tax bodies need increased sensitization about trade mis-invoicing as a main and significantly damaging channel of IFFs.

Transparency and exchange of information measures for cooperation in customs administration

Transparency is an important tool for curtailing trade-based IFFs through mis-invoicing, especially sharing trade data among customs, financial intelligence units and other law enforcement agencies. Transparency, a broad concept, has two crucial features for addressing trade mis-invoicing in African countries: transparency in relation to access to trade information and transparency concerning beneficial ownership.

20 Cited in WCO (2018a, p. 8).
21 Section 3, d of Ghana Revenue Authority Act 791, 2009.

On promoting the disclosure of beneficial ownership, 14 countries have made notable progress setting up regulatory measures, especially in the natural resources sector (table 3.1). Mis-invoicing in international trade is exacerbated by the anonymity of the multinational companies that are the biggest players in global trade. Customs authorities need access to information on the ultimate beneficial owners of the companies involved in trade to investigate the actual parties to transactions and to trace the direction of trade flows (Baker et al., 2014).

Table 3.1. African countries engagement in transparency initiatives

Countries with Extractive Industries Transparency Initiative membership (24 of 52)[a] as of September 2019	Countries with Beneficial Ownership in law (14)	Countries participating in AEIO (31)
Burkina Faso, Cameroon, Central African Republic, Chad, Côte d'Ivoire, Democratic Republic of the Congo, Republic of Congo, Ethiopia, Ghana, Guinea, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Nigeria, São Tomé and Príncipe, Senegal, Seychelles, Sierra Leone, United Republic of Tanzania, Togo and Zambia.	Benin, Botswana, Burkina Faso, Cameroon, Cabo Verde, Chad, Egypt, Nigeria, São Tomé and Príncipe, Senegal, Seychelles, Tanzania, Tunisia and Uganda	Benin, Botswana, Burkina Faso, Cabo Verde, Cameroon, Chad, Côte d'Ivoire, Djibouti, Egypt, Eswatini, Gabon, Ghana,[b] Guinea, Kenya, Lesotho, Liberia, Madagascar, Mauritania, Mauritius,[b] Morocco, Namibia, Niger, Nigeria,[b] Rwanda, Senegal, Seychelles,[b] South Africa,[b] Tanzania, Togo, Tunisia and Uganda

Source: ECA compilation from various sources.
Note: a. http://eiti.org/countries/other.|
b. these the countries committed to dates of first exchange of information—the rest had not committed by January 2020.

Many African countries participate in the Extractive Industries Transparency Initiative (EITI), comprising 24 of the 52 members registered globally as of September 2019 (see table 3.2). Of the case study countries, Côte d'Ivoire, Ghana and United Republic of Tanzania are members of the EITI and are EITI-compliant. Ghana's EITI has been building momentum for beneficial ownership transparency, and the passing of the Companies Act in 2016 provided a firm legal basis for collecting and maintaining a national database on beneficial owners in Ghana[22]. Likewise, United Republic of Tanzania enacted an EITI law in 2015 that requires all extractive companies in the country to disclose their beneficial owners (TEITI, 2018).

A report on beneficial ownership in Tanzania found that of 68 companies surveyed by the Tanzania EITI Committee, only 8 disclosed individuals as the beneficial owners, while 23 are subsidiaries of publicly owned companies and so not required to disclose beneficial ownership (TEITI, 2017). Tanzania EITI plans to organize a series of activities to review the current legal and institutional framework surrounding beneficial ownership and build stakeholders' capacity to implement beneficial ownership requirements. Côte d'Ivoire, by contrast, has yet to enact its intentions on beneficial ownership and has not prepared a roadmap to do so. According to Côte d'Ivoire's 2016 EITI Report, the current legal framework does not require a public register of the actual owners of companies that operate in the extractives industry.

Together with other members of the SACU, Namibia is currently implementing the Regional Preferred Trader Programme, which aims to facilitate customs-to-business infrastructure and relationships. The programme will be the foundation for a full-fledged regional Authorized Economic Operators (AEO) programme to be implemented in line with the World Customs Organizations' AEO programme including all supply chain entities. The SACU programme will develop safety and security criteria and enter AEO mutual recognition agreements with customs administrations in the rest of the world.

22 EITI, 2019. https://eiti.org/ghana.

Although more than half of African (31) countries have participated in discussions on the Automatic Exchange of Information (AEOI), only five—Ghana, Mauritius, Nigeria, Seychelles and South Africa—have committed to specific dates for their first exchanges.

Yet sharing import and export information among customs agencies is crucial to detecting variances in trade data. Information sharing is a key objective of Ghana's Revenue Authority Act (S.2e, GRA Act). That legal framework seeks to promote cooperation in tax matters between the revenue authority, law enforcement agencies and, externally, the revenue agencies of other countries. But enforcement remains minimal, and the law is silent about the formats and kind of information to be shared. Countries can employ a combination of ways of sharing trade information. They do so mainly through regional cooperation arrangements that authorize transmission of physical documentary copies among customs authorities through e-mail/electronic communication channels, and information technology systems. Ghana's Ministry of Trade took a remarkable step in employing EUROTRACE and statistical office data to cross-reference or examine trade data.

Efforts to bolster transparency and cooperation in tax matters have been largely driven through regional economic integration arrangements. All the five case study countries belong to one or more regional economic communities[23].

In West Africa, the adoption of the Economic Community of West African States (ECOWAS) Customs Code in December 2017 was expected to improve cooperation among customs agencies (ECOWAS, 2018). Implementation of the ECOWAS Common External Tariff, which began in January 2015, made the community a customs union—a key milestone towards a single West African regional market. Historically, tax administration cooperation was not an ECOWAS objective and did not feature in the community's 2010 treaty. Recently, a shift to promote and strengthen customs administration cooperation and coordination has been driven by the underlying objective of improving domestic resource mobilization and addressing revenue losses among member States.

Unlike Ghana's legislation, United Republic of Tanzania's does not provide for exchanging information with other countries, limiting the fight against trade mis-invoicing. Although United Republic of Tanzania does not have effective systems in place for tax information exchange with other countries, subregional exchange of customs information takes place within the framework of the East African Community (EAC). The EAC has a strong legal framework for customs cooperation. Under the protocol establishing the East African Customs Union, partner states are obliged to exchange information necessary to prevent, investigate and combat customs offences and are obliged to facilitate the sharing of customs and trade information (Articles 4 and 5 of the protocol). Countries are also required to exchange information on goods that are the subject of illicit traffic (Article 9). The EAC Customs Management Act (2004) spells out the exchange of information. But the implementation of tax coordination measures is still far from the act's requirements (Quak, 2018).

23 Côte d'Ivoire and Ghana in the Economic Community of West African States, Tunisia in the Arab Maghreb Union, Namibia and United Republic of Tanzania in the Southern African Development Community and the Common Market for Eastern and Southern Africa. Tanzania is also a member of the East African Community.

Tunisia is a signatory to the Agadir Agreement, a free trade agreement between Egypt, Jordan and Morocco that provides for cooperation in customs administration among these countries, the Arab League and the European Union. Through this agreement, Tunisia receives administrative assistance for customs valuation. Tunisia's Directorate of Customs adopted a formula for determining the contract value of goods to address falsified invoicing or reduction of the value of registered goods.

The African Continental Free Trade Agreement's opportunities and risks for mis-invoicing

Annex 3 of the African Continental Free Trade Agreement (AfCFTA), "Customs Co-operation and Mutual Administrative Assistance," addresses trade mis-invoicing in the context of the continental free trade area. Its provisions on customs cooperation, transit and trade facilitation require state parties to cooperate closely over simplifying and harmonizing trade procedures and exchanging information promptly. For trade data, the annex calls for establishing and continuously upgrading modern data processing systems to facilitate effective and efficient customs operations and trade data transmission among countries. Countries leveraging the mechanisms for cooperation and capacity building can more effectively work in structured formats on the data, technical and legal challenges underpinning trade mis-invoicing in intra-African trade.

Although the AfCFTA brings opportunities for addressing IFFs, it can also bring new and unexpected challenges. The tariff reductions and anticipated boost to intra-African trade need close monitoring so that mis-invoicing does not hide under the veil of intra-African trade. Manufactured exports expected to be boosted generously by the AfCFTA have such a potential[24].

Although the AfCFTA brings opportunities for addressing IFFs, it can also bring new and unexpected challenges.

Interagency coordination

Interagency coordination is a mechanism used for boosting information sharing among customs agencies. In Tunisia, the General Directorate of Customs collaborates with the national tax authority, the national committee of financial analysis, the central bank, the Judicial Economic and Financial Centre and other relevant bodies. Tunisia's Law 52-2018 poses obligation for the National Enterprises Register to interconnect and exchange data with public institutions including the tax authorities, customs, National Institute of Statistics, the Tunisian Financial Analysis Committee, Social Security, the Agency of Promotion of Industry and the Tunisian Investment Authority.

United Republic of Tanzania has established a complex institutional architecture like Nigeria's for addressing IFFs. Membership in its inter-agency task force for coordinating efforts against IFFs includes the central bank, the ministry of finance and its affiliated institutions such as the Tanzania Revenue Authority (TRA) and the Financial Intelligence Unit (FIU), the judiciary and its affiliated but semi-autonomous Prevention and Combatting of Corruption Bureau (PCCB), and a parliamentary committee to provide oversight of task force activities.

24 Data in the 2019 Africa Regional Integration Report showed that on average trade within the RECs remains low, and while intra-regional trading has increased within them, particularly in the SADC and EAC regions, the amount of intra-regional trade is still low compared with trade in other regions around the world (see ECA et al., 2019).

25 The Arab Maghreb Union (AMU/UMA) External Link in the north, the Economic Community of West African States (ECOWAS) External Link in the west, the East African Community (EAC) External Link in the east, the Intergovernmental Authority on Development (IGAD) External Link also in the east, the Southern African Development Community (SADC) External Link in the south, the Common Market for Eastern and Southern Africa (COMESA) External Link in the southeast, the Economic Community of Central African States (ECCAS) External Link in the centre, and, the Community of Sahel-Saharan States (CENSAD) External Link in the north.

Effectively addressing trade mis-invoicing at the regional level in Africa can only happen when there are clear institutional frameworks for customs unions, rationalized legal norms and structures, harmonized tariff structures and clear and robust legal mechanisms for data exchange and data protection. The eight Regional Economic Communities' unequal pace in achieving these goals means many customs national and regional departments lack the necessary tools and institutional guidance[25]. And in the existing regional customs unions, preferential trade agreements or free trade agreements (FTAs) between individual countries and countries outside the African Union are preponderant. That division shows that harmonization of tariffs structures has been difficult to achieve. And the lingering asymmetries enable ongoing trade mis-invoicing, smuggling, trafficking and other types of revenue fraud, so they must be scrutinized in enforcing and collecting customs duties.

Effectively addressing trade mis-invoicing at the regional level in Africa can only happen when there are clear institutional frameworks for customs unions, rationalized legal norms and structures, harmonized tariff structures and clear and robust legal mechanisms for data exchange and data protection.

Capacity of institutions to detect and prevent trade mis-invoicing

Most African countries have electronic customs administration and valuation systems. A variety of electronic tools and systems is used in customs administration. But their effectiveness in detecting trade mis-invoicing continues to raise concern.

Namibia uses the United Nations Conference on Trade and Development (UNCTAD) Automated System for Customs Data (ASYCUDA) to report on all exports and imports to help with detection. ASYCUDA is an integrated customs management system for international trade and transport operations in a modern automated environment (ASYCUDA, 2020)[26]. Namibia also plans to implement the Container Control Programme, a joint programme of the World Customs Organization (WCO) and the United Nations Office on Drugs and Crime (UNODC). That programme builds capacity in member States to improve risk management, supply chain security and trade facilitation in seaports, airports and land border crossings to prevent the cross-border movement of illicit goods. Presently, a memorandum of understanding for implementing the programme has been drafted, and a responsible unit will be established within Namibia's revenue agency.

The Tunisian customs department developed the automated customs information system (SINDA). The system aims to ensure the documentary and physical management of goods from their arrival at the customs office to automatic clearance. SINDA is connected domestically to the regional centres, the central bank and the National Institute of Statistics and is internationally interoperable with similar platforms in Morocco, Egypt and Jordan. The authorities are working to link SINDA to the Financial Action Task Force and the Ministry of the Interior (Aidi, 2019). In 2002, the customs department digitalized its transport procedure through the platform Tunisie TradeNet (TTN), which enables carriers, companies, shipping agents, air charterers, freight forwarders, customs agents and police to process import and export procedures electronically. TTN aims to facilitate international transport procedures for goods and foreign trade, ensure their traceability and reduce the time goods stay at ports[27.] The system is also linked to the System of Rationalization of Tax and Accounting Action (RAFIC), which integrates tax audit and recovery.

26 The ASYCUDA system has been installed or is being implemented in over 90 countries, territories and regions, including 38 African countries. https://asycuda.org/en/user-countries/.

27 See http://www.tradenet.com.tn/portal/page/notreMission.

The government of Ghana created GCNET, which records the details of all trade passing through customs, to improve customs administration. GCNET is part of the single electronic Ghana TradeNet application for online submission, processing, approval and distribution of a wide range of trade-related documentation by ministries, departments and agencies. The ministry of trade monitors GCNET to ensure data validity and assess linkages with other datasets. An inter-agency committee, including the ministry of trade, customs department, Ghana Statistical Services, central bank, and Ghana Export Promotion Authority, convenes monthly to discuss issues and examine the data.

Box 3.2. GFTrade tool

GFTrade is an online tool designed by Global Financial Integrity to build customs authorities' capacity to detect mis-invoicing as transactions occur and take corrective steps in real time. The GFTrade tool draws on the most up-to-date price data for traded goods reported by over 30 major economies, including China, the EU 28, Japan and the United States. It enables customs officials to quickly and easily use real-time price comparisons to determine if the prices stated for goods in invoices submitted by local importers or exporters are outside the typical ranges for comparable products declared by their trade partner within the past year. It flags invoices for further investigation when warranted. GFTrade tackles trade mis-invoicing and assist governments in maximizing domestic resource mobilization.

Source: GFI, 2019.

Despite these customs administration tools, trade mis-invoicing continues unabated due to challenges, including lack of operating capacity, high maintenance costs and internet outages.

Trade-focused cooperative arrangements for addressing illicit financial flows

National

Trade mis-invoicing causes substantial losses of tax revenues and customs duties and exemplifies broader corruption problems. If unchecked, it provides convenient channels for public officials, criminals and transnational crime and armed groups to launder illicit gains and for high net-worth individuals and businesses to dodge capital controls and taxes.

The prevalence of trade mis-invoicing reflects deep institutional deficiencies in government departments and agencies, insufficient legal frameworks or strong legal frameworks hampered by poor enforcement. These institutional deficiencies in turn damage the climate for investment, trade and business growth, undermine the rule of law and entrench poverty.

At the national level, African countries should consider measures to curtail revenue losses and IFFs due to trade mis-invoicing. They need to enact legislation and regulations that clearly specify trade mis-invoicing as illegal. Where such legislation and regulations already exist, governments should strengthen and scale-up enforcement.

African countries should leverage technology to digitalize their customs operations to detect trade mis-invoicing and take corrective steps in real time.

Stopping the removal of substantial resources from the reach of governments and so from countries' development requires governments to formally join the international Financial Action Task Force (FATF) and to comply with its best practices for addressing the money laundering risks associated with international trade (see chapter 4). Today, only South Africa is a full member, and the African Development Bank is an observer, while other African countries participate remotely through FATF associate member organizations such as the Eastern and Southern Africa Money Laundering Group, Inter-Governmental Action Group against Money Laundering in West Africa, Task Force on Money Laundering in Central Africa and Middle East and North Africa Financial Action Task Force (they are covered in Chapter 4). Chapter 4 also shows governments how trade mis-invoicing is used for money laundering and trade-based money laundering.

If the beneficial ownership of the trading entities is unknown, following money illicitly transferred through trade is challenging. African customs laws should require beneficial ownership registers and require financial system gatekeepers to know the true beneficial owners of any account or client relationship they open. Governments should join networks such as FATF that facilitate access to beneficial ownership registers.

To address cross-border trade-based IFFs, African governments should require multinational companies to publicly disclose their sales, revenues, profits, losses, taxes paid, subsidiaries and staff levels country by country. Along with country-by-country reporting (CbCR), countries should adopt the automatic exchange of information (AEOI) with all other trading partner countries for tax information.

African countries should leverage technology to digitalize their customs operations to detect trade mis-invoicing and take corrective steps in real time. Currently, 38 African countries use the ASYCUDA system to administer their customs operations (described above with Namibia)[28]. GFTrade enables access to the most up-to-date price data for traded goods, allowing customs officials to use real-time price comparisons in examining invoices (box 3.2).

Upgrading technical knowledge will be critical for staff working in customs, the tax authorities and financial intelligence units, particularly on the emerging issues in customs management such as curbing IFFs. Offenders increasingly search out new ways to game the system.

Regional

The Abuja Treaty, signed in 1991 by the African Union, was designed to set a path for forming the African Economic Community (AEC) through eight Regional Economic Communities (RECs)—the Arab Maghreb Union (AMU), Community of Sahel-Saharan States (CEN-SAD), Common Market for Eastern and Southern Africa (COMESA), East African Community (EAC), Economic Community of Central African States (ECCAS), Economic Community of West African States (ECOWAS), Inter-governmental Authority on Development (IGAD) and Southern Africa Development Community (SADC).

The second and third stages of implementing the Abuja Treaty were expected to harmonize tariffs and create customs unions that would ultimately, in the fourth phase, be consolidated into a continent-wide customs union. But most RECs have not yet advanced to customs unions, and trade within each of them remains low. Data from the 2019 Africa Regional Integration Report showed that although intra-regional trade has increased within the RECs, particularly the SADC and EAC, the amount is still small compared with that in other regions around the world (ECA et al. 2019).

28 The 16 countries not using ASYCUDA are: Algeria, Botswana, Egypt, Ethiopia, Ghana, Kenya, Libya, Mauritius, Morocco, Mozambique, Senegal, Somalia, South Africa, South Sudan, United Republic of Tanzania and Tunisia.

Effectively addressing trade-based IFFs at the African level requires clear institutional frameworks for customs unions, rationalized legal norms structures, harmonized tariff structures, clear and robust legal mechanisms and methods for data exchange and data protection. The delay in RECs creating these structures has deprived many customs departments at both the national level and regional level of tools and institutional guidance for preventing trade-based IFFs.

To benefit from improved intra-regional trade, African countries have to address the gaps in information exchange, customs integrity, harmonization of tariffs and supervision and oversight of commercial entities in the trade chain. The gaps produce unresolved tensions between the imperative to streamline trade facilitation and thus promote more trade and the imperative to establish better controls, supervision and oversight of trade flows. Until meaningful progress is made at the REC and AU levels, any improvements in trade facilitation will be offset by continued losses of trade revenue in mis-invoicing and other abuses. Examples from SACU, EAC, ECOWAS and CEMAC will illustrate these problems.

Southern African Customs Union (SACU).

SACU continues to be held back by institutional inefficiencies, unreliable trade statistics, and controversies around members' allocations from the common revenue pool. It is characterized by high revenue leakage risks. These inefficiencies have undermined SACU's ability to target trade mis-invoicing. Even so, SACU has made some progress, with recent targeting of limited resources to the areas of greatest vulnerability improving customs risk assessment. SACU has also developed frameworks for real-time data exchange and data protection among its members, including robust IT-based frameworks that enable customs officials to flag discrepancies in declared origin, value, quantity and type of goods being imported and exported.

Serious challenges remain. For example, a World Bank report on customs between the South African Revenue Service and the Eswatini Revenue Authority identified the need for data exchange between the two agencies due to significant trading volumes. Inaccuracies and delays in paper-based cross-border trade data exchange between SACU members offer gaps ready for abuse and contribute to revenue leakages due to trade mis-invoicing. The absence of a legal framework has hampered recent efforts to eliminate the dual capturing of customs data in declarations and to create a one-stop border post, which would improve risk management and mitigation and compliance oversight and supervision. Since there are no rules governing collection, storage, protection and use of data, any data captured cannot be used for enforcement purposes. The World Bank report attributes governance challenges to the absence of the necessary internal guidelines. All members of the SACU region have ratified real data exchange, but no actual exchanges have yet taken place.

Although SACU's Mutual Administrative Assistance legal instrument came into force in 2017, secondary implementation arrangements at the bilateral or multilateral level are still required before this instrument can be fully implemented. SACU members are still negotiating over the details of such arrangements. And SACU members' national customs legislation is similar but not compatible, obstructing efficient dispute settlement and enforcement of actions on trade mis-invoicing and other forms of commercial/revenue fraud.

SACU now realizes that to fully address these challenges, it requires a single customs law governing member States. Progress on such legislation and its implementation could overcome many of the historic hurdles the union has faced.

***East African Community (EAC)*.**

The EAC, founded in 1917, established the East African Community Customs Union in 2004 to:

- Enforce a common external tariff.
- Further liberalize intra-regional trade in goods on the basis of mutually beneficial trade arrangements among partner States.
- Promote efficiency in production within the community.
- Enhance domestic, cross-border and foreign investment in the community.
- Promote economic development and diversification in industrialization in the community[29].

The EAC has postponed the full implementation of the customs union three times due to challenges in agreeing on harmonization and the collection of joint taxes. In theory, the members' agreement on a common external tariff should rationalize customs administration and enforcement against trade mis-invoicing. But because of asymmetries in implementation, some member States still have individual tariff rates. For instance, the Ugandan government amended legislation in 2017 to tax cigarettes produced outside the country at a higher rate. This went against established provisions in of the East African Community Treaty (Articles 1 and 75 [6]), the EAC Customs Union Protocol (Articles 1 [1] and 15 [1] [a] and [2]) the EAC Common Market Protocol (Article 6 [1]). The matter was decided in 2019 by the East Africa Court of Justice, which held that Uganda acted in contravention of its commitments under the regional agreements. For customs officials at the border seeking to implement a single customs territory, these asymmetries cause confusion and provide gaps in which trade mis-invoicing flourishes.

Other continuing problems affect the implementation of a single customs territory and boost the incidence of trade mis-invoicing. They include non-tariff barriers, restricted flow of cargo, multiple security bond regimes, weak enforcement mechanisms, problems with customs integrity, congestion at ports and border stations, differences in applying customs laws and instruments, multiple customs declarations at internal borders, varying valuation approaches among the member states and complex clearance procedures involving multiple government agencies.

The ongoing problems reduce revenue collection for all members. For instance, in Kenya mis-declaration of imports and concealment of goods and cargo to avoid taxes are rampant. In United Republic of Tanzania and Uganda, smuggling continues to affect revenue collection (see box 3.3 on United Republic of Tanzania). And although revenue department officials acknowledge that national strategies pay little in dividends and that revenue leakages must be addressed for increased domestic resource mobilization, trade disputes between Kenya and Tanzania, and between Uganda and Rwanda cause frequent changes in customs procedures and rules governing trade for political purposes.

The Revenue Authority Digital Data Exchange (RADDEx), a web-based application, enables EAC member states to exchange export/re-export and transit information. The information exchanges include declaration number and date, exporter/importer/agent name, number of packages, total/gross weight, country of origin, customs value, commodity description and commodity code. The customs officials of destination (or transit) locations can target and profile goods in advance and reconcile that information with the data elements of the corresponding import/export or transit declaration of goods on arrival. Clearing agents are also able to access the system to obtain the same information. RADDEx operates this system on a bilateral basis between exporting and importing countries. EAC governing legislation protects data and provides penalties for violations of data protection norms.

29 Amendments in 2015 and 2017 to be discussed in final draft.

An inherent weakness in RADDEx may be that while providing the customs value and commodity code is mandatory, providing the invoice value is optional. No supporting documents, such as invoices and certificates of origin, are available—they must still be physically submitted at customs offices at borders. And since RADDEx is web-based, it experiences network failure at remote borders. Since it operates country to country, each bilateral relationship in the system needs to be developed, implemented and maintained.

There are also reports that because all the rules and protocols for the customs union are in English, implementation has been slow in Francophone members such as Rwanda and Burundi (this could also affect Democratic Republic of the Congo as it applies to join EAC).

Box 3.3. Risk management in United Republic of Tanzania

Before 2013, trade mis-invoicing in United Republic of Tanzania was treated lightly. Perpetrators were punished with a maximum fine of $10,000 and nullification of their licence. In an effort to address the problem, new amendments to the law made trade mis-invoicing a criminal offence and thus allowed perpetrators to be prosecuted, mis-invoiced goods to be impounded and business licences of those convicted to be nullified. The proposed changes sought to tackle traders taking advantage of Tanzania's pre-arrival declaration system to declare false values for goods or misclassify them to evade payment of duties.

Even so, trade mis-invoicing continues to be a considerable problem in Tanzania, and in the region more generally. Tanzania plays a major role in ethanol smuggling within the EAC. In 2019, it was estimated that Kenya lost 30 billion shillings ($300 million) in revenue from ethanol smuggling. First ethanol is exported from Kenya to Tanzania, taking advantage of Kenya's low export duties and the large difference in excise duties between the two countries. The ethanol is then smuggled back into Kenya from Tanzania and distilled into various products by illegal liquor producers.

The Tanzanian Revenue Authority (TRA) is continually making institutional changes to address trade mis-invoicing, but implementation of many of the new legal frameworks remains problematic. In June 2019, Tanzania welcomed the World Customs Organization's first Anti-Corruption and Integrity Promotion mission to the TRA. The TRA has also been working to improve its risk management procedures for the past two years in cooperation with the Japan International Cooperation Agency. A new draft customs risk management document, currently being finalized, seeks to address changing risk and the needs of customs administration. The document prioritizes regional and international cross-border risks to Tanzania over a more narrowly focused domestic framework.

Source: GFI (2019).

Economic Community of West African States (ECOWAS).

ECOWAS has been evolving from a free trade area to a customs union since the entry into force of the ECOWAS common external tariff in January 2015. In the past, ECOWAS grappled with the challenges of coordination and is still working to consolidate its customs union by enhancing mechanisms for information exchange and customs cooperation. Improvements in these areas will mitigate the systemic risks from the security challenges and resurgent illicit trafficking in the region. ECOWAS is also attempting to expand customs department mandates in the region to include combatting trafficking, terrorist financing and money laundering. Expanding those mandates and intensifying cooperation on information exchange are viewed as critical steps to curbing the growth of the transnational crime.

Economic Community of Central African States (CEMAC).

Both the Economic Community of Central African States (CEMAC) and the West African Economic and Monetary Union (WAEMU) have been working for many years to promote economic integration in the West African region. Despite many efforts to streamline the implementation of common external and preferential tariffs; harmonize national customs legislation, procedures and practices; facilitate transit and ease the flow of goods across borders and increase cooperation among the members' customs administrations, many challenges remain. Discrepancies in the application of tariff rates, rules and practices among the member states impede tariff harmonization. Such asymmetries impede trade facilitation and enable trade mis-invoicing and smuggling. Other ongoing challenges include delays in computerizing systems, which has primarily been left to individual national administrators, increasing the risk of implementation discrepancies. So, there are calls to establish regional IT modules. Both CEMAC and WAEMU adopted a community customs code in 2001. WAEMU has not yet adopted a regional investment code and though CEMAC adopted one in 1965, it has not been implemented in practice.

International

To tackle IFFs more broadly, African countries need to use diplomatic clout mechanisms in the international arena to support organizations and policy initiatives that require international cooperation to curb IFFs, particularly trade mis-invoicing. International efforts will be crucial to increase transparency in the global financial system, such as measures reducing the secrecy of tax havens and anonymous companies and efforts to curtail money laundering techniques and improve cross-border customs cooperation.

To tackle IFFs more broadly, African countries need to use diplomatic clout mechanisms in the international arena to support organizations and policy initiatives that require international cooperation to curb IFFs, particularly trade mis-invoicing.

World Customs Organization (WCO). All 54 African countries had ratified the Harmonized System (HS) convention as of 21 February 2020[30], and 4 (Equatorial Guinea, Seychelles, Somalia, and South Sudan) had applied for but not yet been accepted as contracting parties to the convention. Only 29 apply the HSC[31], and of these, only 6 apply the WCO Council recommendation on improving tariff classification related to infrastructure, while only 8 countries apply the recommendation on advanced rulings[32].

On October 4 2018, the WCO Secretary General signed a €5 million contract to harmonize the classification of goods and enhance trade in Africa. The programme, funded by the European Union, aims to aid the establishment of the African Continental Free Trade Area and the implementation of the World Trade Organization Trade Facilitation Agreement (WTO-TFA) over 41 months. African countries are grouped by the WCO subdivisions: East and Southern African, West and Central African, and Middle East and North African. The longer-term objective is to provide African countries with the organizational capacities and resources to migrate and apply future HS versions in a timely manner, coordinated throughout the entire continent and region thus benefitting the RECs, customs administrations and relevant stakeholders, including the Africa Union Commission, selected national government administrations and the private sector. Ultimately, fostering integrity remains key to mitigating the risks of trade mis-invoicing. Additional global efforts to ensure integrity in international trade are highlighted in box 3.4.

30 http://www.wcoomd.org/en/topics/nomenclature/~/media/WCO/Public/Global/PDF/Topics/Nomenclature/Overview HS%20Contracting%20Parties/List%20of%20Countries/Countries_applying_HS.ashx. Accessed 1 March 2020.
31 http://www.wcoomd.org/en/media/newsroom/2019/march/launch-of-the-eu-wco-programme-for-harmonized-system-in-africa.aspx.
32 http://www.wcoomd.org/en/media/newsroom/2018/october/signing-ceremony-for-the-hs-programme-in-africa-between-the-eu-and-the-wco.aspx.

Box 3.4. The role of customs integrity measures in addressing trade mis-invoicing

Given the importance of international trade and trade facilitation for global economic growth, the substantial costs due to non-tariff barriers, including a lack of integrity in border control and customs, can affect the long-term economic growth of society as a whole. The World Customs Organization (WCO) estimates that at least $2 billion is lost in customs revenue each year and that improved trade facilitation could reduce trade cost by 16.5 per cent for low-income, 17.4 per cent for lower-middle income countries and 14.6 per cent for upper-middle income countries. Implementing appropriate integrity measures can reduce trade costs between 0.5 per cent and 1.1 per cent. A survey of the G20 countries found that the following steps at least helped address integrity within customs. For Africa that survey should be modified and carried out to see how many countries on the continent have measures to address the survey's six key areas, as follows:

- Strengthening control environments for promoting integrity, including legislative oversight, anti-corruption and risk assessment strategies and communications strategies to strengthen the leadership's messages on integrity.
- Ratifying both the Harmonized System Convention and the WCO Revised Kyoto Convention.
- Simplifying customs procedures to increase their effectiveness and reducing the opportunities for rent-seeking and mis-invoicing, including through establishing a dedicated unit for assessing policy effectiveness, conducting ongoing performance reviews and using automated systems to enhance effectiveness and internal controls.
- Increasing predictability and accountability in customs procedures, including through large public awareness campaigns of the main customs rules, procedures and tariffs; appropriate guidance on the use of discretionary powers and guaranteed security and confidentiality of the commercial and personal information of customs users.
- Promoting effective whistle blower communication channels to enhance internal auditing.
- Providing for effective communication channels with the private sector to proactively address emerging issues.

Source: GFI (2019).

Information exchange and customs cooperation

The cross-border nature of trade makes the prevention, detection, and enforcement of trade mis-invoicing dependent on robust and comprehensive legal and data frameworks for information exchange and customs cooperation across jurisdictions. Article 12 of the Trade Facilitation and Customs Cooperation sets out those responsibilities[33].

33 Article12.2, provides that "Members shall exchange the information set out in subparagraphs 6.1(b) and/or (c) for the purpose of verifying an import or export declaration . . . " "6.1 (b) . . . specific information as set out in the import or export declaration, or the declaration, to the extent it is available, along with a description of the level of protection and confidentiality required of the requesting Member" "6.1 (c) . . . specific information as set out in the following documents, or the documents, submitted in support of the import or export declaration, to the extent it is available: commercial invoice, packing list, certificate of origin and bill of lading, in the form in which these were filed, whether paper or electronic, along with a description of the level of protection and confidentiality required of the requesting Member."

Several international agreements have implications for trade mis-invoicing. They include free and preferential trade agreements, customs cooperation and mutual assistance agreements; multilateral environment agreements (the Convention on International Trade in Endangered Species of Wild Fauna and Flora of the Basel Convention); the framework agreement on facilitation of cross-border paperless trade, mutual recognition agreements and others under the WCO's Standards to Secure and Facilitate Global Trade (SAFE Framework); and multilateral agreements (Convention on the International Transport of Goods under Cover of TIR Carnets [TIR Convention] and Convention on the ATA Carnet for the Temporary Admission of Goods [ATA Convention]). Each of the agreements and the commitments under them has separate and distinct implications for trade mis-invoicing in separate sectors and deserves study.

Box 3.5. Customs risk assessment

Risk management according to standard 6.3 of the Revised Kyoto Convention (RKC) is the systematic application of management procedures and practices that provide customs with the necessary information to address movements or consignments that present a risk. Risk management and its application is one of the seven principles identified in RKC as integral to trade facilitation.

According to the World Customs Organization (WCO), the five main steps in customs risk management are:

Establish context:	Identify risk:	Analyse risks:	Assess and prioritize risks:	Address risks:
import of goods, export controls, passenger traffic.	revenue protection (such as under-valuation, origin, classification), prohibitions and restrictions (such as drug trafficking, IPR, firearms and so on)	likelihood of a risk occurring (less likely, likely, highly likely)	assess the impact and consequence of risked events occurring (high, medium, low).	define countermeasures and assign to risk levels (tolerate, treat, transfer or terminate).

But customs still apply a 100 per cent physical inspection regime in many countries, according to the UN Economic Commission for Europe (UNECE). This causes substantial delays at ports, airports and border crossings. Additionally, a 100 per cent inspection regime fosters an enabling environment for informal payments or bribes to move the process forward.

The customs capability reports published by the Global Express Association and cited by the UNECE show that only 37 of 114 countries surveyed applied a risk-based selectivity approach, 18 examined all shipments and the others selected ships randomly or at the sole discretion of the inspecting customs officer. In the African context, the East African Community finalized its regional customs risk management strategy in 2017, though reports on the progress are still unavailable.

In many countries, staff resources have not increased with time—in Japan, they are the same as in 1999. Customs risk management is invaluable for allocating limited resources effectively. It is consistent with efforts in the private sector and other government agencies to curb related offences, such as transitional crime, money laundering and terrorist financing. Customs risk assessment would be a first step for countries at both the national and regional level to better understand the vulnerabilities due to products, regions and trade routes (ship, land and air).

The WCO published its WCO Customs Risk Management Compendium in 2011. Volume 1, available to the public, provides principles, frameworks and processes for managing risk. Volume 2, a living document available only to members, discusses risk indicators, profiling and targeting. Separate manuals have been created on maritime risk indicators for pre-arrival, arrival and post-arrival. Similar manuals exist for air cargo risk indicators, land cargo risk indicators and the structure of an information and intelligence strategy. Although these manuals were published almost a decade ago, their implementation by WCO members is unclear, specifically at the national level in Africa. A survey to determine their implementation would support efforts to curbing trade-based illicit financial flows.

Additional guidance on customs risk management can be found from:

- Customs Risk Management Framework, European Commission (2018).
- Economic and Commercial Cooperation of the Organization of Islamic Cooperation (COMEC): Improving Customs Risk Management System in the OIC Member States (2018).
- UNCTAD Trade Facilitation Technical Note No.12—Risk Management (2014).
- Supply Chain Risk Assessment Guide, Customs and Border Protection, US Department of Homeland Security (2014).
- Compliance Risk Assessment Tools in Customs and Trade, OECD (2016).
- Customs Risk Management: A Survey of 24 WCO Member Administrations (2011).
- Customs modernization handbooks, World Bank (2005).

Source: ECA staff compilation from multiple sources.

Information exchange and customs cooperation in the African Union can be bilateral, multilateral and regional, or multilateral and international. The information exchange can take the form of customs compliance programmes, customs mutual assistance programmes (to facilitate investigations and enforcement), globally networked customs information exchange (customs-to-customs information sharing including from commercial sources) or an authorized economic operator (AEO) programme that offloads some compliance and oversight responsibility for trade mis-invoicing to the private sector.

The WCO in 2005 adopted the SAFE standards to secure and facilitate global trade (the SAFE framework) to deter international terrorism, secure revenue collections and promote trade facilitation worldwide. The 2018 edition of the standards provides greater detail on such new and updated tools as the AEO Validator Guide, the updated AEO Template, the Mutual Recognition Arrangement/Agreement (MRA) Strategy Guide, MRA Implementation Guidance, Advance Cargo Information (ACI) Implementation Guidance, the updated Integrated Supply Chain Management Guidelines, the Recommendation and Guidelines on Trader Identification Number (TIN) and the Handbook on Data Analysis; as well as frequently asked questions (FAQ) on linkages between the SAFE AEO programme and Article 7.7 of the World Trade Organization Trade Facilitation Agreement—all essential to ensuring integrity and safety in trade, and key tools in addressing the risks of trade mis-invoicing (box 3.5, see boxes 3.4).

More recently, the WCO has tried to implement its Globally Networked Customs (GNC) protocol which is defined as "The voluntary arrangement between two or more Members for a seamless exchange of cross border information at a customs-to-customs level. The GNC is the WCO's attempt to deal with more than 50+ existing bilateral systems, Single Window Systems (NSW), Regional Multilateral Information Exchange Platforms, etc. for information exchange, all of which have to be individually and separately crafted." GNC provides standard agreements across a variety of customs-related areas to facilitate and standardize customs connectivity and exchange of information. At present, SACU is the only regional customs union in Africa that has begun to implement GNC (it will be discussed below).

Globally, 30 customs compliance programmes are currently operational. Of them, 13 are in Africa—7 in East and Southern Africa (Madagascar, Mauritius, Mozambique, Rwanda, South Africa, United Republic of Tanzania and Zambia); 4 in West and Central Africa (Cameroon, Nigeria, Senegal and Togo) and 2 in North Africa (Algeria and Sudan). Zambia has committed as of 2019 to launch a customs compliance programme.

Among the WCO membership, 74 bilateral mutual recognition agreements (MRA) have been concluded, but none in Africa except for the North African countries of Egypt, Jordan, Morocco and Tunisia, which concluded the Agadir Agreement in April 2016. Separately Egypt is negotiating MRAs with Saudi Arabia and the United Arab Emirates. The SACU is negotiating an MRA with South Africa and intra-SACU individual MRAs with Botswana, Eswatini, Lesotho and Namibia. Uganda is negotiating separate MRAs with India and China.

Operational Authorized Economic Operator (AEO) programme. According to the WCO SAFE Framework of Standards, an AEO is a party involved in the international movement of goods, in whatever function, that has been approved by, or on behalf of, a national customs administration as complying with WCO or equivalent supply chain security standards. AEOs include manufacturers, importers, exporters, brokers, carriers, consolidators, intermediaries, ports, airports, terminal operators, integrated operators, warehouses and distributors.

The AEO standards came about because the role of customs administrations expanded in the 1970s to include the security of international trade and participation in global security programmes. With the potential use of trade mis-invoicing by organized criminal groups and terrorists, standards were developed to ensure that entities in the trade chain had adequate compliance measures to document their legitimacy.

A 2019 review of the implementation of these various initiatives shows 83 operational AEO programmes globally. Only 8 are in Africa, of which 5 (Burundi, Kenya, Rwanda, Mauritius and Uganda) are concentrated in the East and Southern African region and 3 in North Africa (Egypt, Morocco and Tunisia). As of 2019, 10 countries on the continent committed to developing AEO programmes of their own. They include 5 countries in West and Central Africa (Côte d'Ivoire, Democratic Republic of the Congo, Gabon, Ghana and Nigeria)—the first time AEO programmes will become operational in that region. Five additional East and Southern African countries have also committed to implementing AEO programmes—Angola, Botswana, Lesotho, Seychelles and South Africa.

Although the idea behind the AEO programme is laudable and broad-based uptake would deepen information and spread due diligence practices to the private sector, entities have had to make substantial investments to obtain AEO status and must continue to invest to maintain it. And customs departments often do not offer substantial trade facilitation in return, increasing the cost of trading. So, the worldwide uptake of AEO programmes is slow[34]. To complete the realization of benefits from the AEO programme, customs departments across the continent will have to improve the benefits packages available to operators that fall under their purview.

To complete the realization of benefits from the AEO programme, customs departments across the continent will have to improve the benefits packages available to operators that fall under their purview.

34 http://tfig.unece.org/contents/authorized-economic-operators.htm.

Conclusions and policy recommendations

This chapter has explored trade mis-invoicing, its anatomy, its harms to African economies and efforts to curb it nationally, regionally and internationally. Effective solutions can only come from concerted bilateral, multilateral and regional efforts—nations cannot solve these problems by themselves. Trade-based IFFs entail transboundary trade, so solutions to curb them must cross borders, as well.

Individual case studies and the Abuja Treaty's plan recognize this need for collaborative effort both for revenue generation and for trade facilitation and economic growth. National administrators in the case study countries recognize that solutions to trade mis-invoicing require regional integration and domestic policy coherence through a whole-of-government approach. The following recommendations address such changes, which are systemic:

National strategy

Although several African countries have tried to broaden the mandate of their tax and customs agencies to address trade mis-invoicing, unawareness down the organizational chain has hampered their effectiveness. So, a more comprehensive approach is needed that entails increased sensitization among policymakers, customs and tax operators and oversight bodies about trade mis-invoicing as a main and significantly damaging channel of IFFs, and the modalities for tackling it.

> *...a more comprehensive approach is needed that entails increased sensitization among policymakers, customs and tax operators and oversight bodies about trade mis-invoicing as a main and significantly damaging channel of IFFs, and the modalities for tackling it.*

Laws

- African countries must enact laws and regulations that criminalize trade mis-invoicing, and where such legislation and regulations already exist, they should strengthen and scale up enforcement to plug revenue leakages.
- African countries must establish comprehensive legislative frameworks that provide customs and revenue bodies comprehensive mandates to tackle trade mis-invoicing for goods and services, including trade facilitation, coordination and awareness raising among relevant agencies in the trade mis-invoicing value chain.
- Those legislative frameworks must include clear provisions for rules governing the collection, storage, protection and sharing (within and outside the country) and use of trade data, servicing risk analysis, mitigation and management as well as compliance oversight and supervision.
- Since trade-based IFFs are transboundary, legislation must authorize national tax and customs authorities to collect, share and request trade and related data and information from other customs and tax jurisdictions to facilitate the prevention and curbing of illicit trade, tax fraud and transnational crime.
- As trade mis-invoicing is exacerbated by the anonymity of owners of multinational companies (the biggest players in global trade), African countries must enact laws demanding the declaration of beneficial owners of multinational companies and legal entities involved in trade through or within their jurisdictions.
- Legislation on trade-based IFFs must require all transactions to be backed by appropriate documentation, particularly invoices, made available to customs and revenue authorities' audits of all trade-involved economic entities.
- To effectively tackle cross-border trade-based IFFs, African governments must legally require traders, including multinational companies, to publicly disclose their revenues, profits, losses, sales, taxes paid, subsidiaries and staff levels in each country by adopting country-by-country reporting (CbCR) and the automatic exchange of information (AEOI) for tax information with all other trading partner countries.

Operational procedures

- African countries should share trade information, mainly through regional cooperation arrangements that enable a combination of methods—transmission of physical documentary copies among customs authorities, e-mail/electronic communication channels, memorandums of understanding and IT systems.
- Countries must equip customs and revenue authorities with the operational capacity and technology to digitalize their operations to detect trade mis-invoicing as transactions occur and take corrective steps in real time, and the countries must meet the high costs of maintaining such systems and ensure reliable internet at all customs and border posts.
- African countries must equip their customs and revenue services with staff with the skills to carry out audits, investigations and revenue collection prosecutions and must ensure ongoing training of staff with cutting edge skills to counter the latest criminal practices.

African countries should share trade information, mainly through regional cooperation arrangements that enable a combination of methods...

Special operational arrangements

To effectively address trade mis-invoicing, African countries must establish legally based institutional frameworks for the collaboration and coordination of the agencies involved in the trade-based IFF value chains, such as customs and revenue authorities, financial intelligence units, anti-smuggling units, anti-corruption units, financial institutions and central banks, as well as policy agencies such as ministries of finance, trade and industry.

Regional and international cooperation

- African countries must establish coherent institutional frameworks at the subregional and regional levels for customs unions, rationalized legal structures (such as customs codes), harmonized tariff structures and clear and robust legal mechanisms for data generation, recording, exchange and protection.
- To benefit from improved IFF-free intra-regional trade, African countries must address the gaps in information exchange, customs integrity, supervision and oversight of commercial entities in the trade chain. And they must harmonize tariffs. RECs and the AU must improve control systems for trade facilitation, supervision and oversight to support country efforts to combat trade-based IFFs.

RECs and the AU must improve control systems for trade facilitation, supervision and oversight to support country efforts to combat trade-based IFFs.

- With diverse electronic customs administrations and valuation systems of varying effectiveness in addressing trade mis-invoicing, African countries should establish interoperable regional IT modules (for example with Globally Networked Customs—GNC), supported by coherent region-wide customs code and trade facilitation frameworks that require submission of invoices and certificates of origin.
- African countries should establish a regional mutual administrative assistance legal instrument interoperable with national systems and international standards for mutual support in efficiently settling disputes and enforcing actions on trade mis-invoicing and other forms of commercial and revenue fraud.
- African countries should join the Authorized Economic Operator (AEOs) programmes to assign some compliance and oversight responsibility for trade mis-invoicing to the private sector and should enhance their participation in the AEOI.
- African countries must publish all relevant regional trade facilitation documentation in the languages of the African Union to speed their implementation and curtail trade-based IFFs and smuggling.
- African countries must establish an apolitical dispute settlement and trade facilitation authority to promote regional efforts to curb trade-based IFFs.
- To deepen information exchange, African countries should establish information sharing bureaus devoted to cross-border trade. Laws to ensure information exchange must specify the type of information to be shared. The information sharing bureaus can maintain that information and make it accessible to customs and revenue agencies.

ANNEX

Table A3.1. Institutional architecture for addressing trade mis-invoicing in Africa, by country

Country	Customs authority	Extractive Industries Transparency Initiative (EITI)	Beneficial Ownership Registers	Automatic Exchange of Information (AEOI)	Customs IT Platform	WCO Revised Kyoto Convention	Harmonized System Convention	Authorized Economic Operator
Algeria	Yes		Yes		Yes	Yes	Yes	No
Angola	Yes				Yes	Yes	Yes	No
Benin	Yes				Yes	Yes	Yes	No
Botswana	Yes				Yes	Yes	Yes	No
Burkina Faso	Yes	Yes			Yes	Yes	Yes	No
Burundi	Yes				Yes		Yes	No
Cameroon	Yes	Yes			Yes	Yes	Yes	No
Cabo Verde	Yes				Yes	Yes	Yes	No
Central African Republic	Yes	Yes[a]			Yes		Yes	No
Chad	Yes	Yes			Yes		Yes	No
Comoros	Yes				Yes		Yes	No
Republic of Congo	Yes	Yes			Yes	Yes	Yes	No
Democratic Republic of the Congo	Yes	Yes			Yes	Yes	Yes	No
Côte d’Ivoire	Yes	Yes			Yes	Yes	Yes	No
Djibouti	Yes				Yes		Yes	No
Egypt	Yes				No	Yes	Yes	No
Equatorial Guinea	Yes				Yes		Yes	No
Eritrea	Yes				Yes		Yes	No
Eswatini	Yes				Yes	Yes	Yes	No
Ethiopia	Yes	Yes			Yes		Yes	No
Gabon	Yes				Yes	Yes	Yes	No

Country	Customs authority	Extractive Industries Transparency Initiative (EITI)	Beneficial Ownership Registers	Automatic Exchange of Information (AEOI)	Customs IT Platform	WCO Revised Kyoto Convention	Harmonized System Convention	Authorized Economic Operator
Gambia	Yes				Yes		Yes	No
Ghana	Yes	Yes		Yes[a]	Yes	Yes	Yes	No
Guinea	Yes	Yes			Yes		Yes	No
Guinea-Bissau	Yes				Yes		Yes	No
Kenya	Yes		Yes		Yes		Yes	No
Lesotho	Yes				No	Yes	Yes	No
Liberia	Yes	Yes			Yes		Yes	No
Libya	Yes				Yes		Yes	No
Madagascar	Yes	Yes			Yes	Yes	Yes	No
Malawi	Yes	Yes			Yes	Yes	Yes	No
Mali	Yes	Yes			Yes	Yes	Yes	No
Mauritania	Yes	Yes			Yes		Yes	No
Mauritius	Yes				Yes	Yes	Yes	No
Morocco	Yes				Yes	Yes	Yes	No
Mozambique	Yes	Yes			Yes	Yes	Yes	No
Namibia	Yes				Yes	Yes	Yes	No
Niger	Yes				Yes	Yes	Yes	No
Nigeria	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No
Rwanda	Yes				Yes	Yes	Yes	No
São Tomé and Príncipe	Yes	Yes			Yes	Yes	Yes	No
Senegal	Yes	Yes			Yes	Yes	Yes	No
Seychelles	Yes	Yes		Yes	Yes		Yes	No

Country	Customs authority	Extractive Industries Transparency Initiative (EITI)	Beneficial Ownership Registers	Automatic Exchange of Information (AEOI)	Customs IT Platform	WCO Revised Kyoto Convention	Harmonized System Convention	Authorized Economic Operator
Sierra Leone	Yes	Yes			Yes	Yes	Yes	No
Somalia	Yes				No		Yes	No
South Africa	Yes			Yes	Yes	Yes	Yes	No
South Sudan	Yes				No		Yes	No
Sudan	Yes				Yes	Yes	Yes	No
United Republic of Tanzania	Yes	Yes			Yes		Yes	No
Togo	Yes	Yes			Yes	Yes	Yes	No
Tunisia	Yes				Yes	Yes	Yes	No
Uganda	Yes				Yes	Yes	Yes	No
Zambia	Yes	Yes			Yes	Yes	Yes	No
Zimbabwe	Yes				Yes	Yes	Yes	No

a. The country was recently suspended.

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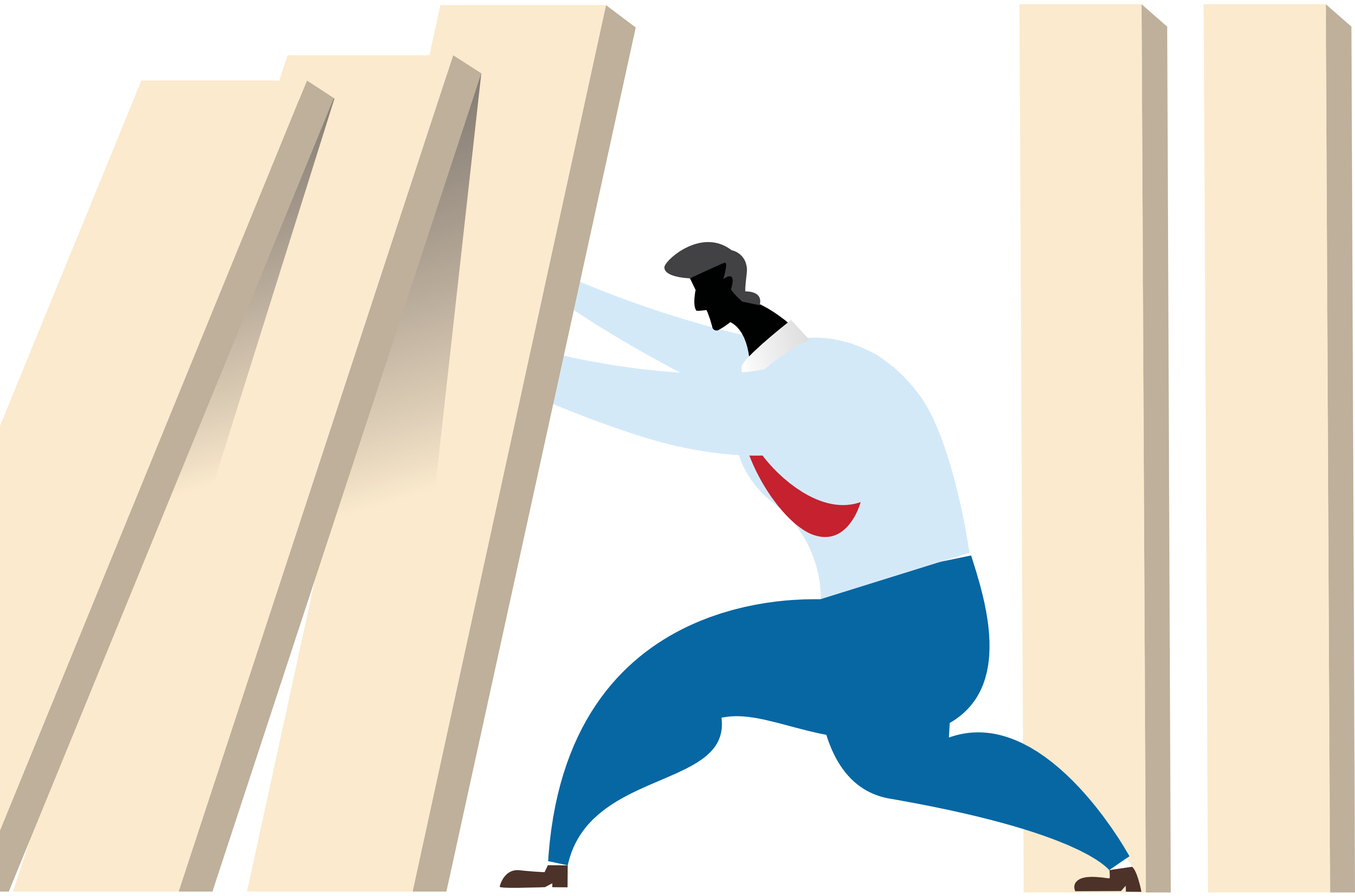


CHAPTER 4:

National financial system architecture to address illicit financial flows

Key messages

- **Financial technology and modernization.** African financial systems are being transformed by the emergence of new institutions, functions and financial products, the integration of high technology–based payment systems (such as mobile banking), regionalization of banking and finance and steady integration into the global financial system. Although these developments show the overall sophistication of financial systems, they also challenge financial regulation and raise risks of money laundering and other forms of illicit financial flows (IFFs).
- **Political will and high-level involvement.** Combatting IFFs and money laundering require determined, clearly articulated, and publicly asserted political will at the highest level, starting with the presidency or premiership. Through legislation and political action, the government must convince the public domestically and internationally that it is determined to do everything at its disposal. Political will is also essential for establishing and implementing laws that criminalize money laundering and IFFs, a key condition for success.
- **Whole system approach.** Money laundering and IFFs involve the whole spectrum of financial institutions, functions, and activities. Yet traditionally, attention to the financial sector has typically focused on the formal banking subsector. African countries must design and implement policies and strategies approaching the entire chain of IFFs through money laundering holistically. Any entity involved in any stage of the IFF and money laundering "value chain" must be subject to anti–IFF/money laundering regulation and control. Those entities include formal and informal non-banking institutions, such as microlending institutions, informal payments and money transfer services.
- **Combatting trade-based money laundering.** The anti–IFF/money laundering agenda must focus particularly on trade-based money laundering, especially the smuggling and mis-invoicing of mineral resources. That focus requires investing in human and technological capacity in the government agencies involved. It also requires establishing inter-agency collaboration to better track the production, pricing and trade of mineral resources. Effective inter-agency collaboration would improve the surveillance of mining and content declarations, obstruct transfer pricing by auditing and benchmarking costs and increase the sharing of information and expertise.

The anti–IFF/money laundering agenda must focus particularly on trade-based money laundering, especially the smuggling and mis-invoicing of mineral resources.

- **Strengthening institutional frameworks.** Although African countries have established dedicated institutional frameworks for combatting IFFs and money laundering, substantial gaps remain. The lack of inter-agency collaboration, duplicated, competing agency mandates and inconsistent political support for reforms weakens their effectiveness. Inter-agency coordination and cooperation should be a key priority in strengthening these institutional frameworks.
- **Global advocacy.** African countries should leverage the elevated continental and global attention to IFFs and money laundering to mobilize regional and global financial and technical support. They should capitalize on the growing knowledge of best practices in this combat.

In recent years, financial technology (fintech) has been used widely to innovate, improve and automate the delivery of financial services in many countries, including in Africa. Fintech connects to different sectors and industries such as education, retail banking, fundraising and non-profit management and investment management, as well as the development and use of cryptocurrencies. Fintech thus makes financial systems more efficient and competitive. And it broadens access to financial services for unbanked populations.

With fintech lending and financing are not relegated to traditional banking institutions and big non-banking financial institutions but extend to various non-traditional platforms. Those platforms have democratized the loan market and enhanced transparency in operations. Further, these platforms, because of their low operating costs, offer lower interest rates than traditional banks.

Fintech has created digital payment systems, e-wallets and mobile wallets, all of which have affected transactions. Mobile wallets let users store money and credit cards on their mobile devices and perform transactions through their phones without ever opening their physical wallets. And fintech has produced applications (apps) to help individuals manage money and invest better. Fintech is improving finance and expanding data-driven decision making. For instance, technology companies can identify better loan prospects based on algorithms driven by millions of data points—overcoming human bias and prejudice. Fintech is rapidly expanding the global banking industry and its multi-trillion-dollar market capitalization to occupy a bigger share of the global economy.

With fintech as a backdrop, this chapter examines the various ways financial systems in Africa are vulnerable to IFFs, including money laundering (ML). The chapter discusses key mechanisms, actors and enablers of IFFs and ML; describes the financial institutions designed to combat IFFs and ML, drawing on global and regional frameworks, and assesses the performance of these structures and the challenges African countries face, drawing on country examples. The discussion and analysis lead to policy recommendations for strengthening Africa's national and regional financial infrastructure for addressing IFFs and money laundering.

African financial systems: structure, institutions and functions

This section describes the key features of financial systems in Africa, focusing more on functions and less on the specificities of institutions. The functional approach is important in understanding the role of the financial system as a vehicle for IFFs and ML and designing appropriate policy responses.

Functional approach

Financial systems in Africa are changing in structure, size and scope. Three conceptual frameworks help examine the dynamics of the institutional changes (Crane et al., 1995). The first focuses on the market dynamics of prices and quantities (Crane et al., 1995). The second is a "static institutional perspective" that regards institutions as the conceptual anchor and considers the role of public policy "to help institutions currently in place to survive and flourish." The third approach, drawing on the two previous perspectives, "takes as given the economic functions performed by financial institutions and then seeks to discover the best institutional structure for performing those functions at a given time and a given place" (Crane et al., 1995). A financial system performs six key functions:

- **Clearing and settling payments.** Banks and affiliated institutions do this through wire transfers, chequing account operations, credit cards, cash cards and other payment instruments.
- **Pooling resources.** Pooling the resources of savers meets the needs of firms for investment capital while providing savers the opportunity to invest their savings in "large indivisible investments."
- **Transferring resources across time and space.** By pooling resources, the financial system facilitates household life cycle allocations of saving and consumption and facilitates the allocation of capital to the most productive use by firms.

- **Managing risk.** The financial system provides means for risk-pooling and risk-sharing by firms and households. Risk-pooling enables the separation of providers of working capital for physical investments from providers of risk capital who bear the financial risk of those investments.
- **Providing information.** The financial system provides information needed by households to make efficient consumption and saving decisions and for firms to efficiently select investment projects and determine their financing strategies.
- **Reducing incentive problems.** A properly functioning financial system serves to reduce incentive problems in financial contracts, thus making them less costly. It helps to alleviate frictions arising from moral hazard, adverse selection and information asymmetries.

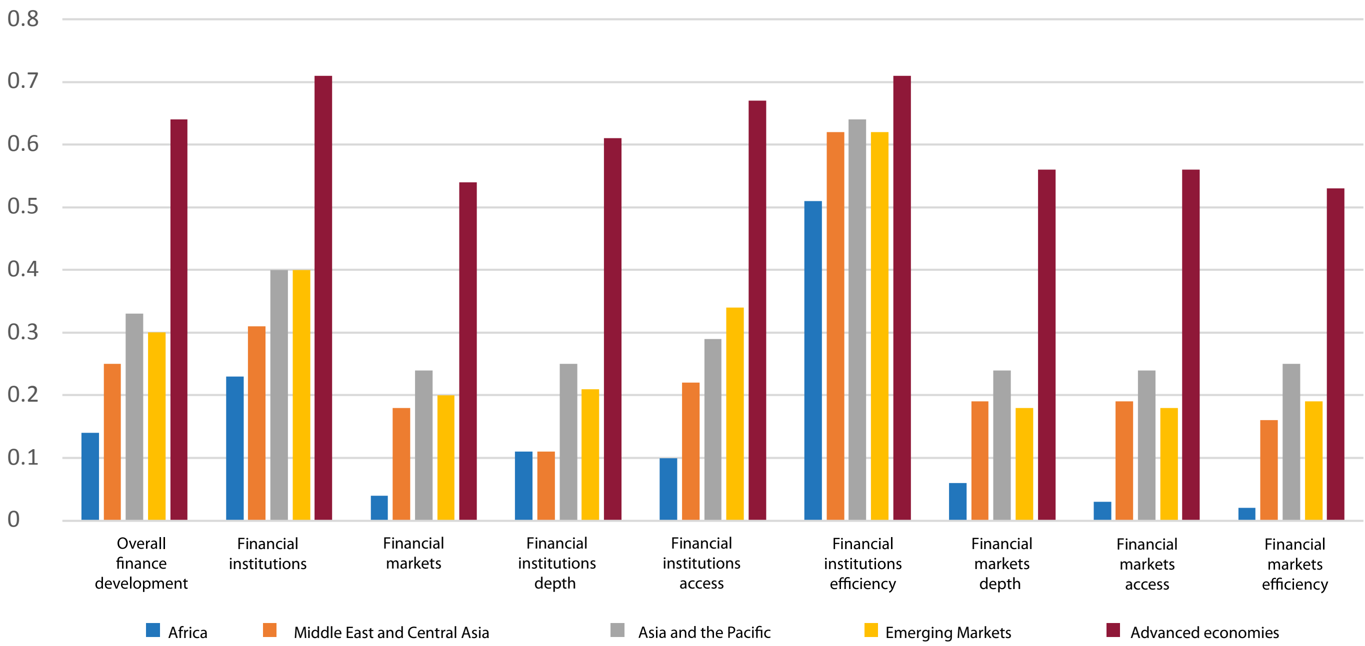
Emerging changes in the structure of African financial systems

Observations of financial systems in Africa

African financial systems are using fintech to innovate and expand rapidly. But African financial institutions remain under-developed compared with those in other regions of the world, and they are not fully integrated into global financial markets. This was evident during the 2007–2008 financial crisis, which African financial institutions largely escaped due to weak contagion resulting from Africa's narrow financial systems (Beck et al., 2011). Although Africa's systems have continued to improve since the crisis, they are still under-developed relative to those in other regions.

Indices have been developed that summarize how developed the depth, access and efficiency of financial institutions and financial markets are (Svirydzenka, 2016). The indices are then aggregated into an overall composite index of financial development. All the indices, including the overall financial development index, range between 0 and 1, with values closer to 1 implying well-developed systems. Africa's overall financial development averages 0.14, compared with 0.25 for the Middle East and Central Asia, 0.33 for Asia and Pacific and 0.30 for emerging economies (figure 4.1). While all the components are lowest in Africa, the efficiency of the continent's financial institutions, measuring 0.51, is higher than other African indices. The higher efficiency can be attributed to the dominance of foreign banks in the continent's financial system, which is largely bank-based (Beck et al., 2014).

Figure 4.1. Financial development indicators: Africa and other regions, 2000–2018



Source: Constructed using Svirydzenka's (2016) data.

Modern technology–based banking

Africa has emerged as a leader in modern technology–based banking or mobile banking (Demombynes and Thegeya, 2012; Mbiti and Weil, 2015). Mobile banking, initially introduced in Kenya for domestic payments and money transfers, has expanded to include credit and international transfers. The use of mobile banking for payments and money transfers is widespread in Africa. More than 50 per cent of the population ages 15 and older in Kenya, Namibia, Mauritius and Uganda use electronic means for payments and money transfers (table 4.1).

The increased penetration of modern technology–based banking opens immense opportunities for financial inclusion. Even so, the question arises whether the emerging technology–based financial development potentially exposes African financial systems to higher risks of IFFs. The evolution of such services could pose a challenge to regulatory authorities in terms of technical capacity as well as budgetary resources to keep pace with innovation in the sector.

Table 4.1. Use of mobile money, select countries, 2019

Countries	Electronic payments used to make payments (%, ages 15+)	Mobile phone used to send money (%, ages 15+)
Kenya	76.4	50.1
Namibia	63.1	24.0
Mauritius	53.5	6.8
Uganda	51.3	35.1
Gabon	49.9	29.6
Zimbabwe	49.2	27.2
Ghana	43.4	29.5
South Africa	43.1	10.1
United Republic of Tanzania	39.8	26.2
Côte d'Ivoire	35.4	23.8
Mauritania	9.9	3.1
Morocco	8.7	5.1
Ethiopia	6.9	0.1
Central African Republic	6.4	4.2
Egypt	5.9	0.1
Eswatini	4.7	16.2
South Sudan	4.6	2.9
Burundi	2.2	4.0
Djibouti	1.5	3.5
Comoros	0.4	0.5

Source: World Bank, World Development Indicators (2019).

How the financial system aids illicit financial flows

Banking sector exposure to illicit financial flows

IFFs are cross-border inflows or outflows characterized by breach of rules and regulations at one of three levels: acquisition of the funds, cross-border transfer of the funds, or concealment of the funds in transit and after arrival. In a weak and inefficient regulatory environment, financial institutions and markets can facilitate IFFs purposefully or inadvertently since the financial institutions receive lucrative returns for their services and IFF perpetrators gain pecuniary benefits and protection from prosecution (table 4.2).

Table 4.2. Banking features used for illicit financial flows

Feature	How it can facilitate illicit activity
Multiple accounts Banker opens multiple accounts in multiple names in multiple jurisdictions for clients	Impedes monitoring and tracing client activity and assets and allows quick and confidential movement of funds. May hide or facilitate illicit activity
Offshore accounts Shell corporations or trusts are formed to hold client assets offshore. Banker opens accounts in the name of offshore entities	Impedes monitoring and tracing client activity and assets. May hide or facilitate illicit activity
Special name or numbered accounts Banker opens an account in code name	Impedes monitoring and tracing client activity and assets. May hide or facilitate illicit activity
Wire transfers Banker facilitates complex wire transfers from multiple accounts to multiple destinations with substantial amounts	Allows quick, complex movement of substantial funds across jurisdictional lines
Concentration accounts Banker uses a single account for the processing and settlement of the transactions of multiple individual customers. The account that mixes the funds is used for internal purposes of the bank, but it can also be a method of hiding the origin of funds	Impedes monitoring and tracing client activity and assets. May hide or facilitate illicit activity
Offshore record keeping Bank maintains client records offshore and minimizes or eliminates information in the country of residence	Impedes bank, regulatory and law enforcement oversight
Secrecy jurisdictions Bank conducts business in a jurisdiction that criminalizes the disclosure of bank information and bars some other jurisdictions' bank regulators	Impedes bank, regulatory and law enforcement oversight

Source: Heggstad and Fjeldstad, 2010.

Such banking features can hide or facilitate illicit activity, allow the quick and complex movement of substantial funds across jurisdictional lines, and impede monitoring and tracing client activity and assets and thus bank, regulatory and law enforcement oversight.

The Financial Secrecy Index (FSI) of the Tax Justice Network is a tool for understanding global financial secrecy, tax havens or secrecy jurisdictions, and IFFs or capital flight[35]. The tool ranks jurisdictions according to their secrecy and the scale of their offshore financial activities. Secrecy jurisdictions (or tax havens) use secrecy to attract illicit and illegitimate financial flows. Using the FSI, Tax Justice Network estimates that between $21 trillion and $32 trillion in private financial wealth is located—untaxed or lightly taxed—in secrecy jurisdictions around the world[36]. The network also finds that illicit cross-border financial flows amount to $1 trillion–$1.6 trillion a year, much more than the $135 billion total of global foreign aid. And since the 1970s African countries have lost more than $1 trillion in capital flight, while Africa's combined external debts are less than $200 billion, so Africa is a major net creditor to the world. Unfortunately, the assets of Africa are in the hands of a wealthy elite and protected by offshore secrecy, while the broad African populations shoulder the debt. A global industry, comprising the world's biggest banks, law practices, accounting firms and specialist providers, designs and markets secretive offshore structures for their tax- and law-dodging clients. Most often financial institutions in jurisdictions that provide strict secrecy facilities are more attractive to such clients in the web of global financial markets.

Attempts by the international community to close tax havens and financial secrecy have been ineffective because of the complexity of the challenges and the gigantic inflows to powerful recipients who make most of the rules in the global financial system.

Attempts by the international community to close tax havens and financial secrecy have been ineffective because of the complexity of the challenges and the gigantic inflows to powerful recipients who make most of the rules in the global financial system. But the situation has been improving since the 2007–2008 global financial crises and ensuing economic crises. Combined activism and exposure of IFFs by civil society actors and the media, along with rising concerns about inequality in many countries, have created political alliances to stem the tide of IFFs. The G20 countries, for example, mandated the Organisation for Economic Co-operation and Development (OECD) to create a new global system of automatic information exchange to help countries discover the cross-border holdings of their taxpayers and criminals.

The Global Forum on Transparency and Exchange of Information for Tax Purposes was established in 2000[37]. Its mandate is to implement the two internationally agreed standards of exchange of information for tax purposes: exchange of information on request (EOIR) and automatic exchange of financial account information (AEOI). The forum monitors, through an in-depth peer review process, its members' full implementation of the standards of transparency and information exchange they have committed to. To date, the forum has achieved the following (OECD, 2019):

35 The secrecy scores are based on 20 indicators: (1) banking secrecy, (2) trusts and foundations register, (3) recorded company ownership, (4) other wealth ownership, (5) limited partnership transparency, (6) public company ownership, (7) public company accounts, (8) country-by-country reporting, (9) corporate tax disclosure, (10) legal entity identifier, (11) tax administration capacity, (12) consistent personal income tax, (13) avoids promoting tax evasion, (14) tax court secrecy, (15) harmful structures, (16) public statistics, (17) anti–money laundering, (18) automatic information exchange, (19) bilateral treaties and (20) international legal cooperation. For full explanation of the methodology and data sources and methodology see www.financialsecrecyindex.com/PDF/FSIMethodology.pdf.

36 See https://financialsecrecyindex.com/en/ for a fuller discussion.

37 It is made up of 160 jurisdictions, including all G20 and OECD members, all key international financial centres and developing countries working together to combat tax evasion. Currently, 29 African countries are members of the Global Forum, and 18 organizations are observers, including the United Nations, the World Bank Group, the African Development Bank Group, the African Tax Administration Forum, and the Cercle de Réflexion et d'Échange des Dirigeants des Administrations Fiscales.

- Bank secrecy for tax purposes no longer exists, all financial centres are engaged in the automatic exchange of financial information (through the OECD's Common Reporting Standard—CRS) and 4,500 exchange of information agreements are in force, with 90 jurisdictions implementing the CRS in 2018. Information on some 47 million offshore accounts—with a total value of around €4.9 trillion—has been shared for the first time. It is estimated that countries have generated more than €95 billion in additional revenue (tax, interest and penalties) due to such initiatives since November 2018.
- Bank deposits in international financial centres (IFCs) have fallen by approximately 34 per cent over the past 10 years, a decline of $551 billion. About two-thirds of that decline is due to the onset of AEOI.
- Some 21,000 previously secret tax rulings have now been shared, an increase of 4,000 rulings since the last Global Forum report. That means companies can no longer negotiate secret, sweetheart deals that would deprive other countries of their revenues.
- Eighty jurisdictions in 2019 (up from 62 in 2018) have engaged in the exchange of country-by-country reports (CbCR) on the activities, income and assets of multinational enterprises, which began in June 2018. CbCR provides tax administrations extensive and consistent information on the largest foreign multinationals, which pose the greatest risk of base erosion and profit shifting (BEPS) to their jurisdictions, given their size and the potential revenues at stake.
- Preferential tax regimes allowed multinationals to avoid tax on their international activities, contributing to base erosion. Since 2015, over 250 regimes have been reviewed, and virtually all that were identified as harmful have been amended or abolished. Around the world, harmful regimes can no longer be used by countries to attract the tax base from other countries by specifically targeting non-residents and foreign income.
- With the OECD's Multilateral Instrument on BEPS covering 88 jurisdictions and already ratified by 25, treaty shopping, which deprives countries of billions of euros in revenue, is coming to an end. All treaty shopping hubs have now signed the instrument, and tax administrations are reporting meaningful behavioural changes among taxpayers.

Preferential tax regimes allowed multinationals to avoid tax on their international activities, contributing to base erosion. Since 2015, over 250 regimes have been reviewed, and virtually all that were identified as harmful have been amended or abolished.

For African economies, multiple accounts, offshore accounts, concentration accounts, offshore recording and secrecy deserve close examination.

Multiple accounts enable operators to dissociate funds from their beneficial owners and to break or blur the link between the source of the funds (or predicate activity) and the funds themselves as domiciled in the banking institutions. The risk associated with multiple accounts is likely to increase with financial development, openness and linkages with the global financial system. Links with secrecy jurisdictions and offshore financial centres particularly exacerbate the risks of facilitating IFFs through multiple accounts. Although there is no empirical evidence on whether these risks also increase with foreign bank penetration, regional integration and the emergence of monetary unions, it could be intuitively argued that broadening the scope of regulation for already weak frameworks and access to bank accounts across territories could curtail IFFs.

Offshore accounts make it possible to disguise the identity of beneficial owners of assets and of transactions associated with funds that were acquired or transferred illegally. Offshore financial centres that offer strong protection of customer identity attract IFFs. While customer privacy is desirable for legitimate users of financial systems, it can be easily abused by those seeking to use the system for illicit reasons. There is currently a lack of data on whether Africa-owned investments or account intermediation for non-African investments predominates in the relationship between financial systems in Africa and offshore financial centres. Traditionally offshore financial centres were found in foreign lands, not on the continent. But that image is changing as African financial markets feature on the list of territories providing banking secrecy. Kenya comes at the top of the African list with the highest financial secrecy index (FSI), followed by Mauritius, South Africa, United Republic of Tanzania, Seychelles, Ghana, Botswana, and Gambia. African markets are small from a global perspective, with a combined share in global financial services exports of 0.24 per cent, most of it represented by South Africa (0.18 per cent), Kenya (0.04 per cent) and Mauritius (0.02 per cent).

Concentration accounts are operated by financial institutions to settle multiple individual customer transactions. In principle, such accounts expand the scope of the settlement system and thus facilitate trade and financial transactions. But they also can be abused to disguise illicit transactions. They especially raise concerns in countries and financial systems where the quality of reporting by banks and clients is inefficient and opaque either by design (as in offshore financial centres and secrecy jurisdictions) or due to technical and regulatory incapacity.

Offshore record-keeping and secrecy in financial systems also offer mechanisms for IFF and ML. Even without explicit and deliberate intent to disguise the nature and destination of financial transactions, poor record keeping makes it difficult for regulators to track IFFs and ML. The low probability of detection or prosecution provides an incentive for illicit activity. So, strategies to combat IFFs and ML must include investing more in reform and technical capacity building to improve record keeping and transparency in African countries' financial systems.

Money laundering

Money laundering (ML) constitutes a major conduit for IFFs intermediated through the financial system. It is as old as the use of money. The basic features of money laundering are **illegality** and **concealment**. Its processes first delink the origin and the owner or operator of an illegal activity—or predicate offense—from the pecuniary benefits, and then enable the legal use of the proceeds of the illegal activity by integrating them into the legal financial system.

Definitions of ML revolve around those basic characteristics. A simple definition by the Financial Action Task Force (FATF) is, "ML is the processing of these criminal proceeds to disguise their illegal origin." The Ghana Anti-Money Laundering Act 2008 (as amended in 2014) defines money laundering as "the conversion, concealment, disguise, or transfer of property which is or forms part of the proceeds of crime; the concealment and disguise of the lawful origin of the property; and the acquisition, use, or possession of the property." US federal law says that "money laundering is commonly understood as the process of cleansing the taint from the proceeds of crime" (18 USC 1956, cited in United States Department of State, 2019).

Money laundering involves a number of intricately linked stages that vary depending on the circumstances and players involved. The three most commonly identified stages are: placement, layering and reintegration (Schneider and Windischbauer, 2008), also referred to informally as the "wash, spin, dry" stages of money laundering (Van Jaarsveld 2011, p. 168).

The **placement** stage is the physical operation of injecting or infiltrating money acquired from an illegal activity into the financial system. It entails placing the illegal money into a legal financial instrument. To avoid detection, this is typically done through "structuring" and "smurfing," in which the money to be laundered is divided into smaller parts that fall below the reportable threshold (for example, $10,000 in the United States for incoming international transfers) and so avoid the receiving financial institution's obligation. The small deposits may be made in one or several bank accounts of the same institution or separate institutions.

The placement of large sums requires complex operations. They may include converting the dirty money into other assets, such as high-value goods (jewellery, for instance) or setting up a front company in a cash-intensive sector (sometimes hotels, retail car sales or high-end luxury art galleries). Such placement typically involves creating counterfeit documents for a transaction or a company.

In the second stage, **layering**, launderers conceal the source of the illegal funds by moving the money around. They use several forms of high-speed transaction to blur the traces of the money. They may use specific transactions explicitly designed to move money, such as trade over-invoicing or under-invoicing. Another method is a back-to-back loan, in which the money launderers deposit money in a bank and subsequently obtain a loan from the same institution, thus in effect financing their own loans.

In the last stage, **reintegration**, once the money has been washed, spun and dried, it is time to put it out in plain view for consumption or investment. It is then integrated into the legal economy. Laundered money used in a legal transaction has been "legitimated," a proof that laundering has succeeded.

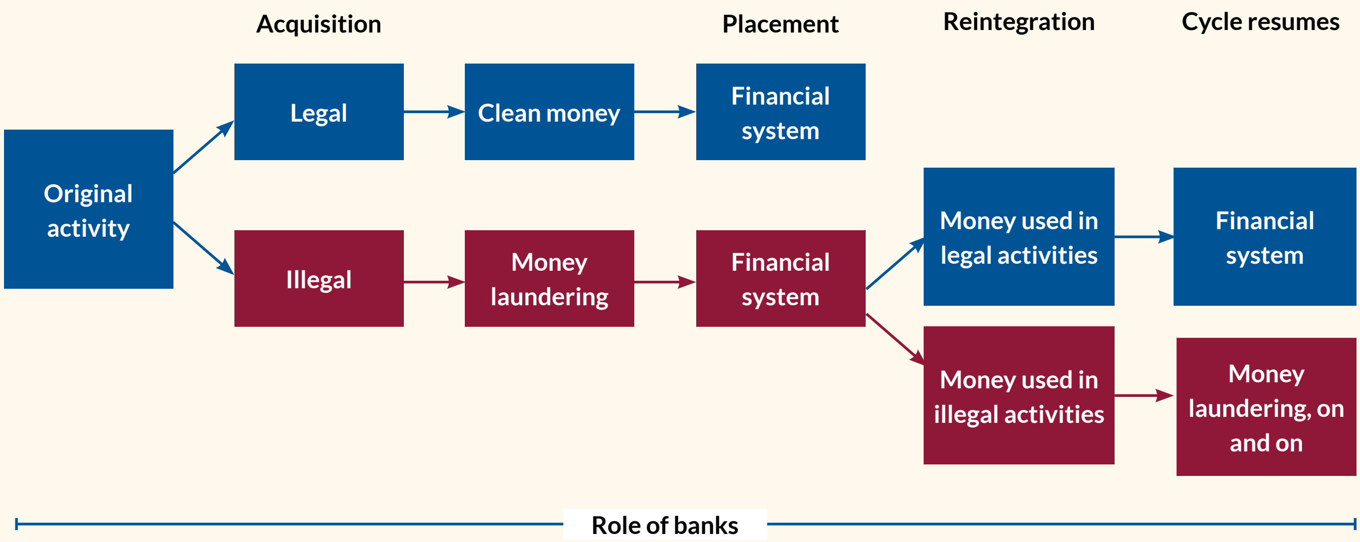
Other, less frequently profiled stages of money laundering are possible, such as justification and social integration, embedding, exchange and legitimation (Van Jaarsveld 2011, p. 168).

The financial system in the money laundering process

Money laundering occurs in a real economy where both legal and illegal activities take place. Legal activities make the illegal ones possible: without legal activities and the possibility of using the proceeds of illegal activities in legal transactions, funds from illegal activities would have no value. This relationship has an important implication—that the value of the proceeds from illegal activities depends inversely on the probability of the detection of money laundering at the various stages just described. In other words, the value of laundered money is inversely related to the quality and efficiency of the anti–money laundering apparatus in the country concerned.

Financial institutions provide payments, transfers and investment service to both legal and illegal activities. As depicted in figure 4.2, money laundering could be layered, via placement, in the financial system. That system is also used to house the proceeds of money laundering and to finance the legal activities at money laundering's integration stage.

Figure 4.2. Banks in the money laundering process



Source: ECA compilation from various sources.

Overall, ML is complex, involving multiple operations in several stages to break the link between the predicate action (the proceeds of the crime), and the beneficiaries of the crime or its proceeds. For policy, the process implies that anti–money laundering strategies require scrutiny at all stages of the ML process and attention to particular services provided by financial institutions at the various stages, knowingly or unknowingly, through their normal functions of financial intermediation. The presence of a pervasive and high volume of ML in a country typically suggests that financial service providers are extending an enabling hand.

ML most often involves complicit agents in financial institutions who make deals happen and help blur the origins and destination of funds and the identities of the individuals involved. According to FATF (2018, p. 36), "while the exact definition of complicity is a matter of domestic law, it is widely understood as intentional acts carried out with knowledge or wilful blindness of the illicit nature of the funds with which the person is dealing." Money launderers actively recruit the employees and officials of financial institutions to assist them in placing, moving, integrating and concealing the proceeds of illegal activities. These compromised employees serve as complicit insiders in the money laundering process. It is conceivable that entire financial institutions are compromised, further entrenching money laundering in the financial system and in the economy.

The presence of a pervasive and high volume of money laundering in a country typically suggests that financial service providers are extending an enabling hand.

Other important features of the financial system exposed to ML and IFFs are payment processing services and virtual currency payment products and services. Payment processing services assist ML and other IFFs by acting as "follow-through accounts" (FATF 2018, p. 45) while concealing (or at least not voluntarily divulging) the identity of their clients to the financial institutions involved and the regulatory authorities. Payment processing agencies, building on their original function of clearing credit card transactions for domestic retail merchants, have expanded to clear in-store transactions and internet-based transactions by international merchants. Expanding internet-based trade and finance and the growth of virtual currency payments constitute important opportunities for international trade and finance. But for policy they pose crucial challenges in regulating trade and finance and particularly in combatting ML and other forms of IFFs.

Digital technology, cryptocurrencies, mobile money and illicit financial flows

Financial services innovation is not new. It has been ongoing for centuries using improved instruments and financial infrastructure—from Babylonian loan tablets, to double-entry bookkeeping in the 1400s, to automatic teller machines (ATM) and more (Goetzmann and Rouwenhorst, 2005).

Fintech has risen to enhance financial intermediation and other transactions. Financial intermediation is needed due to fundamental economic frictions: incomplete information, lack of commitment and limited enforceability of contracts, transaction costs and difference in the timing of production and consumption. These frictions determine why financial intermediation and financial infrastructure such as fintech are necessary. Fintech enables banks and non-banks to alleviate frictions (Aaron, Rivadeneyra and Sohal, 2017) by:

- Providing liquidity and means of payment.
- Transforming assets in their maturity, credit or liquidity quality, or denomination.
- Managing and processing information by keeping records, monitoring clients and markets and so on.
- Specializing in managing risks such as credit or liquidity risk.
- Providing access to markets.

Fintech helps financial institutions bundling these functions to achieve economies of scope and scale. (Economies of scope occur when increasing the provision of one type of service lowers the marginal cost of providing another.)

Recent innovations in financial technology and the widespread use of the internet have made online commerce, social networks and other uses a large part of many people's lives. Facebook and Amazon are key providers of electronic platforms for such engagement[38]. Some platforms have issued electronic tokens or "digital currencies"—such as Facebook credits or Amazon coins—that individuals can use to purchase real or virtual goods within the platform. With millions of users in many countries, internet platforms have a global reach. The digital currencies could become widely accepted and could even compete with national currencies (Fung and Halaburda, 2014).

Digital currencies have no physical counterpart and do not represent a claim on assets. They are usually not denominated in a national currency but have their own unit of account. Platform-based digital currencies have two main features: the platform maintains control over the design and supply of the currency, and the platform introduces the currency for objectives other than payment services (Fung and Halaburda, 2014). Digital currencies have limited functionality, and since they may not be widely accepted as a medium of exchange, they may not satisfy the economic definition of money as a unit of account, a medium of exchange and a store of value.

Digital currencies vary considerably, depending on the issuer's focus. Some cryptocurrencies provide users flexibility in acquiring goods by letting them both buy goods and earn cryptocurrency within the platform. Platforms can also apply restrictions on how the currencies are spent. However, to date, digital currencies are generally limited in their ability to become widely accepted as a means of payment. Even so, cryptocurrencies can be used for speculation as well as payment. They can be volatile: the Bitcoin bubble peaked at $19,000 per Bitcoin in late 2017 (Lorio, 2019). Using them for payment gives anonymity to the user both on the surface web and the dark web (internet sites inaccessible to ordinary browsers)[39]. So, they can be used for both licit and illicit transactions, such as drug purchases, money laundering and sanctions evasion. Between 1 and 25 per cent of transactions with cryptocurrency are illicit, according to studies Lorio (2019) cites.

More than 1,600 cryptocurrencies are in circulation, all built on blockchain technology (Lorio, 2019). Blockchain acts as a public ledger of every transaction made with a particular cryptocurrency and allows verification of a transaction's authenticity. The public ledger is shared across all the computers in the network. The technology allows the use of cryptocurrency for illicit transactions and for laundering money that may not have started as cryptocurrency. In general, these illicit transactions occur on the dark web. One study reported around $76 billion a year in illegal activities involving a cryptocurrency (cited by Lorio, 2019). The revenues from the use of cryptocurrency are laundered through cryptocurrency tumblers, the purchase of prepaid gift cards or withdrawals from cryptocurrency exchanges and ATMs that do not follow anti–money laundering (AML) regulations. The obscure characteristics of cryptocurrencies, such as their relative anonymity and their mixing services, make them ideal for ML and, by extension, IFFs.

Does digital technology threaten money laundering and illicit financial flows?

Two major phenomena of recent decades affect the fight against ML and IFFs. First, the digital technologies have boosted the volume and pace of finance and trade beyond their historic scale (World Bank, 2016). Second, capital flight, ML and other forms of IFF from both developing and developed countries have exploded[40]. There is little hard evidence on the links between the two phenomena. Still, linkages are possible, with implications for efforts to combat ML and IFFs.

Conceivably, digital technology could be both a facilitator of and an impediment to ML and IFFs. Criminals and their enablers could take advantage of modern information technology to facilitate the various stages of ML—acquisition of illicit funds, placement, transfer, integration and use of the proceeds of illegal activities. But modern digital technology also offers valuable tools for combatting ML and tracking IFFs (table 4.3).

38 Fung and Halaburda (2014) define platforms as enterprises where the value of using the platform increases with the number of market participants that join. The more friends use Facebook, the more attractive it becomes. On the other hand, Amazon Marketplace is more attractive if more sellers are selling their products.

39 The dark web is the part of the World Wide Web that is only accessible by means of special software, allowing users and website operators to remain anonymous or untraceable. The dark web poses new and formidable challenges for law enforcement agencies around the world.

40 See, among others, the analysis by Global Financial Integrity (www.gfintegrity.org) and the Political Economy Research Institute (https://www.peri.umass.edu/capital-flight-from-africa).

Digital technology may emerge as a game changer for ML. It offers unique features to enable ML and IFFs: anonymity, complexity of transactions, weak or no regulation and automation, speed and cross-border operation. These features enable criminals to distance illegally acquired funds from their origin, hence shielding themselves from criminal charges of ML (see table 4.3).

Table 4.3. Digital technologies and illicit financial flows

How digital technologies facilitate illicit financial flows

Earning	Transfers	Use
Sources: • Laundering proceeds of crime • Abuse of power • Market/ regulatory abuse • Tax abuse • Digital underground economy: cybercrime and "crime as a service" • Migration of traditional organized crime online • Embezzlement and fraud in the telecom sector • Tackling crime activities: detection, prevention, digital investigations • Increase transparency and public scrutiny to reduce corruption • Speed up introduction of e-government systems in areas such as tax administration or customs	**Sources:** • Placement • Layering **Combination of:** • Online and mobile banking: slicing and automation of transactions • Electronic payments via unregulated intermediaries • Digital/cryptocurrencies: ensuring anonymity • E-commerce: manipulation of supply of goods • Online gambling/online betting • Monitor suspicious transfers • Trace illegal transfers • Better information exchange (digital platforms, automatic exchange of information) • Facilitate due diligence	**Integration:** Integration of the laundered assets into the legal financial system • Offshore electronic bank and investment accounts • Fake e-commerce companies • Offshore online casinos • Terrorist financing • Retrospective identification of illicit sources • Databases of beneficial ownership • Leaks of electronic documents to the attention of public and competent authorities • platforms, automatic exchange of information) • Facilitate due diligence

Any technological means to fight illicit financial flows have to be combined with:

- Harmonization of legal frameworks
- Mechanisms for international cooperation and mutual legal assistance
- Public–private collaboration

Source: Tropina (2016, p. 3).

But digital technologies can also be an instrument for preventing, disrupting, and prosecuting ML by shedding light on the darkness of ML and IFFs. Digital technology is instrumental in data gathering, reporting, and sharing, a major weapon for anti–money laundering programmes. Digital technology can produce, disseminate, and share real-time data on trade and financial transactions and can increase transparency in trade and finance, both national and international. Rapid information collection combats ML by equipping government regulatory bodies and the public—especially civil society organizations focused on governance, transparency, and accountability—with tools to identify, track and prosecute actors in illicit financial transactions and their enablers (table 4.4).

Table 4.4. Digital technology contributions to preventing, investigating and detecting illicit financial flows

Illegal money acquisition	Illegal money transfer	Illegal money integration
Digital tools to investigate crime (interception of content data and traffic data, remote forensic software, and so on)	Maintaining risk-based profiles based on transactional activities	Retrospective identification of illicit sources
Digital tools to trace and disrupt crimeware	Real-time payment screenings	Digital tools for searching for and obtaining beneficial ownership information in various databases
Databases for profiling	Creation of lists: fraud lists, blacklists, frozen lists and so on.	Leaks of electronic data transfer trails and electronic documents brought to the attention of public and competent authorities
Platforms for cross-border information exchange among law enforcement	Better information exchange (digital platforms, automatic exchange of information)	

Source: Tropina (2016, p. 19).

Does mobile money enable illicit financial flows?

The implications of a special digital technology subsector, mobile money, for ML and IFFs also raises questions, particularly in Africa, where this medium of payment is rapidly transforming the financial landscape. Mobile money originated as a means to facilitate payments and money transfers, especially the transfer of remittances between urban centres and rural areas. It has expanded and is now used as a global medium to transfer remittances from the diaspora.

Mobile money differs from electronic banking as established in advanced economies. Online banking in advanced economies links to a real account held with a regular financial institution. Its financial operations are duly regulated.

In contrast, mobile money emerged to fill the needs of populations cut off from the formal banking system. Peculiarly, it relies on both banks and telephone companies. The service it supplies is unregulated. And mobile money typically involves micropayments since it caters to individuals and microenterprises with limited revenue who conduct very low-volume transactions. These features make mobile money difficult to regulate.

In Kenya, the leading country in mobile money, risks due to the unregulated nature of the mobile money sector raised concerns. But those concerns proved unfounded. As long as mobile money operators abide by the rules of requiring proper identification of customers, starting with the creation of the account and including all stages of transactions, there is no reason to expect mobile money to be riskier than conventional payment mechanisms (Vlcek, 2011). And the small volumes of funds in individual transactions suggest that at the aggregate level, any risk of ML is likely to be limited.

Policy must balance two objectives in fighting IFFs and ML in the context of mobile money. The first is to promote digital innovation to serve the interests of the economy, including universal access to finance, that is, financial inclusion. For African economies, this objective is crucial given the pervasive gaps in access to finance, especially in rural areas and in the informal sector in general.

The second objective is to ensure the security of the mobile money sector and protect it from ML, IFFs and other financial crimes. Governments must invest in regulatory bodies' technical capacity so they can keep up with financial sector technological innovation to supervise and monitor adequately, while also incentivizing innovation. Globally, coordination and mutual legal assistance must be ensured in anti–money laundering and in the regulation of digital technology. A deepening "cybersecurity divide" must be avoided between advanced and developing countries, detrimental to financial transparency and the anti–money laundering agenda.

Governments must invest in regulatory bodies' technical capacity so they can keep up with financial sector technological innovation to supervise and monitor adequately, while also incentivizing innovation.

Enablers: Professional money laundering

The actors who originate ML activities rely on other individuals, agencies, and corporations—professional money launderers (PMLs)—for their professional skills, expertise, and brand name. PMLs are "individuals, organizations and networks that are involved in third-party laundering for a fee or a commission" (FATF, 2018, p. 6). Third-party ML is "the laundering of proceeds by a person who was not involved in the commission of the predicate offence" (FATF 2018, p. 10).

PMLs leverage their skills to conceal the identity of the originating actors and facilitate the placement, transfer, and integration of laundered funds. Key activities and services of PMLs include providing account management services, creating and registering financial accounts, locating investments or purchasing assets, establishing companies or legal arrangements and recruiting and managing networks of cash couriers or money mules (FATF 2018, p. 7).

PMLs fall into three categories: individuals, organizations (PMLO) and networks (PMLN). Individual PMLs have skills and expertise in placing, moving, and integrating funds. Their key services are accounting, financial services, legal services and forming companies.

PMLOs are structured groups of individual PMLs that provide services to individual criminals and organized criminal groups. ML may be the core activity or just a subsidiary activity of a PMLO.

PMLNs are a collection of individual PMLs or PMLOs that operate nationally and globally. They leverage their global presence to offer services to their clients by opening bank accounts and helping establish real or shell companies in various territories. Their knowledge of national regulations enables them to advise their clients on the best location of their businesses to facilitate the concealment of funds and transactions and evade legal obligations, particularly corporate profit taxes and transaction taxes.

The business model of PMLs has three stages (figure 4.3). In the first, criminal proceeds are transferred to or collected by PMLs. Funds can be in the form of cash, bank accounts or virtual currency. The second stage uses account settlement mechanisms for layering the funds. In the third stage, the washed proceeds are returned to the owner for investing and spending. The key mechanisms used by PMLs and their clients are fictitious trade and other forms of trade-based ML, proxy structures such as bank accounts where the laundered money is transferred and virtual currency and e-wallets to settle online sales of illicit goods.

Figure 4.3. Three stages of professional money laundering

Source: FATF (2018, p. 17).

Legal and accounting services

In addition to financial service providers, professionals specializing in law, accounting, and associated services facilitate ML. Lawyers and accountants are the lynchpin of PML. Lawyers' superior knowledge of national and international law exposes them to the risk of criminals misusing their services for ML. Although legal professionals may knowingly assist in ML, even law-abiding professionals are vulnerable to criminals misusing their services. Legal services may facilitate ML and other IFFs through use or misuse of client accounts, purchase of real property, creation of trusts and companies, management of trusts and companies, management of client affairs, serving as liaisons between business parties, litigation and setting up and managing charities on behalf of clients.

Legal professionals must be held to high standards of ethics and professional responsibility to minimize their exposure to being used as enablers of ML and IFFs. The International Bar Association has established international principles of conduct to guide lawyers and law firms in exercising customer due diligence to minimize involvement in ML.

Combatting money laundering and illicit financial flows through the financial system

Historical background

ML was originally associated with criminal activities, especially drugs and human trafficking. AML emerged as an expansion of the war against drugs. But in the wake of the 11 September 2001 terrorist attacks, AML became part of the war on terrorism to prevent financing for terrorism.

AML success requires a strategy for cooperation in exploring tools to track ML activities and evaluating existing initiatives so that appropriate reforms can emerge.

The United States has long been at the forefront of AML. The first step, in 1970, was the enactment of the Financial Record-keeping and Reporting of Currency and Foreign Transactions Act, known as the Bank Secrecy Act. That was the first comprehensive AML law in the world. The next US initiative was the 1986 ML Control Act. Even so, the most effective efforts in fighting against ML have come from coordinated national and multilateral efforts based on global conventions.

Two major conventions were agreed in the landmark year of 1988. The first was the United Nations Convention against Illicit Trafficking in Narcotics, Drugs and Psychotropic Substances, known as the Vienna Convention of 19 December 1988. It addressed the confiscation of assets associated with ML, issues of banking secrecy and—probably the biggest innovation—mutual legal assistance between member states in fighting ML. The second was the Basel Statement of Principles on the Prevention of Criminal Use of the Banking System for the Purpose of ML. It spelled out principles for the banking system, namely, rules on customer identification and cooperation with law enforcement authorities in preventing ML.

AML success requires a strategy for cooperation in exploring tools to track ML activities and evaluating existing initiatives so that appropriate reforms can emerge. For this purpose, the G7 (Canada, France, Germany, Italy, Japan, the United Kingdom and the United States) created the Financial Action Task Force in 1989. The G7 invited other advanced economies: Australia, Austria, Belgium, Luxemburg, Netherlands, Spain, Sweden and Switzerland, to join. The main motivation was enhanced international cooperation and continuous assessment of AML policies globally. FATF contributed to global AML efforts by exerting pressure on countries to cooperate and threatening to name and shame non-cooperative states. It also helped push financial institutions to collect financial intelligence and report to competent authorities more actively. Since the mid-1980s financial intelligence units (FIU) and similar agencies were introduced as national AML instruments. A financial intelligence unit is "a national centre for the receipt and analysis of: suspicious transaction reports and other information relevant to money laundering, associated predicate offences and financing of terrorism, and for the dissemination of the results of that analysis."[41] In the United Kingdom, the National Drugs Intelligence Unit was established in 1985. The United States established the Financial Crimes Enforcement Network (FinCEN) in 1990. In 1995, the Egmont Group was created—as an informal organization aimed at enhancing cross-border information exchange, a key part of its mission was to promote the creation of national FIUs across the globe. The Egmont Group envisaged four models of FIUs: judicial, law enforcement, administrative and hybrid.

- The judicial model is established within the judicial branch of government, where investigative agencies receive disclosures of suspicious activity from the financial sector so that judiciary powers can be brought into play by seizing funds, freezing accounts, conducting interrogations, detaining people, conducting searches and so on.

41 Egmont Group: https://egmontgroup.org/en/content/financial-intelligence-units-fius.

- The law enforcement model implements AML measures alongside existing law enforcement, supporting the efforts of multiple law enforcement or judicial authorities with concurrent, or sometimes competing, jurisdictional authority to investigate ML.
- The administrative model is a centralized, independent, administrative authority that receives and processes information from the financial sector and transmits disclosures to judicial or law enforcement authorities for prosecution. It functions as a buffer between the financial and the law enforcement communities.
- The hybrid model serves as a link and an intermediary for disclosures to both judicial and law enforcement authorities. It combines elements of at least two of the other FIU models.

Challenges to anti–money laundering enforcement

Combatting ML has always presented national and global challenges. One general issue is the lack of clarity in the operational definition of ML in national legislation, which opens opportunities for ML actors and their enablers to game the system and get away with crime. Law enforcement then finds it difficult to identify ML acts and establish convincing cases against the actors and their enablers.

Domestic and international AML success relies heavily on quality information and effective reporting on individual and firm financial and trade transactions. Poor data quality and inadequate information exchange between various national government bodies and between governments across the globe is by far the biggest constraint on AML programmes. Learning the causes of those information gaps is crucial for designing effective national and international strategies. Two major factors are the technical capacity of specialized bodies such as FIUs and the police and the lack of political will to invest in information systems and to share information between countries.

AML depends on systematic reporting of suspicious activities by all agencies potentially involved along the various stages of ML. Agencies need clarity and guidance on when and what to report: when is an activity deemed suspicious, and what triggers suspicion that a particular transaction might involve ML or another illicit financial transaction? What makes a customer suspicious, and how is a criminal distinguished from an honest customer—this question is especially delicate in cases involving politically exposed persons (PEPs)? In the FATF 40 Recommendations of October 2003, politically exposed persons are defined as "individuals who are or have been entrusted with prominent public functions in a foreign country, for example Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state-owned corporations, important political party officials" (FATF, 2004). FATF goes on to point out that "business relationships with family members or close associates of PEPs involve reputational risks similar to those with PEPs themselves." Institutions must exercise enhanced due diligence in handling transactions by or on behalf of PEPs.

Identifying PEPs is easy at the national level, at least in principle. It is much more complex at the international level, where properly identifying PEPs requires adequate knowledge of the administrative and political structure of the customer's country of origin or residence. That includes understanding the threshold for a senior PEP, the quality of the AML regulation and especially the level of corruption in the PEP's country.

The task of identifying PEPs and handling their transactions to detect, track and prevent ML is politically sensitive. Institutions risk being accused of political bias, whether positive or negative. Any treatment will be scrutinized that appears to be lenient towards PEPs of strategic interest or overly stringent against PEPs from less favoured territories. For the financial institution concerned, the potential cost of scrutiny of PEPs is the loss of important clients to themselves or to other businesses from their country. The PEP and his or her country could shift their businesses to institutions with less stringent identification rules against ML. So, few institutions may desire to be champions of AML. In the extreme, as happens in secrecy jurisdictions, private institutions in the absence of strong regulation could compete in a race to the bottom seeking the lowest standards in due diligence towards PEPs.

Infrastructure for combatting illicit financial flows and money laundering

The infrastructure for combatting IFFs and ML comprises five main pillars (figure 4.4; see also table A4.1 in the annex for country-by-country activities).

Figure 4.4. Pillars of the infrastructure for combatting illicit financial flows and money laundering

National strategy

- Medium- and long-term vision and goals
- Link to legal and law enforcement system
- Resource allocation

Legal framework

- Criminalization of money laundering
- Rules, laws and regulations
- Dedicated and legally empowered entities (for example, financial intelligence units)

Administrative procedures

- Money laundering and terrorist financing risk assessment
- Customer due diligence
- Suspicious transactions reporting
- Record keeping

Special focus areas

- Politically exposed persons
- Foreign banks
- New digital technologies

Regional and international cooperation

- Multilateral and bilateral cooperation agreements
- Regional economic organizations
- International networks (for example, Egmont Group)

Source: ECA compilation from various sources.

National AML strategy. A key condition for success in combatting ML and other forms of IFFs through the financial system and other sectors is a national strategy that sets a framework for developing laws, rules and regulations to prevent, detect, prosecute and penalize ML and IFFs. A national strategy sends a clear signal of high-level political will and commitment. It shows that AML is integral to the national development strategy, specifically to the financial system's stability and sustainable development. The national strategy offers a framework for mobilizing resources, dividing responsibilities among government branches and coordinating the activities of all bodies involved in AML in the country. It communicates to the international community the government's commitment and serves as a framework for articulating cooperation mechanisms with bilateral and multilateral partners.

Legal framework. Strong laws that criminalize ML and terrorism financing are critical to AML national strategy. The institutions in charge of prosecuting and punishing ML must be clearly designated. Specifically, a legal framework determining and implementing sanctions against ML must be established. It will include supervising and regulating financial institutions—both banks and non-bank institutions. It will also expand regulation to other entities vulnerable to ML outside the formal financial system and will equip regulatory bodies with the human, budgetary and technical capacity to keep pace with the rapidly evolving technologies that drive finance and commerce. FIUs are critical to the anti–money laundering/combatting the financing of terrorism (AML/CFT) institutional infrastructure due to two key features: the operational independence of the FIU from the bodies to which it reports and efficient oversight by the board of the FIU.

ML risk assessment infrastructure, rules and procedures. The adequacy of risk assessment at all stages of ML and in all institutions vulnerable to ML and terrorist financing (ML/TF) is critical to the AML/CFT infrastructure (figure 4.5). The institutions include banks, non-bank financial institutions, insurance companies and all the enablers of money laundering and IFFs—law firms, accounting firms, trust companies, payments and money transfer services, and so on. Success in AML/CFT requires:

- Establishing institutions to oversee and enforce risk assessment by banks, non-bank financial institutions and others.
- Providing adequate resources and building capacity for risk assessment in banks, non-bank institutions and regulatory institutions charged with AML/CFT.
- Establishing clear reporting mechanisms and minimizing inconsistencies across institutions in reporting and prosecuting ML activities.
- Enforcing penalties against inadequate risk assessment and reporting.
- Focusing on IA3M: identify, assess, monitor, manage and mitigate risks associated with money laundering.

Customer due diligence (CDD). Critical to ML/TF risk assessment, customer due diligence must cover a broad range of actors. It also needs the participation of many institutions. CDD requires a clear definition of beneficial ownership and clear procedures for establishing it along the entire transaction value chain. FATF provides the following operational definition: "Beneficial owner refers to the natural person(s) who ultimately owns or controls a customer[42] and/or the natural person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate effective control over a legal person or arrangement" (FATF, 2012, p. 13).

Suspicious transactions reporting (STR). Establishing and enforcing clear rules on suspicious transactions reporting by banks, non-bank financial institutions and all other entities that directly or indirectly deal with financial transactions are important to AML/CFT regulation. The framework must include specific guidelines for coordination and collaboration between all the regulatory, legal and law enforcement bodies concerned. STR is especially important when there are multiple reporting requirements—for example, a requirement to report to both law enforcement and the FIU.

42 "Ultimately owns or controls" and "ultimate effective control" refer to situations in which ownership/control is exercised through a chain of ownership or by means of control other than direct control.

Record keeping and reporting. High-quality, systematic and broad record keeping is central to the AML/CFT framework. It is needed for reconstructing specific transactions and identifying other transactions directly or indirectly related to a particular transaction. Customer identification, account characteristics and all correspondence related to financial transactions and accounts are needed. Records must be kept long enough—for a minimum of five years.

Politically exposed persons (PEPs). The AML/CFT framework must provide for handling the transactions and assets of politically exposed persons (PEPs) and related social and business parties. Both domestic and foreign PEPs must be covered. The framework must specify clear formal legal obligations for banks, non-banking institutions and all businesses involved in finance and transactions to determine whether a client is a PEP or working on behalf of a PEP. Enablers and "front persons" are pivotal in identifying the ultimate beneficial owner of a transaction or an asset. PEP identification must apply to all the products, instruments, and assets the financial system holds and exchanges—for example, to insurance policies. The rules must require extended customer due diligence and enhanced monitoring of transactions and assets owned by PEPs or related to PEPs.

Foreign banks. As noted, some African countries have a large presence of foreign banks in their financial systems—in some countries all commercial banks are foreign. AML/CFT regulations for foreign banks must incorporate risk assessment for their countries of origin, posing challenges for African regulators. The regulation and supervision of foreign banks must include enhanced customer due diligence for those with headquarters and affiliates in high-risk countries, especially offshore financial centres. African regulators must rely on and leverage knowledge accumulated by bilateral partners and multilateral organizations and networks such as the United Nations Office on Drugs and Crime (UNODC) and the Egmont Group.

AML/CFT related to new technologies. Banking and financial operations are increasingly driven by fast-evolving technologies, challenging AML/CFT regulation. Criminals are often a step ahead of regulators and financial institutions due to the time it takes to revise or create rules, laws and procedures. Regulators and financial institutions must incorporate in ML risk assessment frameworks specific new technology-based products and instruments. Training, capacity building and infrastructure upgrading programmes must incorporate this challenge.

Strategies to combat money laundering and illicit financial flows in Africa

Key vulnerabilities and challenges

The vulnerabilities and channels of IFFs in Africa vary by country, influenced primarily by the size of presumably lucrative or weakly regulated sectors, the porosity of borders, the ties with offshore tax havens and other features[43]. In Algeria, for example, the key vulnerabilities are the real estate sector, commercial invoice fraud and the use of offshore havens for evading taxes and concealing stolen assets. Algeria's geographical location exposes it to drug trafficking, for instance, by Al-Qaida, in the Maghreb region. Benin, by contrast, faces high exposure to ML, especially due to the risk of the Port of Cotonou being used as transit point for illicit trade in the subregion. The port is suspected to be a major hub of drug trafficking from Africa (especially Nigeria), South America and Asia (especially Pakistan) towards Europe, South Asia, and South Africa. ML in Benin also targets the real estate sector, bulk cash smuggling and second-hand car transiting towards neighbouring countries.

The vulnerabilities and channels of IFFs in Africa vary by country, influenced primarily by the size of presumably lucrative or weakly regulated sectors, the porosity of borders, the ties with offshore tax havens and other features.

43 The information in this section on the current frameworks designed to combat ML and IFFs in some African countries draws on the US State Department's report on International Narcotics Control Strategy Report of March 2019 (U.S. State Department, 2019), country notes prepared by United Nations Economic Commission for Africa staff and consultants for the Economic Governance Report, as well as other secondary sources.

Figure 4.5. Elements of assessing the effectiveness of the anti–money laundering/combatting the financing of terrorism (AML/CFT) framework

High level objectives

Financial systems and the broader economy are protected from the threats of money laundering and the financing of terrorism and proliferation, thereby strengthening financial sector integrity and contributing to safety and security.

Money laundering threats are detected and disrupted, and criminals are sanctioned and deprived of illicit proceeds. Terrorist financing threats are detected and disrupted, terrorists are deprived of resources and those who finance terrorism are sanction, thereby contributing to the prevention of terrorist acts.

Intermediate outcomes

Policy, coordination and cooperation mitigate the money laundering and financing of terrorism attack

Proceeds of crime and funds in support of terrorism are prevented from entering the financial and other sectors or are detected and reported by these sectors

Money laundering and terrorist financing risks are understood, and where appropriate, actions coordinated domestically to combat money laundering and the financing of terrorism

International cooperation delivers appropriate information, financial intelligence and evidence, and facilitates action against criminals and their assets

Supervisors appropriately supervise, monitor and regulate financial institutions and designated non-financial businesses and professions (DNFBP) for compliance with AML/CFT requirements commensurate with their risks

Financial institutions and DNIFBPs adequately apply AML/CFT preventive measures commensurate with their risks, and report suspicious transactions

Legal persons and arrangements are prevented from misuse for money laundering or terrorist financing, and information on their beneficial ownership is available to competent authorities without impediments

Financial intelligence and all other relevant information are appropriately used by competent authorities for money laundering and terrorist financing investigations

Money laundering offences and activities are investigated, and offenders are prosecuted and subject to effective, proportionate and dissuasive sanctions

Proceeds and instrumentalities of crime are confiscated

Terrorist financing offences and activities are investigated, and persons who finance terrorism are prosecuted and subject to effective, proportionate and dissuasive sanctions

Terrorists, terrorist organizations and terrorist financiers are prevented from raising, moving and using funds, and from abusing non-profit organizations

Persons and entities involved in the proliferation of weapons of mass destruction are prevented from raising, moving and using funds, consistent with the relevant United Nations Security Council Resolutions

Source: FATF (2013, p. 16).

In Côte d'Ivoire, smuggling and trade mis-invoicing are prevalent, with cocoa exports the most exposed sector, while mineral exports are also affected. Therefore, efforts to combat IFFs and ML ought to focus on these sectors in the first instance. Other vulnerable sectors are real estate, used cars and cash-based transactions, which are prevalent due to low banking penetration, among other factors.

Ghana's large gold endowment and the mining sector more broadly have attracted trade mis-invoicing. Other activities exposed to ML are designated non-financial businesses and professions (DNFBPs), which include real estate agencies, traffickers in precious metals, gaming (casinos) and remittance transfer agencies. Vulnerabilities are compounded by ineffective enforcement of AML rules and guidelines, including customer due diligence—or "know your customer" (KYC) requirements—especially in non-bank financial institutions.

In Namibia, vulnerable areas include the illicit diamond trade, drug trafficking and car smuggling. Tax evasion motivates most such activities, costing the country an estimated 9 per cent of GDP, a staggering amount that exceeds the public safety budget and nearly equals the social sector budget. Clearly, IFFs drain national resources and handicap economic growth.

Key laws and regulations

Most countries have developed a legal and regulatory framework to curb ML and IFFs. The framework usually features a central penal code for AML laws and strict requirements for financial institutions to cooperate with law enforcement in reporting and investigating ML and illicit finance. Financial intelligence units or centres often play a key role in identifying, detecting and prosecuting ML and IFFs.

In Nigeria, the key AML/CFT regulations include the Money Laundering Prohibition Act of 2011 (as amended), the Terrorism Prevention Act of 2011 (as amended) and the Economic and Financial Crimes Commission Act of 2004. The Central Bank of Nigeria, the Securities and Exchange Commission and the National Insurance Commission have established regulations on the obligations of financial institutions under the AML regime, including know your customer rules and suspicious transaction regulations (STR). The regulatory framework includes criminalization of ML and enhanced customer due diligence for both foreign and domestic PEPs. In 2018, the House of Representatives passed a Proceeds of Crime Bill—providing a legal and institutional framework for seizing, confiscating, forfeiting, recovering and managing assets associated with ML—which was awaiting concurrence by the senate and transmission to the president for signature at the time of writing.

Mauritius has a fairly developed financial system, with foreign banks accounting for 55 per cent of banking sector assets. The country's prominence as a financial centre, coupled with its image as a low tax jurisdiction, exposes it to a high risk of ML and other forms of IFF. The Eastern and Southern Africa Anti–Money Laundering Group, in its 2018 report, found important issues in Mauritius's AML/CFT regulatory framework and put the country on a one-year observation. Afterwards an evaluation will assess progress in addressing them. The key issues were (IMF 2019, p. 17, box 3):

- Lack of understanding of ML and terrorist financing risk.
- Inadequate risk-based AML/CFT supervision of reporting entities.
- Poor implementation of the AML/CFT framework by reporting entities.
- Gaps in the legal framework for customer due diligence measures, including those concerning beneficial ownership of legal entities and arrangements.

Since then, the Mauritius government has undertaken measures to address these deficiencies. Key steps are:

- Amendment of the AML law to include customer due diligence requirements for reporting entities, enhanced due diligence for PEPs and new provisions on gathering and maintaining beneficial ownership information.
- A national risk assessment, which was to be finalized in 2019 (See Mauritius National Risk Assessment Working Group 2019).
- A pilot of a risk-based plan for AML/CFT supervision of banks.
- Development of a centralized know your customer system to improve customer due diligence and beneficial ownership information.

A country belonging to an economic community generally has more robust and coordinated mechanisms to curtail ML and IFFs. For example, the 2018 West African Economic and Monetary Union Uniform Law (Act 2018-17) provides a framework for standardizing AML/CFT regulations among member states. It facilitates the criminalization of ML (replacing laws from 1997 and 2016) and strengthens the 2012 law against financing of terrorism.

International and regional cooperation

The Financial Action Task Force is an intergovernmental body established in 1989 by the ministers of its member jurisdictions. It aims to set standards and promote effective implementation of legal, regulatory, and operational measures for combatting ML, terrorism financing and other related threats to the integrity of the international financial system. The FATF is therefore a policymaking body trying to generate the political will to bring about national legislative and regulatory reforms in these areas[44]. All African countries belong to subregional chapters of the FATF except Eritrea, South Sudan and Western Sahara (table 4.5). It is recognized as a key instrument in addressing the cross-border character of IFFs and ML.

The Egmont Group is a body of 164 financial intelligence units. It provides a platform for the secure exchange of expertise and financial intelligence to combat money laundering and terrorism financing. FIUs are uniquely positioned to cooperate and support national and international efforts to counter terrorism financing. They are trusted gateways for sharing financial information domestically and internationally in accordance with global AML/CFT standards.

The FATF's regional body in West Africa is the Intergovernmental Action Group against Money Laundering in West Africa (GIABA), established by the Central Bank of West African States (BCEAO). The central bank sets requirements for declaring bulk cash crossing borders to neighbouring countries, especially Nigeria. GIABA coordinates regional AML activities. In collaboration with the Senegal National Financial Intelligence Processing Unit, GIABA conducts the mutual evaluation on the fight against ML and the financing of terrorism.

Nigeria is also a member of GIABA. The Nigerian Financial Intelligence Unit (NFIU), in operation since 2005, became a member of the Egmont Group in 2007. It was suspended from the Egmont Group in July 2017 following repeated failures to address concerns over protecting confidential information and concerns over the NFIU's lack of operational independence from Nigeria's Economic and Financial Crimes Commission. The suspension was lifted in September 2018 (U.S. Department of State, 2019).

Algeria and Morocco are members of the Middle East and North Africa Financial Action Task Force, an FATF regional body. Morocco's Financial Intelligence Processing Unit is a member of the Egmont Group. The US–Algeria mutual legal assistance treaty was signed in April 2010 and was ratified and entered into force in 2017. Mauritius is a member of the FATF regional body, the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG), and Mauritius's financial intelligence unit, FIU-Mauritius, is a member of the Egmont Group. FIU-Mauritius deployed United Nations Office on Drugs and Crime (UNODC) goAML software in January 2014 to fully automate data collection and dissemination on AML (FIU–Mauritius, 2015).

44 https://www.fatf-gafi.org/.

Table 4.5. Membership of the Financial Action Task Force and its regional bodies

Financial Action Task Force (FATF)	Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG)		Economic and Monetary Community of Central Africa (GABAC)	Intergovernmental Action Group against Money Laundering in West Africa (GIABA)		Middle East and North Africa Financial Action Task Force (MENAFATF)
	Angola	Mozambique	Cameroon	Benin	Liberia	Algeria
	Botswana	Namibia	Central African Republic	Burkina Faso	Mali	Djibouti
	Eswatini	Rwanda	Chad	Cabo Verde	Niger	Egypt
	Ethiopia	Seychelles	Republic of Congo	Comoros	Nigeria	Libya
South Africa	Kenya	South Africa	Democratic Republic of the Congo	Côte d'Ivoire	São Tomé and Príncipe	Mauritania
	Lesotho	United Republic of Tanzania	Equatorial Guinea	Gambia	Senegal	Morocco
	Madagascar	Uganda		Ghana	Sierra Leone	Somalia
	Malawi	Zambia	Gabon	Guinea	Togo	Sudan
	Mauritius	Zimbabwe		Guinea Bissau		Tunisia

Source: https://www.fatf-gafi.org/countries/.

Namibia is also a member of the ESAAMLG. Namibia's international cooperation in cross-border ML/TF, led by the Financial Intelligence Centre (FIC), focuses on exchanging information and technical assistance and especially capacity building in collaboration with partners including the Egmont Group, ESAAMLG, the FATF, the World Bank, UNODC, the International Monetary Fund and the Alliance for Financial Inclusion. Namibia's FIC also has bilateral relationships, such as a partnership with the Australian Transaction Report and Analysis Centre. Mozambique is also a member of ESAAMLG, and its FIU has expressed interest in joining the Egmont Group and has implemented some of the measures required for membership. The United States and Mozambique are in the early stages of establishing records-exchange procedures in support of AML/CFT.

Other challenges

Given the layers of legal instruments and monitoring functions in African countries, challenges remain, highlighting the complexity and pervasiveness of IFFs and ML. Across the region, the quality of banks' reporting needs improvement, and increased investment is needed in technical and human capacity to implement ML risk assessment and identify, track, prosecute and prevent ML and IFFs.

A few countries lack the resources to fully take advantage of available international support, such as membership in the Egmont Group. Inadequate capacity constrains the legal system, especially the lack of specialized training for judges in the investigation and prosecution of financial crimes. The incapacity delays processing reported ML cases. For example, as many as 728 suspicious transaction reports were filed in Benin in 2017–2018, but only 17 were presented to court, all of which were still pending as of March 2019 (U.S. Department of State, 2019). The AML/CFT effectiveness remains limited, with little evidence of actual ML prosecutions and convictions.

Supervision should be strengthened over non-bank financial institutions, capital markets and all potentially vulnerable sectors, including gaming. The AML framework retains important flaws, including the lack of a broad cross-border currency declaration system. And a record of tangible AML outcomes must be established to build the credibility of the regulatory and institutional framework in the eyes of the domestic and international public. Rules about PEPs also raise major concerns, since in some countries the enhanced customer due diligence requirements apply only to foreign PEPs. In other countries a weak legal framework leads to the ineffective identification and monitoring of PEPs and their associates by financial institutions and capital market operators. In such situations, the highly political nature of monitoring PEPs can reduce political will. Political influence has also been a factor where multinational corporations in mining have manipulated the quantities and prices of imports to evade taxation.

The key challenge to the AML agenda in Nigeria is the legal framework's weakness, especially the inadequate identification of beneficiaries and the unavailability of meaningful beneficial ownership information. Inadequate information dissemination and the incompatibility of databases—especially the Bank Verification Number database, the Independent National Electorate Commission database and the Immigration and Drivers' License database—compound the problems. Such incompatibility is not unique to Nigeria. Several countries lack the technical and technological capacity to collect and analyse data and prosecute cases of ML and illicit financial activities. Inadequate record keeping also hampers the investigation and prosecution of illicit activities.

The large scale of informal activities in Africa poses an additional challenge. In Senegal and Mozambique, for example, informal activities outside the regulatory scope of the AML/CFT infrastructure pose a threat for ML and IFFs. The high volume of remittances in Senegal—more than $2.52 billion a year (World Bank, 2019)—and the growing mobile payments system, for instance, pose risks, aggravated by informality. The Wari mobile money service recorded more than $2 million in remittances transferred shortly after opening a new service point in Touba in central Senegal. Transfers of money outside the financial system, some motivated by tax evasion, pose another threat, aided by some foreign exchange bureaus and money transfer services. In 2017, the Bank of Tanzania revoked the licences of 144 foreign exchange bureaus due to ML concerns.

The legal and regulatory framework has flaws that can be exploited for ML and IFFs. For example, terrorism financing is not a crime in Kenya. In many African countries, police access to bank records and the seizure of bank accounts are impeded by bureaucratic constraints where the police must first obtain a court order by presenting evidence linking a bank deposit to criminal violations. This breach of confidentiality risks tipping off the criminals possessing the suspect accounts and assets. Inadequate resources for building institutional capacity, especially investigative and prosecutorial skills, are another constraint.

Progress against ML and IFFs requires scaling up investment in technical and human capacity, even as the government, supported by its development partners, strengthens and fine-tunes the institutional structures of the AML/CFT framework.

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Summary and conclusion

This chapter shows that IFFs from African countries deserve high-level attention. They drain national private and public capital, handicapping the continent's efforts to achieve sustainable development. And Africa (except North Africa) faces high levels of poverty and inequality, and massive financing gaps for infrastructure and public services.

IFFs constrain aid effectiveness. Beyond that, some IFFs and the private wealth accumulated from them are financed by the embezzlement of foreign loans and aid through outright theft and inflated expenses for debt- and aid-funded public projects.

IFFs compromise the integrity of the financial system. High and persistent IFFs evince ineffective financial regulation, among other problems.

IFFs pose a moral issue. These flows are driven by tax evasion and the circumvention of the regulatory system to avoid legal scrutiny of the origin of ill-gotten wealth. And IFFs are orchestrated to benefit the wealthy political and economic elite, thus widening income inequality and the economic alienation of the poor.

For all these reasons, the combat against IFFs should be at the centre of national development policy and the heart of strategies for financial, institutional and legal reforms.

Recommendations

African countries should undertake the following:

- Investing in technological infrastructure to collect, track and store the data to support anti–money laundering/combatting the financing of terrorism activities with a view towards enhancing transparency and bridging the cybersecurity divide between developing and advanced countries. Countries also need to build the human capacities in their financial intelligence units (FIUs) to enforce policies and laws aimed at stemming illicit financial flows (IFFs).
- Enhancing data quality, embarking on comprehensive information exchange within and outside their jurisdiction, and improving data analysis to efficiently combat IFFs and money laundering (ML). African governments must fund FIUs well enough to track, monitor and evaluate national strategies and legal instruments for stopping IFFs.
- Improving the coordination of institutions working against IFFs, especially since greater volumes of transactions are moving through virtual channels rather than through the traditional forms of cash, cheques and physical banks.
- Putting mechanisms in place through legislation and political action at the highest level of governments to clearly articulate and publicly assert commitment and determination to combat ML and IFFs. African governments, through such high-level political will, should aggressively implement laws that criminalize ML and IFFs.
- Designing and implementing policies and strategies that take a holistic approach to the entire "value chain" of ML process. The approach should involve all institutions and entities associated with combatting IFFs and ML. It should include formal and informal non-banking institutions such as microlending institutions, informal payments, and money transfer services.
- Strengthening the established and dedicated institutional frameworks for combatting IFFs and ML, removing gaps that hinder the frameworks' effectiveness. African governments should enhance their efforts to strengthen inter-agency collaboration, coordinate reporting and harmonize duplicated and competing mandates.
- Leveraging the elevated continental and global attention to IFFs/ML to mobilize regional and global financial and technical support. African countries should capitalize on new knowledge on best practices in the combat against IFFs/ML.

ANNEX

Table A4.1. Institutional architecture to address illicit financial flows through the financial system, by country

Country	Financial intelligence unit (FIUs)	Egmont Group	Financial Action Task Force (FATF) chapter membership	Anti-money laundering (AML)/ counter-terrorism financing (CTF)	Suspicious transactions reporting (STRs)	Customer due diligence (CDD)	Professional money laundering (PMLs)
Algeria	Yes	Yes	MENAFATF	Yes	Yes	Yes	
Angola	Yes	Yes	ESAAMLG	Yes	Yes	Yes	
Benin	Yes	Yes	GIABA	Yes	Yes	Yes	
Botswana	Yes	No	ESAAMLG	Yes	Yes	Yes	
Burkina Faso	Yes	Yes	GIABA	Yes	Yes	Yes	
Burundi	Yes	No	No	Yes	No	No	
Cameroon	Yes	Yes	GABAC	Yes	Yes	Yes	
Cabo Verde	Yes	Yes	GIABA	Yes	Yes	Yes	
Central African Republic	Yes[a]	No	GABAC	Yes	No	No	
Chad	Yes	Yes	GABAC	Yes	Yes	Yes	
Comoros	Yes	No	GIABA	Yes	Yes	Yes	
Republic of Congo	Yes	Yes	GABAC	Yes	Yes	Yes	
Democratic Republic of the Congo	Yes	No	GABAC	Yes	Yes	Yes	
Côte d'Ivoire	Yes	Yes	GIABA	Yes	Yes	Yes	
Djibouti	Yes	No	MENAFATF	Yes	Yes	Yes	
Egypt	Yes	Yes	MENAFATF	Yes	Yes	Yes	
Equatorial Guinea	Yes	No	GABAC	Yes	Yes	Yes	
Eritrea	No	No	No	Yes	Yes	Yes	
Eswatini	Yes	No	ESAAMLG	Yes	Yes	Yes	
Ethiopia	Yes	Yes	ESAAMLG	Yes	Yes	Yes	
Gabon	Yes	Yes	GABAC	Yes	Yes	Yes	
Gambia	Yes	No	GIABA	Yes	Yes	Yes	
Ghana	Yes	Yes	GIABA	Yes	Yes	Yes	
Guinea	No	No	GIABA	Yes	Yes	Yes	
Guinea-Bissau	Yes	No	GIABA	Yes	Yes	Yes	
Kenya	Yes	No	ESAAMLG	Yes	Yes	Yes	

Country	Financial intelligence unit (FIUs)	Egmont Group	Financial Action Task Force (FATF) chapter membership	Anti-money laundering (AML)/ counter-terrorism financing (CTF)	Suspicious transactions reporting (STRs)	Customer due diligence (CDD)	Professional money laundering (PMLs)
Lesotho	Yes	No	ESAAMLG	Yes	Yes	Yes	
Liberia	Yes	No	GIABA	Yes	Yes	Yes	
Libya	Yes	No	MENAFATF	Yes	Yes	Yes	
Madagascar	Yes	No	ESAAMLG	Yes	Yes	Yes	
Malawi	Yes	Yes	ESAAMLG	Yes	Yes	Yes	
Mali	Yes	Yes	GIABA	Yes	Yes	Yes	
Mauritania	Yes	No	No	Yes	Yes	Yes	
Mauritius	Yes	Yes	ESAAMLG	Yes	Yes	Yes	
Morocco	Yes	Yes	MENAFATF	Yes	Yes	Yes	
Mozambique	Yes	No	ESAAMLG	Yes	Yes	Yes	
Namibia	Yes	Yes	ESAAMLG	Yes	Yes	Yes	
Niger	Yes	Yes	GIABA	Yes	Yes	Yes	
Nigeria	Yes	Yes[b]	GIABA	Yes	Yes	Yes	
Rwanda	Yes	No	ESAAMLG	Yes	Yes	Yes	
São Tomé and Príncipe	No	No	No	Yes	Yes	Yes	
Senegal	Yes	Yes	GIABA	Yes	Yes	Yes	
Seychelles	Yes	Yes	ESAAMLG	Yes	Yes	Yes	
Sierra Leone	Yes	No	GIABA	Yes	Yes	Yes	
Somalia	Yes	No	MENAFATF	Yes	Yes	Yes	
South Africa	Yes	Yes	ESAAMLG	Yes	Yes	Yes	
South Sudan	Yes	No	No	Yes	Yes	Yes	
Sudan	Yes	Yes	MENAFATF	Yes	Yes	Yes	
United Republic of Tanzania	Yes	Yes	ESAAMLG	Yes	Yes	Yes	
Togo	Yes	Yes	GIABA	Yes	Yes	Yes	
Tunisia	Yes	Yes	MENAFATF	Yes	Yes	Yes	
Uganda	Yes	Yes	ESAAMLG	Yes	Yes	Yes	
Zambia	Yes	Yes	ESAAMLG	Yes	Yes	Yes	
Zimbabwe	Yes	No	ESAAMLG	Yes	Yes	Yes	

a. Not operational due to lack of funding and staff.
b. The country was suspended in July 2017.

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CHAPTER 5:

Anti-corruption measures to curb illicit financial flows

Key messages

Countries that have not yet ratified the African Union (AU) Convention on Preventing and Combating Corruption should do so and also adopt the implementation monitoring framework of the AU Advisory Board on Corruption.

- Illicit financial flows (IFFs) and corruption are symbiotic, both products of secrecy and enabled by opacity. Operationally, corruption drives or at least facilitates IFFs. Anti-corruption laws should be based on a broad understanding of corruption that addresses both demand and supply and both domestic cases and the channels through which corruption is internationalized.
- Countries that have not yet ratified the African Union (AU) Convention on Preventing and Combating Corruption should do so and also adopt the implementation monitoring framework of the AU Advisory Board on Corruption (AUABC). The AU should consider linking the work of the AUABC to the African Peer Review Mechanism.
- Countries should review their national anti-corruption legislation to give anti-corruption bodies adequate independence and predictable funding and move their ambitions closer to those of the United Nations (UN) and AU anti-corruption conventions. In particular, they should equip their anti-corruption bodies with the mandate and powers to address IFF-related corruption—notably the corruption risks associated with trade and capital flows. Initiatives such as the Single Customs Territory (SCT) of the East African Community (EAC) may be worth replicating. The SCT aims to reduce trade mis-pricing by integrating EAC customs systems to enable real-time information exchange between partner states' customs departments. It also creates a payment system managing revenue transfers within the region.
- Continental and global institutions should strongly promote the **ABC** of corporate transparency:
  - **Automatic** exchange of tax information to track the illicit movement and concealment of profits and other incomes.
  - Public registers of the **beneficial owners** of companies, to crack open the concealment of politically significant interests.
  - **Country-by-country** reporting of profits as a step moving towards unitary taxation and disincentivizing the use of IFFs for tax dodging. Similarly, governments should move towards establishing or strengthening transfer pricing units at their revenue agencies to track trade mis-pricing as a means of corruptly transferring wealth abroad.
- African governments should consider establishing IFF-related corruption risk and exposure monitoring initiatives. The new activities would monitor corruption risks associated with international economic relations and transactions—trade, investments (including in the natural resources sector) and portfolio capital flows. They would require governments to step up their data reporting, especially of banking claims and liabilities and inward and outward investments, and their collecting of empirical data. Pan-African institutions such as the AU, the African Development Bank, and the United Nations Economic Commission for Africa (ECA) should increase efforts to spur African governments in these directions.

This chapter assesses whether African government corruption-fighting measures and institutional architecture are adequate to curtail IFFs. It adopts a conception of corruption covering a broad range of actions, actors, motivations, and machinations involved in internationalizing corruption. The chapter proposes a conceptual framework that relates corruption to IFFs, reviews the effectiveness of existing legal instruments and institutional frameworks for fighting corruption and curbing IFFs and presents recommendations for strengthening these measures.

The chapter also reviews the powers, mandates and organizational effectiveness of the anti-corruption bodies governments have established to implement laws. It notes their capacity-building needs and recommends measures to strengthen them.

Conceptualizing corruption in the context of illicit financial flows

Corruption is a complex and dynamic problem with context-specific features, as the fourth **African Governance Report** noted (ECA, 2016). It is both a cause and an effect of poor governance and weak institutions and an impediment to structural transformation in Africa. That report called for a broad conception of corruption so policymakers can address the totality of the phenomenon. The conception should focus on corrupt practices, rather than narrowly on measurements of people's perceptions of corruption based on the traditional conception—the abuse of public office for private gain. The traditional notion overemphasizes the public sector and the legality of acts and overlooks corrupt tendencies in private and non-state sectors, and practices that may not be strictly illegal but are unethical and damaging to the public interest. Policymakers addressing all of corruption must examine both its demand and supply sides.

IFFs constitute the international dimension of that broadly defined corruption. ECA (2016) observed that corruption has ceased to be predominantly domestic and that its players have become far more diverse and corrupt and its acts far more complex. The changes are due to globalized and poorly regulated financial markets, rapid flows of capital around the world and an array of wealth-hiding services and jurisdictions. Illicit cross-border flows that by their very nature constitute corrupt practices may result from public or private sector corrupt practices and may in turn incentivize corrupt public sector practices. Defining corruption identifies the scope of the interventions needed to combat it.

A notion of corruption encompassing IFFs must explain how corruption is internationalized and how its proceeds cross borders. Otherwise, it would exaggerate the public sector's role in cross-border flows of capital and underplay non-African private firms' role in cross-border corruption[45]. Some 99.5 per cent of cross-border corruption, defined as bribe-paying, involves non-African firms, mostly multinational corporations operating on the continent (ECA, 2016). So, the commercial (particularly foreign) sector supplies most cross-border corruption opportunities and accounts for most of the outflow of illicit enrichment, but the complexity of the methods and channels through which these flows take place have left the process poorly understood.

A broad conception of corruption and corrupt acts must capture the full range of motivations and mechanisms associated with cross-border flows of illicit wealth. They include market players rigging markets and abusing regulations and their loopholes to maximize profits, concealing those profits and transferring them abroad—perhaps made possible by powerful economic interests bribing state officials or effecting state capture by for personal gain. Such manipulations are essentially corrupt.

Corrupt practices differ by motivation. Corrupt intent may include the desire to conceal illicit enrichment or to conceal legitimately acquired wealth for illicit reasons (such as aggressive tax avoidance). To successfully conceal a corrupt act could involve manipulating the prices, quantities, or quality of internationally traded goods. It could also involve jurisdictions' enticements such as secrecy or low tax services. Corruption driven by the motivation to conceal undermines the rules that underpin how markets are supposed to work to generate fair economic and social outcomes.

Such commercially oriented corrupt acts have the following factors in common:

- They are grounded in opacity (or secrecy).
- They undermine the integrity of the rules and systems that underpin both the market and the state.
- They shift resources across borders.

45 The Mbeki Panel report estimated that only 5 per cent of capital lost to Africa illicitly is attributable directly to public sector bribery and kick-backs. The impact of public sector corruption on economic growth is even more measured in non–oil rich countries where the capital budget tends to be a minuscule proportion of total expenditure.

- They require intermediary players.
- They produce entirely different national corruption profiles from Corruption Perception Index (CPI)–type rankings.

Above all, these types of corrupt acts undermine the public interest since they violate responsibility and create damage in at least one system of public or civic order. "A system of public or civic order exalts common interest over special interest; violations of the common interest for special interests are corrupt" (Leff, 1964).

A satisfactory definition of corruption linked to IFFs addresses the abuse of power by the public sector in collusion with the private sector for private gain, as well as the independent actions of corporations and high net worth individuals driven by illicit motivations.

The working definition of corruption for this report is:

> The abuse of authority and the undermining of rules, systems and institutions that promote the public interest for the purpose of illicit acquisition, concealment and movement of wealth in the interest of oneself, kin or corporate legal personality or other overriding special interests.

Figure 1.8 in chapter 1 presented a conceptual framework based on that definition of corruption linking IFFs and corruption. It showed IFFs as the outcome of state and market manipulations by private and corporate interests to earn, move and conceal the proceeds of corrupt acts through various economic channels.

The main grounding of both domestic corruption and IFFs is financial, institutional, and jurisdictional opacity, combined with concealment services. Just like corruption, IFFs are concealed: "Corruption is not naked but veiled" (Brasz, 1963). The most important factor transforming domestic corruption into IFFs is what Bullough (2019) calls "Moneyland":

> Multiple low tax havens and secrecy jurisdictions where corporations and the super-rich, including political and administrative kleptocrats, keep, move, hide and spend their money. They choose which laws to obey and which ones to rig. They don't really have a country to which they belong. They belong everywhere and nowhere. They belong to Moneyland which is defined by three characteristics: You steal, you hide, you spend.

These havens, often the design of lawyers and accountants, hide the identity of the beneficial owners of the companies they protect, providing an overriding incentive for companies to manipulate markets and transfer wealth illicitly through any number of economic channels.

The channels of illicit transactions and flows include trade (mis-invoicing), foreign direct investment (under-pricing of inward investments to hide political involvement or shift undeclared income out, or portfolio flows using anonymity to conceal political interests) and banking channels using anonymity to launder money or for round-tripping exploiting tax concessions (see tables 1.1, 1.2 in chapter 1). Through these same channels, wealth acquired through corrupt acts leaves the country. But except for money laundering, these channels and motivations have received limited attention in anti-corruption measures.

With technological advancement and financial globalization, the wife of Nigeria's late general Sani Abacha has ceased to be the face of kleptocracy (she was caught trying to leave the country with 38 suitcases filled with dollars) (Bullough, 2019). Instant wire transfers remove the constraint of weight and distance, while a network of shell companies (trusts and foundations) facilitated by an army of willing lawyers and accountants conceals the beneficial owners of companies and financial accounts. Secrecy jurisdictions, which also tend to be tax havens, provide perfect hiding places for illicit wealth (whether criminal or non-criminal) and drive global tax competition. Meanwhile wealthy countries provide opportunities to spend on plush real estate, yachts, and other objects of conspicuous consumption.

This architecture allows grand corruption, including kleptocracy, to persist locally and be unleashed globally, giving it a transnational network. The architecture facilitates tax avoidance and tax evasion, enables capital flight, provides havens for the proceeds of organized crime (for which anti–money laundering measures are needed) and fosters "pirate banking"—the practice of hiding and managing offshore assets for the world's elite (Henry, 2012). Supplanting secrecy with transparency is a crucial first step in fighting transnational corruption.

Promoting transparency in economic channels to fight corruption

To tackle corruption effectively requires shining light on public sector institutions, particularly in procurement, natural resource contracts and tax incentives, to defeat state capture and grand corruption. But transparency will not stem IFFs unless it is brought to bear on all economic channels and on the institutional mechanisms that promote financial secrecy and facilitate the cross-border movement of wealth, including money laundering and the laundering of illicit enrichment.

Comprehensively reforming financial secrecy helps the fight against corruption. First, it shines light on the providers of secrecy services, helping to take the fight to the facilitators of corruption. Second, financial secrecy indicators can provide guidance on the legal and regulatory measures required to disrupt corruption linked to IFFs.

Monitoring corporate tax havens complements efforts to tackle financial secrecy by investigating how secrecy affects corporate taxation. The intensity and success of a jurisdiction's abuse of its corporate income tax autonomy to incite tax spillovers from other jurisdictions indicate its role facilitating cross-border corruption and the movement of illicit wealth. Such spillovers reduce those other jurisdictions' autonomy in setting tax rules and selecting a tax mix.

Corruption through trade

Trade can be a channel for corruption, tax evasion and money laundering, especially when it involves the manipulation of price, quantity, or quality. It can take several forms. Re-invoicing can route trade on paper through a third-party jurisdiction to produce two different invoices for one transaction. Same invoice mis-pricing can go as far as to fake transactions—an extreme case where no trade at all takes place. And transfer mis-pricing or abusive transfer pricing corrupts intra-group trade within a multinational enterprise. Corruption by or within (multinational) companies can also involve embezzlement, or staff creating and controlling slush funds for bribery or conspicuous consumption. Such schemes can be advanced through bribing customs officials. Or customs officials can face extortion due to drone surveillance in port areas identifying officials opening containers with illegal goods.

International anti-corruption frameworks and instruments

All governments in Africa except Eritrea and Somalia have signed on to global or regional conventions and protocols to guide their national laws and activities to combat corruption. These instruments describe measures, including institutional structures for overseeing implementation, that parties will take to prevent, criminalize, and recover proceeds of corruption. The instruments vary in scope, legal status, membership, implementation, and monitoring mechanisms. But all aim to establish common standards for addressing corruption domestically by criminalizing corrupt conduct; enforcing law through investigation, prosecution and sanctions; and implementing preventive measures. Some international legal anti-corruption instruments also aim to identify and promote good practices and facilitate cooperation between member states (Lagide, 2013, p. 15). All the instruments focus predominantly on the public sector but provide for preventing and criminalizing private sector activities and, in varying degrees, curtailing aspects of corruption-related IFFs.

This section reviews four instruments: the United Nations Convention against Corruption (UNCAC), the African Union Convention on Preventing and Combatting Corruption (AU Convention), the Economic Community of West African States Protocol on the Fight against Corruption (ECOWAS Protocol) and the Southern African Development Community Protocol against Corruption (SADC Protocol) (table 5.1).

The UNCAC is globally recognized as the most far-reaching legally binding instrument on corruption and corruption-related acts. Its provisions are mandatory. It offers a viable framework for cooperation between states on anti-corruption measures, sets out universally agreed standards for government performance and covers a wide array of acts by the public and the private sectors that qualify as corrupt (Transparency International, 2008). Several of its provisions, such as private sector transparency clauses and the prohibition of shell companies, lay the grounds for fighting IFFs. By June 2019, the UNCAC had 186 parties and 140 signatories.

While all AU member countries except Eritrea and Somalia have ratified the UNCAC, 13 have failed to ratify the AU Convention[46]. The AU Convention situates corruption within a good governance framework that underpins the World Bank's World Governance Indicators, including "respect for democratic principles and institutions; popular participation, the rule of law and good governance; respect for human and peoples' rights; transparency and accountability in the management of public affairs" (Article 3). The AU Convention also mirrors aspects of the UNCAC. It has unique features addressing IFFs, such as providing specifically for criminalizing corrupt practices in international trade.

While all AU member countries except Eritrea and Somalia have ratified the UNCAC, 13 have failed to ratify the AU Convention.

The ECOWAS Protocol mirrors the AU Convention[47]. It was adopted both to provide preventive and suppressive measures against corruption and to mitigate the damage of corruption to the political and economic stability of the subregion (UNODC, 2005, p. 211). It focuses on the public sector, though some provisions, such as criminalizing fraud and the bribery of public officials, also affect the private sector.

The SADC Protocol was adopted against a backdrop in many ways like ECOWAS's: porous borders facilitate trafficking weapons and smuggling precious minerals, and wars and strife present opportunities for smuggling, money laundering and other criminal activities by criminal organizations. The SADC Protocol obligates SADC member states to prioritize passing relevant anti-corruption legislation to prevent, detect, punish and eradicate corruption in the public and private sectors[48].

46 By 28 June 2019, the following countries had not ratified the AU Convention: Cabo Verde, Cameroon, Central African Republic, Djibouti, Democratic Republic of the Congo, Equatorial Guinea, Eritrea, Eswatini, Morocco, Mauritania, Mauritius, Somalia, South Sudan and Tunisia. http://www.auanticorruption.org/auac/about/category/status-of-the-ratification.

47 Adopted on 21 December 2001 in Dakar, Senegal, during the 25th Session of the Authority of Heads of State and Government.

48 Protocol against Corruption (2001); https://www.sadc.int/documents-publications/show/.

Table 5.1. Anti-corruption measures and their scope

Measures or instrument	UNCAC	AU Convention	ECOWAS and SADC protocols
Preventive measures	To prevent, deter and combat corruption, state parties should: • Develop participatory and coordinated anti-corruption policies that ensure transparency and accountability • Put in place an independent and well-resourced body or bodies to oversee and coordinate implementation • Adopt measures to prevent and combat acts of corruption committed in and by agents of the private sector, including unfair competition, and respect tender procedures and any other measures to prevent companies from paying bribes to win tenders • The UNCAC explicitly prohibits tax deductibility of expenses that constitute bribes and provides for measures to detect and deter all forms of money laundering activities	State parties should undertake to: • Strengthen national control measures to ensure that the setting-up and operations of foreign companies in the territory of a state party shall be subject to the respect of the national legislation in force. This formulation is unique to the AU Convention • Establish, maintain, and strengthen independent national anti-corruption authorities or agencies • The AU Convention urges the full participation of civil society and the media (Art. 12), and state parties should create an enabling environment to enable them to "hold governments to the highest level of transparency and accountability in the management of public affairs"	The SADC Protocol places a premium on participation by the media, civil society, and non-governmental organizations in corruption prevention efforts. It also emphasizes public education and awareness

Measures or instrument	UNCAC	AU Convention	ECOWAS and SADC protocols
Criminalization	UNCAC lists 13 or more corrupt acts that state parties should criminalize, including illicit enrichment and bribery in the private sector It has no specific mandatory provisions addressing practices in cross-border trade, foreign direct investment or portfolio capital flows that lead to profit shifting or the concealment and transfer of income or profits	The AU Convention criminalizes bribery in the public and private sector, the abuse of functions, diversion of public property, illicit enrichment and the use or concealment of proceeds of corruption The AU Convention uniquely provides specifically to criminalize corrupt practices in international trade transactions	The ECOWAS and SADC protocols list the following acts as corrupt: bribery of/by a public official and private sector person, bribery of or by foreign nationals, influence peddling, diversion of public funds by a public official, illicit enrichment, fraudulent use or concealment of funds or property derived from corruption, aiding and abetment, laundering of proceeds of corruption and similar criminal offences The ECOWAS Protocol also lists fraud as a corrupt act. Neither protocol specifically refers to corporate legal persons
Asset recovery	The UNCAC makes asset recovery a fundamental principle. One of its main innovations is the right to recovery of stolen state assets It provides for verification of the identity of customers and beneficial owners of funds deposited into high-value accounts. It ensures enhanced scrutiny of accounts sought or maintained by politically exposed persons, for the purpose of detecting suspicious transactions. UNCAC prohibits the establishment of shell banks or shell companies	The AU Convention lacks extensive provisions on asset recovery like the UNCAC's. It instead contains Article 16, "Confiscation and Seizure of the Proceeds and Instrumentalities of Corruption"	By the ECOWAS Protocol each state party is to assist the other in the identifying and seizing the assets or items acquired or used in committing the crimes The SADC Protocol contains provisions on "Confiscation and Seizure," which provide that each state party shall adopt confiscation of proceeds including property derived from offences

Measures or instrument	UNCAC	AU Convention	ECOWAS and SADC protocols
Institutional framework for monitoring implementation	The UNCAC Conference of State Parties (CoSP) is the organ established "to improve the capacity of and cooperation between state parties to achieve the objectives set forth in this convention and to promote and review its implementation." The CoSP meets once every two years	The follow-up mechanism for the AU Convention is the Advisory Board on Corruption (ABoC), comprising 11 members, who serve in their personal capacity. The functions of the ABoC include promoting and encouraging the adoption and application of anti-corruption measures on the continent and regularly submitting a report to the AU Executive Council on the progress made by each state party in complying with the provisions of the convention	The ECOWAS Protocol creates a Technical Commission to monitor the implementation of the protocol at both the national and subregional levels and to provide state parties appropriate additional assistance: "The Technical Commission instead of being experts in the field of anti-corruption or related fields, shall comprise experts from the Ministries in charge of Finance, Justice, Internal Affairs and Security of States Parties. It shall meet at least twice every year and submit the reports of its meetings to the Council of Ministers." As of the time of writing, not much is known about the existence of such a commission or whether it has executed its mandate The SADC Protocol establishes a committee to oversee the implementation of the protocol. State parties are required to report to the committee within one year of becoming a party to the protocol and thereafter once every two years. But the SADC Protocol is yet to be implemented

Source: ECA staff compilation from country case studies and UNCAC[49] and AU[50] sources.[51,52]

49 https://www.unodc.org/unodc/en/treaties/CAC/.
50 http://www.auanticorruption.org/auac/about/category/convention.
51 https://www.sadc.int/files/7913/5292/8361/Protocol_Against_Corruption2001.pdf.
52 https://eos.cartercenter.org/uploads/document_file/path/406/ECOWAS_Protocol_on_Corruption.pdf.

Institutional frameworks for monitoring implementation

All the anti-corruption instruments under discussion have institutional arrangements for assessing the status of state parties implementing their provisions.

The UNCAC Conference of State Parties (CoSP) is the organ established "to improve the capacity of, and cooperation between, State Parties to achieve the objectives set forth in this Convention and to promote and review its implementation."

The CoSP, meeting once every two years, established a mechanism for reviewing the phased implementation of the convention. United Nations Office on Drugs and Crime reports based on the first cycle review in 2015 and three years of the second cycle review indicate that:

- A growing number of governments are adopting tougher laws and establishing or strengthening policies to fight corruption. Some 90 per cent of states, after completing their first and second cycle reviews took legislative measures or are in the process of taking or are planning them. Other states have adopted or are in the process of adopting new laws or legal provisions with the aim of better implementing the convention's requirements and addressing recommendations issued during the review (UNODC, 2019c).
- Some 86 per cent of states have carried out reforms to bring their legislation in line with UNCAC requirements (UNODC, 2019c).
- Thanks to increased global advocacy around UNCAC, international cooperation on illicit financial flows, asset recovery and transparency of beneficial ownership are receiving growing attention.
- At least 74 per cent of states found that the review helped identify gaps and shortcomings in their domestic frameworks and systems for fighting corruption and had an overall positive impact on their national efforts.
- Institutional cooperation and institution building made progress overall, as some states instituted inter-institutional coordination bodies, including both various state institutions and members of civil society, to better implement the review's recommendations (UNODC, 2019c).
- Some states established reporting hotlines and online platforms for reporting and sharing information among national authorities.
- Some states created central registers of beneficial owners and enhanced beneficial ownership transparency through public registers.

The follow-up mechanisms for the AU Convention is the Advisory Board on Corruption (AUABC), with 11 members who serve in their personal capacity. AUABC has the duty to promote and encourage the adoption and application of anti-corruption measures on the continent, collect information and analyse the conduct and behaviour of multinational corporations operating in Africa and to disseminate such information to designated national authorities, and to regularly submit a report to the AU Executive Council on each state's progress in complying with the AU Convention's provisions.

But only 41 African countries have ratified AU Convention since the Second Ordinary AU Assembly adopted it in July 2003. In contrast, all but two African countries have ratified UNCAC. Of those that ratified the AU Convention, only 13 (32 per cent) returned questionnaires AUABC sent them in May 2015, in accordance with Article 22 (7) of the convention (Noa P, 2017).

The AU Convention does not explicitly provide for a peer review procedure, unlike the UNCAC's review mechanism under Article 63 (5) (Ogundokun, 2005). So, little information is publicly accessible on how the AUABC review mechanism works in practice. Further, a Transparency International report noted that "it is not possible to assess [the AUABC review's] potential and effectiveness in terms of promoting effective implementation of the AU Convention across African States" (Transparency International, 2014). Since its inception, the AUABC has largely concentrated on getting the rules and procedures for its work in place and has failed to begin substantive work on the implementation of the AU Convention (Chikwanha, 2016, p. 2).

One unique feature of the ECOWAS Protocol is its creation of a Technical Commission (Article 19) to:

- Monitor the implementation of the protocol at both the national and subregional levels.
- Gather and disseminate information among state parties.
- Regularly organize relevant training programmes.
- Provide state parties appropriate additional assistance.

The Technical Commission includes experts from ministries of finance, justice, internal affairs, and security. It is required to meet at least twice a year and submit the reports of its meetings to the ECOWAS Council of Ministers. But it is hard to find information regarding the work of this commission.

The SADC Protocol establishes a committee to oversee the implementation of the SADC Protocol. States parties are required to report to the committee within a year of becoming a party and once every two years after that. But the SADC Protocol has not yet been implemented, since "the heads of states have not mustered the political will to honour their pledge following the adoption of the protocol, namely that preventative and effective measures would be put in place to ensure full implementation of the protocol by member states" (Chikwanha, 2016).

Effectiveness on the ground of anti-corruption measures in combatting illicit financial flows

All the anti-corruption instruments reviewed predominantly focus on the public sector. Not all have explicit provisions on IFFs, though some provisions, such as combatting money laundering or the laundering of the proceeds of crime and corruption, as well as the right to information and other general transparency measures, can be applied to combat IFFs. Only the UNCAC explicitly addresses IFFs, though the AU Convention provides for criminalizing corrupt practices in international trade, opening the door for addressing trade mis-invoicing and related manipulation of trade. Attention to IFFs as a corruption issue in Africa is recent, stimulated largely by the report of the High Level Panel on Illicit Financial Flows (Mbeki Panel) (AU and ECA, 2015) and by efforts to comply with Financial Action Task Force provisions on money laundering.

The heightened interest in IFFs in Africa is reflected in the public sector focus of all the anti-corruption instruments except UNCAC and their limited reference to IFF-related corrupt acts (which only the UNCAC explicitly addresses). So, not much has been concretely implemented based on the conventions and protocols' provisions to curb illicit financial flows—such as criminalizing illicit enrichment, taking anti–money laundering measures and developing and enforcing policies to prevent conflicts of interest by public officers. Besides, the knowledge, data and capacity to track, stop and repatriate illicit financial outflows are poor (AU and ECA, 2015).

That incapacity is reflected in the inadequate understanding of IFF mechanisms and the absence or ineffectiveness of legislative, regulatory and institutional frameworks for curbing them. Oversight institutions also lack capacity and independence. And prosecutorial systems lack the autonomy, resources and skills and infrastructure to combat corruption (AU and ECA, 2015).

Anti-corruption instruments relating to natural resources

Corruption risks in natural resource governance

The fifth African Governance Report addressed how Africa's natural resources can best be managed both to avoid the resource curse of corruption, conflict and economic stagnation and to transform natural resource wealth into domestic resource mobilization and structural transformation (ECA, 2018a).

Addressing corruption risks along the life cycle of natural resource extraction from discovery to mine closures and along the entire value chain is crucial to making the extractive sector a driver of economic transformation.

The natural resource sector is perceived as highly vulnerable to corruption (Chikwanha, 2016; OECD, 2016; UNDP, 2015). Of 19 industries captured in the Transparency International's 2011 Bribe Payers Index (BPI), oil and gas ranked 4 in the prevalence of foreign bribery, while solid minerals ranked 5.

The institutional and policy frameworks for every mineral's value chain, from extraction to revenue use, are said to be riddled with corruption challenges. Addressing corruption risks along the life cycle of natural resource extraction from discovery to mine closures and along the entire value chain is crucial to making the extractive sector a driver of economic transformation. The sector's vulnerability to corruption includes weaknesses in the anti-corruption legal and judicial system which may undermine host governments' capacity to effectively detect, prevent and sanction corruption. It also includes high politicisation and the misuse of discretionary power in decision-making processes for self-interest, as well as inadequate governance arrangements that leave room for favouritism, clientelism, political capture and interference, conflict of interest, bribery and other corrupt practices. (OECD, 2016, p. 15).

The corruption risks, while varying by resource and by the country's stage of economic development, are pervasive. They occur in contracting, sales, revenue sharing and revenue management. And legislative frameworks governing the sector tend to be inadequate.

National anti-corruption legislation concerning transnational corrupt practices are generally weak. As noted earlier, many countries' legal systems do not categorically criminalize the bribery of foreign public officials and officials of public international organizations. And both overt and covert private sector bribery are often overlooked, unless they involve public procurement.

Contracting. Some companies influence contract awards by paying local firms indirectly owned by politicians or senior public officials responsible for awarding contracts, in exchange for intangible services.

Corrupt public officials commonly hide their identity through friends and associates, aliases and shell companies. Anti-corruption legislation in many African countries makes it difficult to combat such crimes in the extractive sector. It often does not explicitly require the public registration and availability of information on beneficial ownership of companies in that sector.

Where the sale of equity through mergers and acquisitions is not transparent and competitive, equity values tend to be under-priced, especially without clear rules for mergers and acquisitions. These practices can be used deliberately to manipulate the equity market to illicitly benefit individuals or firms.

Local content requirements for mining agreements, especially petroleum agreements, present inherent corruption risks, especially where the decision to recommend or approve the local partner is left to the executive arm of government. This incentivizes bribery or the manipulation of what companies offer as local content. Local content requirements can also be abused when contracts to supply goods and services to extractive industry entities are awarded to shell or front companies, resulting in cost inflation and delays in project execution.

Although extractive sector contracting presents high risks of money laundering and IFFs, few countries engage their financial intelligence units or other security agencies in due diligence assessments of contracting.

Sharing and managing revenue. The lack of regular cost audits, long lags in conducting tax audits, disorganization across relevant state institutions and delays in information disclosure are key factors enabling corruption related to revenue collection.

Some large-scale companies sending crude oil or precious minerals to refineries or trading companies they own outside the producing countries may under-price the product or report a lower quality grade to the governments of the receiving countries. The unavailability of price comparability databases to help revenue authorities assess the costs and prices reported by companies in their filings, especially for controlled costs, creates openings for revenue officials to exercise discretion, and without adequate checks, abuses may occur, especially in determining the values of intangibles such as marketing, trading cost, intellectual property and the services of the head office.

Trading and accounting for natural resources poses risks of corruption, especially through pricing. That risk is aggravated in countries without national crude oil or precious minerals pricing policies. The export of minerals (gold and diamonds) is particularly associated with transfer pricing risks (see chapter 2 on transfer pricing).

Overall, natural resource extraction faces the following types of corruption: money laundering; tax-evasion and aggressive tax avoidance; state capture, typically aimed at public procurement or policies, rules or licensing regimes; and outright bribery to gain private sector benefit and companies fronted by people in authority (UNDP, 2015). The natural resources sector tends to predominate among trade-related IFFs, especially through invoice manipulation to avoid taxes or conceal wealth and transfer it abroad illicitly.

Measures to reduce such risks include increasing transparency by institutionalizing robust beneficial ownership disclosure in natural resource policies and agreements, and boosting international cooperation through such mechanisms as automatic exchange of information. A robust and effectively implemented legal and institutional framework is a precondition of combatting natural resource sector corruption and IFFs.

How have these challenges been provided for in the existing regional and global instruments?

Natural resources and the African Union Convention on Preventing and Combatting Corruption

The AU Convention addresses natural resource–prone corruption in part by obligating state parties to adopt legislative and administrative measures criminalizing a prescribed list of offences considered corrupt practices. States are also expected to adopt legislation and practices regulating foreign company operations, to strengthen national anti-corruption mechanisms and generally to address private sector corruption.

On top of state obligations to criminalize acts of corruption likely to occur in the natural resources sector, the AU Convention's Article 11 provides that state parties should undertake to "adopt legislative and other measures to prevent and combat acts of corruption and related offences committed in and by agents of the private sector, establish mechanisms to encourage participation by the private sector in the fight against unfair procedures and respect for tender procedures, property rights, as well as adopt such other measures as may be necessary to prevent companies from paying bribes to win tenders."

The AU Convention also calls on state parties to establish legislation tackling money laundering as a criminal offence, covering:

- The conversion, transfer or disposal of property, knowing that such property is the proceeds of corruption or related offences, for the purpose of concealing or disguising the illicit origin of the property or of helping any person who is involved in the commission of the offence to evade the legal consequences of his or her action.
- Concealment or disguise of the true nature, source, location, disposition, movement or ownership of property or of rights with respect to it if the property is the proceed of corruption or related offences.
- Acquisition, possession or use of property with the knowledge at the time of receipt that such property is the proceed of corruption or related offences[53].

Natural resources and the ECOWAS and SADC protocols

The ECOWAS and SADC protocols mandate state parties to adopt measures to address corruption related to the natural resources sector through regulating activities that directly or indirectly affect the sector. The ECOWAS protocol places a premium on measures to establish revenue collection systems that eliminate opportunities for corruption and tax evasion, as well as measures to provide for regulations requiring companies and organizations to maintain adequate financial books and records and adhere to internationally accepted standards of accounting[54].

The ECOWAS Conflict Prevention Protocol, adopted in December 1999, also addresses corruption[55]. Its provisions cover effective strategies and mechanisms for collaborating against corruption. It calls for promoting close cooperation among the security services of member states to control transborder crime in the ECOWAS subregion and for enacting legislation applicable to all crimes on forfeiture of the proceeds of crime in member states (Article 46). Its Article 49 provides for measures against money laundering, with the ECOWAS Secretariat and the member states to adopt strategies expanding the scope of offences, enabling the confiscation of laundered proceeds and illicit funds and easing bank secrecy laws within and outside the subregion.

The SADC Protocol requires steps towards government revenue collection and control systems that deter corruption and laws that deny favourable tax treatment for any individual or corporation for expenditures in violation of anti-corruption laws. The protocol also urges member states to take measures to deter bribery of domestic public officials and officials of foreign states. Such mechanisms should ensure that publicly held companies and associations of other types maintain books and records that accurately and in reasonable detail reflect the acquisition and disposition of assets, with adequate internal accounting controls for law enforcement agencies to detect acts of corruption.

53 Article 6 of the AU Convention.
54 Article 5 of the ECOWAS Protocol.
55 The Economic Community of West African States Protocol relating to the Mechanism for Conflict Prevention, Management, Resolution, Peace-keeping and Security.

Case study country laws and standards for fighting against corruption and illicit financial flows

How do the anti-corruption legal frameworks of the case study countries— Côte d'Ivoire, Ghana, Namibia, United Republic of Tanzania, and Tunisia address corruption related to IFFs?

Bribery. Except United Republic of Tanzania, the case study countries either have gaps in their private sector legislation or no legislation at all. United Republic of Tanzania has a robust legal framework to deal with corruption in the private sector and the transnational private sector. Ghana has criminalized neither active transnational bribery nor active or passive private sector bribery. Côte d'Ivoire has only partially criminalized private sector bribery and embezzlement, but the law does not explicitly cover managers, directors or business owners. Namibia has partially criminalized embezzlement, misappropriation, and other diversion of property by public officials through the common law offences of theft and fraud.

Illicit enrichment. Illicit enrichment is not a criminal offence in Côte d'Ivoire, United Republic of Tanzania or Tunisia. Namibia and Ghana address it through assets declaration. In Ghana, the Commission on Human Rights and Administrative Justice is the sole institution responsible for investigating breaches of the Assets Declaration law, with persons found liable facing disqualification from holding public office.

Money laundering. Across the continent, government have passed laws criminalizing money laundering and established institutions to enforce these laws, despite its wide scope, its complex nature and the many controversies it has generated since coming to international public attention (UNODC, 2017, p. 68). The legal framework against money laundering has largely been based on principles set out in international conventions and instruments, including UNCAC, the 1988 United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances and the United Nations Convention against Transnational Organized Crime (signed in Palermo, Italy, in 2000). Periodic evaluations by the Financial Action Task Force and similar regional bodies play an important role in determining and harmonizing the relevant legislation[56]. The technical assistance and recommendations of those specialized groups have benefited many countries.

> *Across the continent, government have passed laws criminalizing money laundering and established institutions to enforce these laws, despite its wide scope, its complex nature and the many controversies it has generated since coming to international public attention.*

All five case study countries belong to one of the regional anti–money laundering groups and financial services research bureaus that have been granted observer status at the Middle East and North Africa Financial Action Task Force against Money Laundering and Terrorism Financing (FATF), the Eastern and Southern Africa Anti–Money Laundering Group, the Intergovernmental Action Group against Money Laundering in West Africa and the Action Group against Money Laundering in Central Africa.

Ghana's Financial Intelligence Centre (FIC) is at an advanced stage of developing a one-stop information platform as a money laundering tool connecting the databases of the central bank, the commercial banks, the Ghana Revenue Authority (GRA) and the securities and exchange commission. This is a "first" in Africa[57].

56 Such bodies include the Committee of Experts on the Evaluation of Anti–Money Laundering Measures and the Financing of Terrorism of the Council of Europe, the Asia/Pacific Group on Money Laundering, the Eastern and Southern Africa Anti–Money Laundering Group, the Financial Action Task Force of Latin America against Money-Laundering (known by its Spanish acronym GAFILAT, formerly GAFISUD), the Eurasian Group on Combating Money Laundering and Financing of Terrorism, the Caribbean Financial Action Task Force, the Inter-governmental Action Group against Money-Laundering in West Africa, and the Middle East and North Africa Financial Action Task Force.

57 Author's conversations with the UK Department for International Development, main financier of the system under development.

Fostering transparency. Almost all the case study countries have versions or chapters of the Extractive Industries Transparency Initiative (EITI) and the Open Government Partnership, which help to keep the transparency agenda in the respective countries alive. But beyond that Ghana seems to lead in the transparency of beneficial ownership information—it was one of the first countries in Africa to have a law on beneficial ownership disclosure and transparency (Act 992), though full implementation has yet to take shape.

Public register of beneficial ownership of companies. Only Ghana has so far reported effective steps to roll out a register by 2020.

Automatic exchange of information. The Global Forum on Transparency and Exchange of Information for Tax Purposes adopted Common Standards for Automatic Exchange of Financial Account Information in Tax Matters, developed by the Organisation for Economic Co-operation and Development. The standards incorporate legal and technical requirements for a complete and standardized model for automatically exchanging financial information— including information on assets and accounts held for offshore tax residents by banks, insurers and investment entities (such as funds and certain trusts)[58].

Actual exchange of information under the Common Reporting Standards commenced in September 2017. By 2018, 86 jurisdictions had completed about 4,500 bilateral exchanges. Each exchange contains detailed information on financial accounts held by tax residents in their partner jurisdictions. Ghana, due for reporting in 2019, has already adopted legislation and developed a road map for implementing the Common Reporting Standards. Côte d'Ivoire, United Republic of Tanzania, and Tunisia have also taken steps towards implementing the Common Reporting Standards.

National and local anti-corruption enforcement agencies in case study countries

All the case study countries have established two or more institutions to fight corruption, one of which is a financial intelligence unit (FIU). These bodies vary markedly in mandate, powers and location within governance structures.

Anti-corruption agencies. Ghana has established autonomous anti-corruption enforcement agencies, in addition to a financial intelligence centre (FIC): the Commission on Human Rights and Administrative Justice (CHRAJ), the Economic and Organised Crime Office (EOCO) and the Office of the Special Prosecutor (OSP), dedicated to investigating and prosecuting corruption cases. United Republic of Tanzania has established the Prevention and Combating of Corruption Bureau (PCCB) and the Financial Intelligence Unit. Namibia has the Namibia Anti-Corruption Commission (ACC) and the Financial Intelligence Centre. Tunisia's anti-corruption enforcement agencies are the National Authority for Combating Corruption (INLCC) and the Tunisia Financial Analysis Committee (CTAF) at the central bank, while Côte d'Ivoire has the High Authority for Good Governance (HABG) and the National Financial Information Processing Unit (CENTIF).

Mandate. Of the core anti-corruption agencies other than the FIUs, Ghana's CHRAJ has the most extensive mandate. It is only the second institution in the world (after South Korea's) that combines three functions: human rights, ombudsman, and anti-corruption agency. It investigates complaints and allegations of corruption, allegations of breaches of the Code of Conduct for Public Officers and whistle blower complaints, among others. It has special powers to issue subpoenas, cause a person contemptuous of a subpoena it issued to be prosecuted before a court, and require a person to disclose truthfully and frankly any information it is investigating[59]. Among the case study country institutions, only the CHRAJ law explicitly recognizes whistleblowing.

58 https://www.oecd.org/tax/transparency/AEOI-Implementation-Report-2018.pdf.
59 Section 8 of Act 456.

Ghana's second body, the Economic and Organised Crime Office has two objectives: to prevent and detect organized crime and to facilitate the confiscation of the proceeds of crime. To do so, it investigates serious offences that involve money laundering, prosecutes them on the authority of the attorney general and recovers the proceeds of crime.

United Republic of Tanzania's PCCB is mainly preventive, educational, advisory and investigative, like CHRAJ in many respects. However, unlike CHRAJ, the PCCB may prosecute corruption upon the consent of the director of public prosecutions[60], and may even prosecute without that consent in some circumstances. It is not clear whether the PCCB can issue subpoenas. Namibia's ACC has educational, preventive, and investigative functions, but unlike the PCCB it cannot prosecute. Tunisia's INLCC only gathers information on corruption and provides policy advice but does not have full investigative or prosecutorial functions. Like Tunisia's INLCC, Côte d'Ivoire's HABG can monitor corruption and provide coordination and advice on preventive measures.

Ghana's Office of the Special Prosecutor investigates and prosecutes alleged corruption or suspected corruption and corruption-related offences; recovers the proceeds of corruption and corruption-related offences and takes steps to prevent corruption. The special prosecutor and authorized officers have the powers of a police officer, including arrest, search, seizure and to take possession of documents[61].

Powers. Of the non–money laundering–related agencies, Ghana's CHRAJ has the most extensive powers outlined in law. It can go to court to enforce its decisions and seek remedies, it investigates complaints of whistle blower victimization and it issues orders with the effect and enforceability of an order or judgement of the High Court[62]. It has power to enter and inspect any premises. But it has no power of arrest or prosecution. EOCO officers, in contrast, have the powers of arrest, can exercise police powers and have the immunities conferred on police officers by law.

The director-general of United Republic of Tanzania's PCCB can exercise police officer powers—the power to arrest, enter premises, search, detain suspects and seize property[63]. Namibia's ACC has the power to investigate and enter any premises and to seize anything with or without a warrant issued by a judge of the High Court or by a magistrate. The ACC can investigate any bank account, share account, purchase account, expense account or any other account, or any safe deposit box in any bank, building society or other financial institution. Namibia's ACC has the power of arrest but not the power of prosecution. Besides those noted above, the substantive powers of Tunisia's INLCC are unspecified. Côte d'Ivoire's HABG has no powers to arrest or prosecute.

Institutional location and independence. Ghana's CHRAJ is a constitutional body, not located within any government department. Its permanence and independence are guaranteed under section 225 of the Constitution. It can only be dissolved through a referendum in which at least 40 per cent of the persons entitled to vote do so and at least 75 per cent of votes favour dissolution. It reports to the parliament annually on its functions. The commissioners are appointed by the president with conditions of service like those of justices of the Superior Courts of Judicature in Ghana—they can only be removed on grounds of stated and proven misbehaviour.

The director-general and deputy director-general of United Republic of Tanzania's PCCB both appointed by the president. The law says nothing about their independence and makes no specific provision to protect members from direct or indirect interference from government or other authorities or power. The PCCB is answerable to the president's office (ECA, 2015). The director general of Namibia's ACC is appointed independently. It has its own budget allocated by the Ministry of Finance (UNODC 2016, p. 117 (www. uncaccoalition.org). Under Tunisia's 2014 constitution, INLCC will be replaced by the Good Governance and Anti-Corruption Body (IBOGLUCC) created by the organic law adopted 27 August 2018 by the Assembly of Representatives of the People (Aidi, 2019). Information on its powers and institutional independence is not readily available. Côte d'Ivoire's HABG is an independent administrative authority and legal entity with financial autonomy. It is under the authority of the president of the republic.

60 Section 7 of Chapter 329.
61 Sections 28–31 of Office of Special Prosecutor Act, 2017 (Act 959).
62 Section 14 (5) of Act 720.
63 Section 8 of Chapter 329.

Financial intelligence units. Although they have different names in the case study countries, the FIUs have similar functions and powers across the board. Their focus is to combat money laundering and terrorism financing, guided by the FATF standards. They assist in combatting money laundering, terrorism financing, proliferation of weapons of mass destruction financing and any other transnational organized crime. They make information available to investigating authorities, intelligence agencies and revenue agencies to facilitate law administration and enforcement. And they exchange information with similar bodies in other countries on money laundering, terrorism financing, proliferation of weapons of mass destruction financing and other transnational organized crime.

They do not have powers of investigation or prosecution. The heads of the FIUs are appointed by the president. The units are located in the central bank (the ministry of finance in United Republic of Tanzania) or are independent. To enhance its anti–money laundering capacity, Ghana's FIC is currently working on linking the databases of the central bank, the Ghana Revenue Authority and the securities and exchange commission

Improving the implementation of anti-corruption measures to curtail illicit financial flows

Owing to increased global advocacy around the UNCAC, international cooperation on IFFs, asset recovery and the transparency of beneficial ownership are receiving growing attention. African countries should implement the recommendations emanating from the UNCAC review mechanism, which largely covers those of the AU Convention and the protocols. African countries should pay more attention to anti-corruption measures that can curtail IFFs, such as criminalizing illicit enrichment (possession of unexplained wealth), providing for public registers of the beneficial owners of companies and ensuring that concepts such as conflict of interest and corruption in the private sector context are clearly defined in law. They may also pursue the following:

- Enactment, resourcing, and implementation of right to information laws. Access to information will enhance transparency, particularly corporate accountability. It will crack open public procurement, natural resource contracts with international companies and money laundering through banks, among others.
- Review of anti-corruption laws. These should address all avenues of corruption, including those related to trade, investments, and capital flows in natural resource contracts, and those related to the public sector, such as procurement transparency, privatization, and asset recovery.
- Measures to promote public sector integrity, including right to information legislation that promotes the demand side of integrity.
- Capacity building for national institutions working on IFFs, money laundering and asset recovery, including strengthening mandates, increasing access to resources and protecting the autonomy of the anti-corruption agencies.
- Above all, investment in research and data management to monitor corruption-related IFF risks and so on.

Combatting IFFs involves not only anti-corruption institutions but multiple sectors (customs, crime control, the financial sector and tax administration). Coordination and policy coherence are key.

International cooperation is necessary in fighting corruption and prosecuting cases related to IFFs. It is said that Ghana would have been unable to successfully prosecute an IFF case without the assistance these partners provided to the Ghana FIC: the Egmont Group, the International Criminal Police Organization, the Stolen Asset Recovery Initiative, the Asset Recovery Interagency Network–Asia Pacific, the Asset Recovery Inter-Agency Network for West Africa and the Asset Recovery Network of the Financial Action Task Force of Latin America.

Data and measurement issues

The fourth **African Governance Report** lamented the predominance and limitations of perceptions-based surveys as the main information source on corruption in Africa, the paucity of transaction data (whether surveyed or gathered through administrative reporting) and the consequent limits to evidence-based policymaking in Africa (ECA, 2015). Few countries report regularly to international institutions that compile economic databases, and when they do, the quality is poor and inconsistent. The data limitations severely constrain Africa's ability to mitigate IFFs and corruption risks and to curtail these flows[64].

Table 5.2. Illicit financial flow risk analysis data, 2008–2018

IFF channel/ dataset	Number of African reporter jurisdictions with data on at least one observation 2008–2018	Coverage 2008–2018 (% of 60)	Number of African reporter jurisdictions with data on at least one observation 2008–2018 if secrecy scores of partner jurisdiction are also available	Coverage 2008–2018 (% of 60)
Export	42	70.0	32	53.3
Import	42	70.0	32	53.3
FDI inward	21	35.0	17	28.3
FDI outward (derived)	60	100.0	60	100.0
Banking claims (derived)	60	100.0	60	100.0
Banking liabilities	1	1.7		1.7
Portfolio assets	3	5.0	3	5.0
Portfolio liabilities (derived)	59	98.3	54	90.0

Source: Abugre et al., 2019.

Africa's reported data are particularly poor on banking liabilities, portfolio assets and inward FDI (table 5.2). The story is even more bleak when data consistency over time is assessed. While African governments bear the principal responsibility for improving data, international organizations such as the International Monetary Fund (IMF), the Organisation for Economic Co-operation and Development and the United Nations need to support them to invest in data gathering and analysis. Sometimes there are long lags between data reported through, say, IMF Article IV Reports and their verification and entry into databases managed by these institutions. The fight against corruption and IFFs cannot be won without shining light on the problem. Data are essential for that.

Africa's reported data are particularly poor on banking liabilities, portfolio assets and inward FDI.

64 Data on banking positions come from table A6.2 of the Locational Banking Statistics dataset of the Bank for International Settlements. Africa's reporting in this area is better in relation to liabilities than claims. Data on direct investment positions come from the International Monetary Fund (IMF) Coordinated Direct Investment Survey. Data on portfolio investment holdings come from the (IMF) Coordinated Portfolio Investment Survey (CPIS). Data on trade come mostly from the UN Comtrade database.

Conclusion and recommendations

> *African countries are severely constrained by limited or irregularly reported data essential for analysing IFF risk exposures.*

In establishing a conceptual link between corruption and IFFs, this chapter has used a definition of corruption broad enough to cover the complex motivations, manipulations, and local and international channels through which corrupt practices illicitly move wealth across borders. The corrupt acts leading to the largest illicit transfers of wealth abroad illegally manipulate trade, foreign direct investments, and portfolio capital flows. They conceal and transfer abroad the profits and incomes derived from these practices for illicit purposes, including to avoid and evade taxes. Although public sector kleptocracy is part of the dynamic, transnational companies are the key players in the cross-border movement of this illicitly acquired wealth, and banks, accounting firms and law firms are the main drivers, aided by jurisdictions providing secrecy and the incentive of low taxes.

To curtail public sector corruption, strengthening procurement institutions and requiring public access to procurement information can help, combined with an effective criminal justice system. To curtail the transfer of illicit enrichment abroad requires strong anti-laundering legislation and institutions, properly linked to other channels of IFFs.

In examining the adequacy of the international anti-corruption frameworks for tackling IFFs, the chapter reviewed the UNCAC, the AU Convention and the ECOWAS and SADC protocols. All these instruments provide a good foundation for addressing IFFs by providing for criminalizing laundering the proceeds of crime, bribery in the public and private sectors and diverting public funds. The UNCAC, the most comprehensive, explicitly prohibits certain practices in international trade transactions (as does the AU Convention) and the establishment of shell companies. The UNCAC goes the furthest in addressing the multifaceted channels of IFFs. All the protocols, with different degrees of detail, require the application of due diligence to politically exposed persons. The instruments' attention to the declaration of assets and provisions on tax evasion is also critical.

Even so, more than a fifth of African countries have yet to ratify the AU Convention, and the ECOWAS and SADC protocols are not yet in force. Only 20 of the countries that ratified the AU Convention cared to report to the AU Advisory Council on the progress of their implementation. Agreeing a convention or protocol is one thing, implementing it is quite another. The AU Commission should ensure that all countries ratify the convention and that a peer review mechanism is in place and properly functioning.

Countries have tended to set up distinct institutions with widely varying mandates and powers to prevent money laundering and to prevent, investigate, deter and prosecute corruption and fraud. But their provisions to combat money laundering are similar, modelled on the FATF's Country Reporting Standards. Most of the anti-corruption agencies have limited powers and independence to address corruption or are undermined by the executive's discretionary exercise of budget authority. The powers provided for anti-corruption agencies in national legislation tend to fall far short of those envisioned by UNCAC and the AU Convention. They fall particularly short due to the laws' lack of specific provisions for combatting trade-related IFFs and tax avoidance–driven IFFs. The powers could be bolstered through strengthened anti-corruption legislation.

African countries are severely constrained by limited or irregularly reported data essential for analysing IFF risk exposures. Data paucity is most severe concerning financial flows. Integrating data systems across all economic channels—customs and other tax authorities, commercial banks, central banks, security exchange commissions and registries of companies—is essential to fully track corrupt transactions and the movement of the proceeds across boundaries.

ANNEX

Table A5.1. Summary of anti-corruption institutional arrangements

Countries	Ratification of UN Convention against Corruption (UNCAC)[a]	Ratification of African Union (AU) Convention on Preventing and Combatting Corruption[b]	Ratification of Southern African Development Community (SADC) Protocol against Corruption[c]	Ratification of Economic Community of West African States (ECOWAS) Protocol on the Fight against Corruption[d]	National anti-corruption agency[e]	Membership in asset recovery networks[f]	Whistle blower protection laws
Algeria	25 August 2004	23 May 2006			Central Office for the Suppression of Corruption		
Angola	29 August 2006	20 December 2017	SADC		National Office of Prevention and Combat Corruption		
Benin	14 October 2004	20 September 2007		ECOWAS 1 December 2005	Autorité Nationale de Lutte contre la Corruption)	ARIN-WA	
Botswana	27 June 2011	14 May 2015	SADC		Directorate on Corruption and Economic Crime (DCEC)	ARIN-SA	
Burkina Faso	10 October 2006	29 November 2005		ECOWAS 10 August 2006	Superior State Control Authority (ASCE)	ARIN-WA	
10 March 2006	10 March 2006	18 January 2005			Special Brigade Anti-Corruption Commission of Burundi	ARIN-EA	
Cabo Verde	23 April 2008			Not yet	Independent council at the Court of Auditors	ARIN-WA	
Cameroon	6 February 2006				National Anti-Corruption Commission (CONAC)		
Central African Republic	6 October 2006				National Committee to Fight Corruption		
Chad	26 June 2018	3 March 2015					

Countries	Ratification of UN Convention against Corruption (UNCAC)[a]	Ratification of African Union (AU) Convention on Preventing and Combatting Corruption[b]	Ratification of Southern African Development Community (SADC) Protocol against Corruption[c]	Ratification of Economic Community of West African States (ECOWAS) Protocol on the Fight against Corruption[d]	National anti-corruption agency[e]	Membership in asset recovery networks[f]	Whistle blower protection laws
Comoros	11 October 2012	2 April 2004			Commission Nationale de Prévention et de Lutte contre la Corruption		
Republic of Congo	13 July 2006	31 January 2006			None yet		No
Côte d'Ivoire	25 October 2012	14 February 2012		Not yet	High Authority for Good Governance (HABG)	ARIN-WA	
Democratic Republic of the Congo	23 September 2010		SADC		Commission de l'Ethique et de la Lutte contre la Corruption (CELC)		
Djibouti	20 April 2005				Inspection General State of Djibouti	ARIN-EA	
Egypt	25 February 2005	1 January 2017			None yet		No
Equatorial Guinea	30 May 2018	26 June 2019			None yet		No
Eritrea							
Eswatini	24 September 2012		SADC		Anti-Corruption Commission (ACC)	ARIN-SA	
Ethiopia	26 November 2007	18 September 2007			Federal Ethics Anti-Corruption Commission of Ethiopia	ARIN-EA	
Gabon	1 October 2007	2 March 2009			National Commission to Combat Illicit Enrichment (CNLCEI)		
Gambia	8 July 2015	30 April 2009		ECOWAS 16 May 2008		ARIN-WA	
Ghana	27 June 2007	13 June 2007		ECOWAS 18 October 2002	Commission of Human Rights and Administrative Justice (CHRAJ)	ARIN-WA	
Guinea	29 May 2013	5 March 2012		Not yet	National Anti-Corruption Agency (ANLC)	ARIN-WA	
Guinea-Bissau	10 July 2007	23 December 2011		Not yet	Anti-Corruption Commission	ARIN-WA	

Countries	Ratification of UN Convention against Corruption (UNCAC)[a]	Ratification of African Union (AU) Convention on Preventing and Combatting Corruption[b]	Ratification of Southern African Development Community (SADC) Protocol against Corruption[c]	Ratification of Economic Community of West African States (ECOWAS) Protocol on the Fight against Corruption[d]	National anti-corruption agency[e]	Membership in asset recovery networks[f]	Whistle blower protection laws
Kenya	9 December 2003	2 March 2007			Kenya Anti-Corruption Commission (KACC)	ARIN-EA	
Lesotho	16 September 2005	26 October 2004	SADC		Directorate on Corruption and Economic Offence's (DCEO)	ARIN-SA	
Liberia	16 September 2005	20 June 2007		Not yet	Liberia Anti-Corruption Commission	ARIN-WA	
Libya	7 June 2005	23 May 2004			National Anti-Corruption Commission		
Madagascar	22 September 2004	6 October 2004	Not Ratified SADC		Bureau indépendant anti-corruption, (BIACO)		
Malawi	4 December 2007	26 November 2007	SADC		Anti-Corruption Bureau (ACB)	ARIN-SA	
Mali	18 April 2008	17 December 2004		ECOWAS 16 May 2003	Not yet	ARIN-WA	
Mauritania	25 October 2006				Police Forces for Combating Economic and Financial Crime		
Mauritius	15 December 2004	4 May 2018	SADC		Independent Commission Against Corruption (ICAC)	ARIN-SA	
Morocco	9 July 2007				Central Body for the Prevention of Corruption (ICPC)		
Mozambique	9 April 2008	2 August 2006	SADC		Gabinete Central de Combate à Corrupção, (GCCC)	ARIN-SA	
Namibia	3 August 2004	5 August 2004	SADC		Anti-corruption Commission (ACC)	ARIN-SA	Yes

Countries	Ratification of UN Convention against Corruption (UNCAC)[a]	Ratification of African Union (AU) Convention on Preventing and Combatting Corruption[b]	Ratification of Southern African Development Community (SADC) Protocol against Corruption[c]	Ratification of Economic Community of West African States (ECOWAS) Protocol on the Fight against Corruption[d]	National anti-corruption agency[e]	Membership in asset recovery networks[f]	Whistle blower protection laws
Niger	11 August 2008	15 February 2006		Not yet	Information/ Claims/Anti-Corruption and Influence Peddling Office/ Haute Autorité de Lutte contre la Corruption et les Infractions Assimilées	ARIN-WA	
Nigeria	14 December 2004	26 September 2004		ECOWAS 23 August 2002	Independent Corrupt Practices and Other Related Offences Commission (ICPC), Economic and Financial Crime Commission (EFCC)	ARIN-WA	
Rwanda	4 October 2006	25 June 2004			Office of the Ombudsman	ARIN-EA	
São Tomé and Príncipe	12 April 2006	28 May 2019			None yet	ARIN-WA	
Senegal	16 November 2005	12 April 2007		Not yet	National Commission for the Fight against Non-Transparency, Corruption and Misappropriation	ARIN-WA	
Seychelles	16 March 2006	1 June 2008	Not Ratified SADC		Anti-Corruption Commission of Seychelles (ACCS)	ARIN-SA	
Sierra Leone	30 September 2004	3 December 2008		ECOWAS 10 August 2004	Anti-Corruption Commission	ARIN-WA	
Somalia					Not Yet		
South Africa	22 November 2004	11 November 2005	SADC		Special Investigating Unit (SIU)/Asset Forfeiture Unit (AFU)	ARIN-SA	Yes

Countries	Ratification of UN Convention against Corruption (UNCAC)[a]	Ratification of African Union (AU) Convention on Preventing and Combatting Corruption[b]	Ratification of Southern African Development Community (SADC) Protocol against Corruption[c]	Ratification of Economic Community of West African States (ECOWAS) Protocol on the Fight against Corruption[d]	National anti-corruption agency[e]	Membership in asset recovery networks[f]	Whistle blower protection laws
South Sudan	23 January 2015				South Sudan Anti-Corruption Commission (SSACC)	ARIN-EA	
Sudan	5 September 2014	26 September 2018			National Intelligence and Security Services (NISS)		
United Republic of Tanzania	25 May 2005	22 February 2005	SADC		Prevention and Combating of Corruption Bureau (PCCB)	ARIN-EA	
Togo	6 July 2005	14 September 2009		ECOWAS 14 September 2009	National Commission for Fighting Corruption and Economic Crime	ARIN-WA	
Tunisia	23 September 2008	19 November 2019			Nationale de Lutte Contre la Corruption (INLUCC)		Yes
Uganda	9 September 2004	30 August 2004			Inspector General of Government (IGG)	ARIN-EA	
Zambia	7 December 2007	30 March 2007	SADC		Anti-Corruption Commission (ACC)	ARIN-SA	
Zimbabwe	8 March 2007	17 December 2006	SADC		Zimbabwe Anti-Corruption Commission	ARIN-SA	

Notes: As of 6 February 2020.

a. https://www.unodc.org/unodc/en/corruption/ratification-status.html.

b.https://au.int/sites/default/files/treaties/36382-sl-AFRICAN%20UNION%20CONVENTION%20ON%20PREVENTING%20AND%20COMBATING%20CORRUPTION.pdf.

c. Ratification of SADC Anticorruption protocol. https://actsouthernafrica.wordpress.com/2017/05/17/status-on-the-signature-and-ratification-of-anti-corruption-instruments-by-sadc-member-states/.

d. Date otherwise "Not yet" by the time of the 2013 Annual Report. https://www.ecowas.int/wp-content/uploads/2017/11/2013-Annual-Report_Annexes_English.pdf.

e. Anti-corruption authorities at https://www.acauthorities.org/content/country-profiles.

f. Membership in Asset Recovery Inter-Agency Networks. https://www.unodc.org/documents/treaties/UNCAC/WorkingGroups/workinggroup2/2018-June-6-7/V1803851e.pdf.

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CHAPTER 6:

Conclusions and policy recommendations

This **Economic Governance Report**, building on earlier work by the Mbeki Panel and others, have assessed measures African governments can take by themselves or by drawing on international cooperation opportunities to combat illicit financial outflows. It has reviewed the readiness of African governance institutions to do so, including their legislation and regulatory frameworks and their activities and coordination capacities. In each of the illicit financial flow (IFF) channels and motivations addressed by the report—tax evasion and tax planning for avoidance purposes, trade pricing manipulation, the banking system and money laundering strategies, as well as corruption-related IFFs—institutional activities and capacities are described, and examples from the continent are given. Based on these examinations, the report stresses the need for African countries to double up: to build strong, effective and accountable institutions for curbing IFFs, while standing behind those institutions with political leadership at the highest levels. This concluding chapter highlights a selection of the report's recommendations.

Institutional architecture for addressing illicit financial flows from Africa

Multiple institutions are necessary to combat IFFs, reflecting the complexity of the transactions in the illicit cross-border movement of Africa's wealth and its transfer from the continent. All international economic channels are complicit—trade, financial flows, and investment flows. Motivations range from the desire to launder and conceal criminal proceeds, including those from corruption, to strategies to deliberately sidestep their tax obligations or to conceal wealth from public view, often pursued by rich individuals and multinational enterprises.

Given the profile of the companies and individuals involved in illicit financial flows and the complexity of curtailing them, the report recommends high-level political support and leadership above all. That support is necessary for legislation to be tough and comprehensive enough, for organizations at the forefront to muster courage and for a whole-of-government approach—one with effective cross-government and multi-sectoral coordination—to be pursued.

Multiple institutions are necessary to combat IFFs, reflecting the complexity of the transactions in the illicit cross-border movement of Africa's wealth and its transfer from the continent.

Although all governments have taken some steps to curtail corruption, especially money laundering, and have good lessons to share, the institutions at the front line often lack adequate financial and technical resources and, in some cases, the necessary independence from political meddling to be effective. Countries need to invest seriously in the capacities of revenue, audit and other oversight authorities and anti–money laundering bodies, including their ability to use technology and data for risk mapping as part of the solution.

To demonstrate serious commitments, and in accordance with the Mbeki Panel recommendations, countries should review their legislation to explicitly include combatting IFFs as an objective.

Tax avoidance and tax evasion

On IFFs motivated by tax avoidance and tax evasion, the report examined the African country institutional architecture through which they occur, particularly those pursued by multinational enterprises. To curtail such practices, African countries should review their tax codes to unambiguously outlaw tax avoidance as well as tax evasion and empower law enforcement systems to tackle them. An anti–tax avoidance/evasion strategy, employing a whole-of-government approach, should bring together national agencies engaged in curbing IFFs, provide them with clear mandates and establish an inter-agency task force to coordinate and oversee their activities.

Governments have much to do to strengthen the capacities of tax administration structures, including audit units, transfer pricing units, investigative units, data management units and their interfaces with the court system. Together they constitute the defence against tax avoidance/evasion–motivated IFFs. Across the continent, tax authorities are grappling with the impact of fourth-generation information technology on the tax system, including how to tax digital businesses. African countries should leverage that technology.

Far too few African countries have taken advantage of international initiatives for combatting tax-motivated IFFs, such as the **ABC** of transparency: adopt automatic exchange of information, **beneficial** ownership registration and **country-by-country** reporting. Countries should adopt legislation and regulations should incorporate these initiatives.

Curbing trade-related illicit financial flows

The report assessed the readiness of national, regional, and international institutions in Africa to combat trade-based IFFs, particularly trade mis-invoicing. Trade mis-invoicing occurs when money is illicitly moved across borders through the falsification of the prices, quantities or quality of imports or exports on the invoices importers or exporters present to customs agencies and port authorities. Illicit outflows are mostly motivated by the desire to evade or avoid taxes or the desire to shift wealth from weak currencies into strong currencies. Illicit inflows may be motivated by the desire to evade taxes or to launder the proceeds of illegal activities or finance illegal activities by transnational criminal organizations.

To curtail these practices, the report calls for strengthening currently weak and inadequate legal frameworks, mending government departments and agencies' institutional deficiencies and better enforcing relevant laws.

Nationally, African countries should invest in sensitizing the public to tax and customs agencies' broadened mandates to address trade mis-invoicing. They may need to enact legislation and regulations to criminalize it. Where such legislation and regulations already exist, governments should strengthen and scale up enforcement to plug revenue leakages. The legislative frameworks must also provide rules to govern trade data collection, storage, protection, sharing—within and outside the country—and use. Provisions should also cover servicing risk analysis, mitigation and management and compliance oversight and supervision.

Sharing cross-border information with partner jurisdictions is critical. Where no legislation yet authorizes that, countries need to address the gap. Making trade data available in some forms conducive to analysis could contribute to effective risk profiling. Regional cooperation to transmit physical copies of documents among customs authorities will help track trade mis-pricing.

African countries need to provide adequate resources, including technically competent staff, to the customs and revenue authorities so they can deploy technology to detect trade mis-invoicing in real time and better investigate and prosecute offenders. And given the predominance of natural resources in Africa's exports, requiring transparency and accountability in resource contracts and resource management will help block an important source of trade-related IFFs.

Regionally, African countries want to benefit from improved and IFF-free trade. To do so, they must address the gaps in information exchange, customs integrity, the harmonization of tariffs and supervision and oversight of commercial entities. Further, Africa's regional economic communities and the African Union should improve control systems for trade facilitation, supervision and oversight to support country efforts to combat trade-based IFFs.

Given the diversity of electronic customs administration and valuation systems and their varying effectiveness in addressing trade mis-invoicing, African countries should establish interoperable regional information technology modules. They should support that technology with coherent region-wide customs code and trade facilitation frameworks that require the submission of invoices and certificates of origin.

To complement international legal assistance, the African Union could lead a process for the region to establish a mutual administrative assistance legal instrument interoperable with national systems and international standards. It would aim to efficiently settle disputes and enforce actions on trade mis-invoicing and other forms of commercial/revenue fraud. The African Union could also consider establishing an apolitical dispute settlement and trade facilitation authority to promote regional efforts to curb trade-based IFFs.

Curbing illicit financial flows through the financial system

The report examined African financial institutions and systems as channels for IFFs, including money laundering, the mechanisms they use and strategies for curtailing them.

IFFs damage both the financial system and the broader economy. They drain national private and public capital and compromise the integrity of the financial system. High and persistent IFFs are a symptom of ineffective financial regulation, among other things.

To combat finance-related IFFs countries need to invest in technological infrastructure to collect, track and store data for anti–money laundering/combatting the funding of terrorism activities. The infrastructure should enhance transparency and bridge the cybersecurity divide between developing and advanced countries. Countries also need to build human capacities in their financial intelligence units to enforce policies and laws to stem IFFs.

Governments should improve institutional coordination, create necessary legislation, effectively implement existing laws, and strengthen their established institutional frameworks for combatting IFFs and money laundering, aiming to fill gaps that prevent success.

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Anti-corruption measures in addressing illicit financial flows

Corruption, an important channel of IFFs, is complex and dynamic. A broad conceptualization is needed to link it to IFFs, encompassing both demand and supply, the public and private dimensions, and the domestic and international dimensions. Corruption facilitates IFFs in multiple ways. It undermines the integrity of the regulatory framework and fosters collusion for laundering illicit enrichment. And IFFs themselves are corrupt at their core and driven by corrupt and dishonourable motivations. Both corruption and IFFs are products of secrecy and enabled by opacity. In IFFs, corruption manifests itself as manipulating trade pricing, laundering illicit enrichment through the financial system and enjoying unwarranted tax concessions or the proceeds of contract manipulation, among others.

Anti-corruption measures include international and regional conventions and protocols backed by national anti-corruption laws and enforcement agencies. All African countries except Eritrea and Somalia have signed on to the United Nations Convention against Corruption (UNCAC). Fewer countries have signed on to the African Union Convention on Preventing and Combating Corruption (AU Convention), and fewer still to the regional protocols—the ECOWAS Protocol against Corruption and the SADC Protocol on Corruption. Although these instruments vary in scope, legal status, membership, implementation and monitoring mechanisms, all aim to establish common standards for addressing corruption domestically by criminalizing corrupt conduct, boosting law enforcement (investigation, prosecution, and sanctions) and implementing preventive measures. **The Economic Governance Report** notes that all the protocols prescribe measures to prevent corruption in both the public and private sector, but to varying degrees of detail. Except the UNCAC, none of the conventions and protocols expressly addresses IFFs, though all can be applied to them to some extent.

All countries have established at least one anti-corruption agency and a financial intelligence unit. The agencies have different mandates, powers, independence, and technical/administrative capabilities. All have limited financial independence, which constrains their ability to oversee government activities.

The report calls on African countries to strengthen their procurement institutions to address corruption in the context of IFF, make procurement transparent and increase penalties for breaking procurement laws.

African countries that are parties to the UNCAC or AU Convention should fully implement their terms, fully align their own national strategies to the conventions and make combatting IFFs explicit in their national laws. The African Union and regional economic communities must prevail upon countries that have not ratified the AU Convention and the ECOWAS and SADC protocols to do so urgently.

African countries should strengthen the powers and independence of anti-corruption agencies so they can effectively address corruption, money laundering, the laundering of illicit enrichment and other forms of IFFs.

African countries should integrate data systems across all institutions and economic channels—customs and other tax authorities, commercial banks, central banks, security exchange commissions and company registries—to effectively track corrupt transactions in their fullness, and the movement of the proceeds of corruption across boundaries.

Conclusion

The recommendations in this report do not suggest that African institutions have failed. On the contrary, it contains rich examples of country-level initiatives ranging from legislative frameworks to data management and information sharing to bold steps to prosecute both corrupt officials and corrupt international companies. There is much that African countries can teach each other. Yet the report also indicates the bold moves African countries must take to equip themselves to curb the illicit flow of financial resources from their economies and boost their domestic resource mobilization to finance programmes to achieve the Sustainable Development Goals and the aspirations of the African Union Agenda 2063.

United Nations
Economic Commission for Africa