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#AUEUTracker

Infosheet Bulletin: Combatting Illicit Financial Flows

The Africa-Europe dialogue could profit from stronger alignment between the goals, aspirations and initiatives of the African Union (AU) and the European Union (EU). The AU has been highlighting the dangers of Illicit Financial Flows (IFFs) for over a decade. In 2012, the AU and the United Nations Economic Commission for Africa (UNECA) established a High-Level Panel (HLP) on IFFs, chaired by President Thabo Mbeki. This HLP delivered comprehensive recommendations in 2015 focusing on actions at member state level and the need for better collaboration with key partners, such as the EU.

Illicit Financial Flows refer to the movement of money across borders that is illegal in its source (e.g., corruption, smuggling), in its transfer (e.g., tax evasion), or in its use (e.g., terrorist networks financing). While relatively easy to define, IFFs are difficult to quantify. Official estimates present global IFFs as likely very large, with trade mis-invoicing accounting for the majority.

To realise its development potential and tackle spiralling sovereign debt burdens, African countries are seeking new sources of sustainable finance. The need to increase domestic resource mobilisation for development purposes, if only to strengthen African ownership, makes tackling IFFs a key challenge. To date, only parts of West Africa have shown some progress on combating IFFs with little resonance among other member states. In parallel to that, the EU has implemented a range of proactive policies that have targeted IFFs that undermine Europe's own tax base, but have given little priority to align these efforts with international development goals.

At the 6th AU-EU Summit held in February 2022, following the discussions held during the Roundtable on Finance, co-chaired by President Macky Sall, Chair of the AU, and President Emmanuel Macron, holding presidency of the European Council, Combatting Illicit Financial Flows was included as a key commitment in the Summit's Final Declaration.

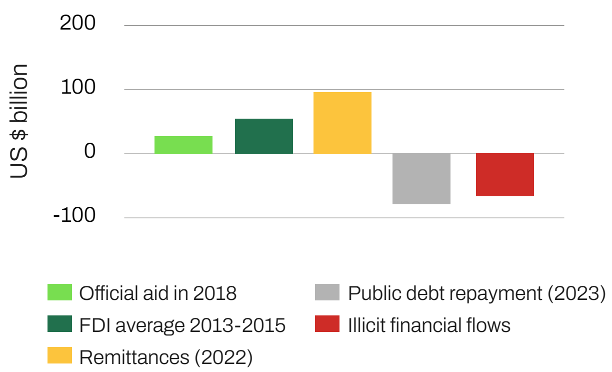
Implementing this commitment is key. There is a compelling case for a real Africa-Europe partnership approach to tackle IFFs: they affect both Africa and Europe, with both suffering damaging social and political impacts. Europe is responsible for a significant source of risk, and acts as a destination of IFFs from Africa. At the same time, it has the tools and systems available to meaningfully address IFFs quickly. Tackling these flows will not only provide much needed financing for Africa, but can also contribute to addressing other risks for both continents (e.g., organised crime, terrorism).

Africa will not transform with its current sources of finance. It must invest at least $130-170bn annually to bridge its infrastructure gap and generate sustainable growth a rate of 5% or more. This cannot be achieved with Africa's current sources of external finance – Official Development Assistance (ODA), Foreign Direct Investment (FDI), and remittances from Africans working overseas. These cumulated inflows are largely negated by the outflow of funds from debt service and conservative estimates of IFFs.

"WE COMMIT TO COMBATTING ILLICIT FINANCIAL FLOWS (IFF) AND TO ADDRESSING DOMESTIC TAX BASE EROSION, PROFIT SHIFTING (BEPS), AND COOPERATE IN TAX TRANSPARENCY. IN THIS REGARD, WE AGREE TO CONTINUE COOPERATING TO DEVELOP AND CONSOLIDATE THE STRATEGIC CAPACITY IN THE FIGHT AGAINST DIFFERENT TYPES OF IFFS INCLUDING MONEY LAUNDERING, THE FINANCING OF TERRORISM, AND PROLIFERATION FINANCING AS WELL AS THOSE LINKED TO FISCAL GOVERNANCE SYSTEMS AND RETURN OF STOLEN FUNDS AND ITEMS FROM COUNTRIES OF ORIGIN."

Final Declaration from 6th EU-AU Summit A Joint Vision for 2030 (February 2022)

Figure 1: Financial flows to/from Africa



African domestic resource mobilisation is key to strengthen African sovereignty, implement the SDGs and Agenda 2063, and achieve the continent's development potential. While the very low tax to GDP ratio of 17% in Africa must also be increased, along with a better use of African pension funds and sovereign funds, tackling **IFFs is a critical challenge for developing countries**[1]. This is also recognised in the Sustainable Development Goals (SDG 16.4) – with a global commitment to "significantly reduce" IFFs by 2030.

IFFs whilst rather straightforward to define - money illegally earned, transferred or used (i.e., illegal in origin, movement or use[2]) - **are difficult to quantify**. Estimates are based on discrepancies in trade and balance of payments data but these do not generate robust estimates of all IFFs[3,4]. The United Nations Conference on Trade and Development (UNCTAD) now estimates that Africa loses $88.6 billion dollars from illicit capital flight per year[5] - more than the total the continent received in FDI[6] or net ODA[7] in 2021.

Trade mis-invoicing accounts for most IFF flows. Multinational corporations (MNCs) account for 65% of IFFs with trade mis-invoicing being the largest single source[8]. Others estimate 87.4% of all IFFs are related to cross-border transfer pricing[9]. The second largest source of IFFs is criminal transactions such as money laundering, smuggling and trafficking in humans, drugs and arms. Corruption by government officials contributes to 5% of IFFs from acts such as bribery, theft of state assets and abuse of office. However, corrupt officials are enablers of both commercial and criminal drivers[10].

IFFs have a devastating impact on Africa's development prospects. Beyond financial loss, IFFs also thwart development in several ways and generate physical, societal, economic, environmental and governance harm. IFFs are closely linked to the mining sector and are associated with environmental destruction. They accounted for $1.6bn of illegal wildlife trade in just eight Southern African countries in 2006-2014. IFFs finance terrorism and degrade livelihoods, undermine institutions and reinforce policies and the politics of impunity which are corrosive to democratic norms[11]. They crowd out domestic investment in Sub-Saharan Africa in both short and long-terms, with the impact on investment amounts being greater than the initial transfer of illicit funds[12].

AU AND EU OBJECTIVES AND AREAS OF ACTION

The AU has highlighted the dangers of IFFs for over a decade. The 2015 report of the AU/UNECA High-Level Panel on IFFs from Africa provided detailed recommendations for tackling flows. With the main focus on actions needed by AU Member States, the report identified strategies to address the commercial component (trade mispricing, transfer pricing, and profit shifting), the criminal component and the corrupt component of IFFs. It also highlighted the role of the AU and regional cooperation as well as the need for international collaboration, noticeably with the EU. However, to date, few of the report's recommendations have been implemented.

"THE UK IS DETERMINED TO PUT A STOP TO IFFS. WE AND OUR PARTNERS KNOW THAT BILLIONS ARE SIPHONED OUT OF DEVELOPING COUNTRIES EVERY YEAR, OFTEN THROUGH ANONYMOUS SHELL COMPANIES, BEHIND WHICH HIDE CRIMINALS AND KLEPTOCRATS. WE HAVE BEEN PLAYING OUR PART TO ADDRESS THIS IN THE UK BY INTRODUCING OPEN REGISTERS OF BENEFICIAL OWNERSHIP, AND WE WILL PROVIDE SUPPORT TO STRENGTHEN REGISTERS OF BENEFICIAL OWNERSHIP IN AFRICA."

Andrew Mitchell MP, Minister of State in the UK Foreign, Commonwealth & Development Office

Quoted in 2023 *Ibrahim Forum Report: Global Africa (July 2023)*

The EU has implemented a range of policies targeting IFFs that undermine Europe's own tax base - but with little priority to align these efforts with international development goals[13,14]. In the High-Level Panel on IFFs from Africa, 'best practice' is cited from the Organization for Economic Cooperation and Development (OECD), the Extractive Industries Transparency Initiative (EITI), the G20, the US and UK governments and UN agencies – but not a single endorsement of an EU initiative. The Centre for Global Development suggests that the EU adopts 'soft versions' of international standards – so that relatively secretive practices remain compatible with European Law. A recent ruling from the EU Court of Justice (November 2022) against Beneficial Ownership registries, a key tool in the fight against IFFs and shell companies, prompted European countries to begin taking down public registers of who owns their companies[15].

Figure 2: Contrasting approaches to IFFs in Africa and Europe

- **Inter-Governmental Group Against Money Laudering in West Africa (GIABA)** was set up by ECOWAS in 2000, to promote anti-money laundering and counter financing of terrorism.
- **Addis Ababa Action Agenda** in 2015 commits to reducing and eventually eliminating IFFs.
- **AU Agenda 2063** cites curbing IFFs as a key tactic to achieve domestic resource mobilisation. AU committed to half IFFs by 2023.
- **African Development Bank** adopted a strategic framework and action plan to prevent IFFs in Africa 2017-2021.
- **High Level Panel report on IFFs in Africa** in 2015, AU advocacy has been strong - but member state response has been 'limited and siloed'.
- **AU dedicated 2018** to 'Winning the fight against corruption. A sustainable path for Africa's transformation.
- **Africa Tax Administration Forum (ATAF)** established Executive Masters' in Taxation in 2014 and African Tax Outlook in 2015.
- **Advocacy with limited practical action**

- **EU Anti-Tax Avoidance Package (ATAP)** developed as part of a June 2015 action plan. Focuses on increasing tax transparency and reducing competitive distortions for businesses operating in the EU.
- **Automatic exchange of Information on Tax Rulings** created transparency and compliance between EU and member states laws from 2017 onwards.
- **Automatic exchange of information on country-by-country reports (CbCR)** was launched in 2016 in response to pressure from European Parliament. 127 large MNCs have to file their annual accounts in the member state for which they are tax residents.
- **Agreements on exchange of financial information of EU residents with Switzerland, Liechtenstein, Andorra, San Marino and Monaco** signed in 2016
- **Common Consolidated Corporate Tax Base (CCCTB)** reintroduced in 2016 as a proposal for a single set of rules to calculate companies taxable profits in the EU.
- **EU blacklist of tax havens** in November 2016 agreed criteria to single out non-EU tax havens and publish a blacklist.
- **Action with little focus on Africa**

POLICY SPACE FOR ENHANCED PARTNERSHIP

A strong case for Africa-Europe partnership on IFFs. Both Africa and Europe suffer damaging economic, social and political effects of IFFs. Addressing them can provide additional resources for Africa, while also addressing shared risks for both continents (organised crime, terrorism, tax base erosion). As a main trading partner, Europe is responsible for a significant source of risk, and acts as a destination of IFFs from Africa. It already has governance systems and tools in place to effectively tackle IFFs quickly. These could be shared as best practices with the AU and its member states as part of the longer-term strategy.

Insterest in a joint Africa-Europe approach to combatting IFFs

Europe and Asia are reponsible for most of Africa's IFF risks, with recent analysis estimating that 40% and 44%, respectively, of Africa's vulnerability to IFFs from import and export trade, are attributed to Europe[5]

Europe has tools to confront IFFs[1] and, in taking action against Russia and oligarchs in February 2022, demonstrated theses can be used rapidity and effectively[2]

A global agreement to control IFFs will take time. However, unilateral action by one country cannot stop IFFs, meaning there's a clear **role for regional entities**[4]

IFFs are **undermining public insitutions and the social contract** in Europe[3]

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[2] A Caprile and A delivarian (March 2023) EU sanctions on Russia: overview, impact, challenges *European Parliament Research Centre Briefing*

[3] S. Kitenge (2020) The global challenge of illicit financial flows *Policy Brief Mars 2020 20/20* Policy Centre for the New South

[4] A Erskine and J Eriksson (2018) Improving coherence in the illicit financial flows agenda *U4 anti-corruption Reousrce Centre Issue 2018:8 CMI*

[5] C Abugre et al (2019) Vulnerability and Exposure to IFFs risk in Africa *Tax Justice Network report*

PROGRESS HIGHLIGHTS

→ **The African Union's EUR 10.4 million Multi-Donor Action with the EU, Finland, and Germany Good Financial Governance in Africa programme**, launched in 2020, to enhance efforts to combat IFFs in Africa with a focus on tax-motivated IFFs through strengthening the capacities of the AU Commission to play a pivotal role in coordinating anti-IFFs policies on the continent. Additionally, the project focuses on the implementation of country pilot measures via the pan-African networks.

→ **The G20/OECD Inclusive Framework on Base Erosion and Profit Shifting (BEPS)** - in line with the Addis Tax Initiative principles, the EU supports capacity-building in partner countries through a EUR 5 million financing to the OECD Inclusive Framework (2023). Since 2013, the Inclusive Framework gathers over 135 countries and jurisdictions collaborating on the implementation of 15 actions to tackle tax avoidance, improve the coherence of international tax rules and ensure a more transparent tax environment. Important progress includes the BEPS Minimum Standards, designed for developing countries and including 4 of the 15 actions. It is subject to a peer review process that evaluates how each member implements those actions and any recommendations for improvement. In addition, as of September 2022, 137 countries and jurisdictions have joined the Two Pillar Solution agreement, which constitutes an unprecedented reform to the international tax system.

→ **The Africa Initiative of the OECD's Global Forum on Transparency and Exchange of Information for Tax** – an international body working on the implementation of international standards on tax transparency. Launched in 2014 by the African members of the Global Forum, the membership of the Initiative has grown to 37 African countries in 2023. The EU supports the Initiative, along with other 16 donors and partners. As per a 2022 report, this initiative has resulted in nearly 2,000 African officials being trained, which has resulted in a 26% increase in Exchange of Information Requests (EOIRs) on tax transparency. Since its launch in 2014, nine African countries have "identified or recovered EUR 233 million in additional revenue" via Exchange of Information Requests (EOIRs).

→ **The EU Global Facility on anti-money laundering and countering the financing of terrorism (AML/CFT) regional programme targetting IFFs in East, Southern, Central Africa & Yemen (ESCAY).** Initially funded by the EU Emergency Trust Fund for Africa (EUTF) with EUR 5 million over 3 years, the programme was to improve the coordination and investigation methods used against money-laundering and cross-border criminal investigations on human trafficking and organised crime. The project started in 2015 with 9 countries in the Greater Horn of Africa (GHoA) and Yemen, but was gradually extended to 34 countries in Eastern, Southern and Central Africa during the second (2019-2022 – EUR 5 million) and third phases (2022-2024 – EUR 5 million) of the project. Support has been gradually refocused on AML/CFT and Transnational Organised Crime (TOC).

→ **The Organised Crime: West African Response to Money Laundering and the Financing of Terrorism programme (OCWAR-M).** The EU supports this four-year project established in 2018 with a budget of EUR 7.5 million and activities across 16 countries (ECOWAS member states and Mauritania). It aims to contribute to the adoption and effective application of international standards to fight against money laundering and the financing of terrorism. Activities include practical training for various stakeholders, strengthen legal frameworks (regulations, manuals, procedural guidelines), and implement relevant tools (technology, statistical analysis, etc.) to improve prosecution and prevention efforts. The project supplemented by a EUR 750,000 grant in support of the GIABA.

→ **The EU Global Facility on Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT)** established by the European Commission in 2017 with a budget of EUR 20.15 million, to support third countries in the enhancement of measures to prevent money laundering and cut off funding for terrorist activities. It engages with several countries in the region to provide specialised technical assistance and limited supplies to increase compliance with the Financial Action Task Force (FATF) and EU standards in complementarity with bilateral and regional programmes notably in niche areas such as beneficial ownership, crypto currencies and risks for nonprofit organisations (NPOs).

→ **The Team Europe Initiative on Illicit Financial Flows and related Transnational Organised Crime (TOC) in Africa is expected to launch in 2023**, bringing together a minimum provisional amount of EUR 240 million in contributions from EU Institutions and participating EU Member States (Germany, France, Sweden and Finland) under a common strategic framework focused on : preventing the expansion of IFFs (including tax- and trade-based) and fighting money laundering and the financing of terrorism; enhancing the related law enforcement, prosecutorial and judicial capacities; and enhancing international and regional coordination and cooperation. This Team Europe Initiative will encompass and build on existing initiatives and programmes.

All these initiatives are yet to be evaluated for their impact. However, as they largely focus on the origin (Africa) rather than the destination (often Europe) of the IFF transaction, achieving intended, and large scale, results remains a significant challenge. Combatting large-scale and sophisticated criminality through public administration and governance systems in Africa, which often are weak and requiring significant strengthening, may be necessary but importantly excludes the financial administrations in Europe that have the capacity and resources to move faster and further. Moreover, these initiatives are based on a flawed conception of IFFs as an African – rather than a joint – problem.
Substantial literature provides empirical support for a different approach, which may prove more effective[21 22 23 24]. Elements of this include:

- Improve the in-country evidence base on the full supply chain of IFFs from Africa to their destination, to allow more effectively targeted policy.
- Given the challenges of mobilising a global response, prioritise responses that target the most harmful IFFs and most influential actors and places where there is political will in place.
- Build political will in Europe as well as Africa to treat IFFs as a development, as well as a tax issue. Build state capacity in Africa to engage with European counterparts to combat IFFs more effectively.
- Ensure appropriate legal frameworks are in place and strengthen the regulation of IFFs particularly in transit and destination jurisdictions.
- Improve transparency around beneficial ownership, especially in the mining and property sectors in Europe.
- Tighten financial regulations in major transit and destination jurisdictions for African IFFs.
- Foster partnerships with the private sector, particularly with financial institutions.
- Strengthen regional and international cooperation, making full use of the opportunities presented in Forums like the Africa-Europe Foundation, where the High-Level Group of Personalities recommitted the AEF to tackling IFFs as a shared agenda in their April 2023 meeting in Nairobi.

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[4] A Erskine & F Eriksson (2018) Improving coherence in the illicit financial flows agenda *U4 Issue 8*

[5] UNCTAD (2020) UNCTAD Tackling Illicit Financial Flows for Sustainable Development in Africa, *Economic Development in Africa Report*

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