Coalition for Dialogue on Africa

Track it! STOP IT! Get it!

iff

CHAPTER 3

DEBATES AND DEVELOPMENTS ON ILLICIT FINANCIAL FLOWS

CONTENT

03 IFFS: POST 2015 DEBATES & DEVELOPMENTS

INTRODUCTION

- The 2015 AU/EC Report (Mbeki Panel Report) sought to serve three purposes:
  - To highlight magnitude & channels of loss of Africa's financial resources (IFFs);
  - To recommend ways of curbing IFFs; and
  - To advance ways of financing development from Africa's own financial resources.
- Africa's own financial resources are deemed to include: taxes, levies, and loans from "domestic" capital markets (Domestic resources): UN System, most academics and development analysts.
- Financing Africa's development from foreign money is emphasized in the report, as the root of Africa's IFFs challenge, hence Domestic Resource Mobilization (DRM).
- Central thesis of this chapter is to highlight key developments and propose Africa's novel approach to financing her own development. The approach is based on heterodox monetary economic theory of endogenous money.

04 KEY DEVELOPMENTS AND DEBATES

- Since 2015, major activities in regard to IFFs centred around three focus areas:
  - Awareness and advocacy;
  - Implementation of recommendations of the HLP on IFFs; and
  - IFFs definition and measurement methodology.
- Awareness & Advocacy:
  - The AUC, AU's HLP on IFFs, the Secretariat of the HLP along with many other African institutions played and continue to play a central role in popularizing IFFs and the closely related matter of DRM on the continent.
  - The UN System (IMF, World Bank, UN-ECA etc) continues to work against IFFs at a global level.
  - Academic institutions (some) are also invested in IFFs teaching.

05 KEY DEVELOPMENTS AND DEBATES

Implementation of Recommendations of the AU Panel

- Nation states, especially in Africa, have onboarded AU IFF policy recommendations onto domestic policy.

- However, for most states, the scope of the fight against IFFs has been, largely, limited to money laundering and terrorism financing (ML/TF). The commercial component of IFFs (over 65%) is mostly excluded.

- The bias towards ML/TF owes, in large measure, to the regulatory requirements imposed by the international Financial Action Task Force (FATF).

- Efforts to standardise IFFs framework towards one recommended by the Panel are ongoing. The AU-HLP Secretariat is well engaged.

06 DEFINITIONAL & MEASUREMENT ISSUES

Definition & Measurement: IFFs

- The main controversy surrounding IFFs lies in the definition. There are many definitions, comprising both "narrow" and "broad" ones. The definitional debate between "narrow" and "broad" in turn complicates their measurement, impact assessment and policy clarity to curb or eliminate IFFs.

- "Narrow" definition confines itself with clear breaches of law, whereas "broad" includes unethical practices, yet formal, such as aggressive tax avoidance.

- There is thus no agreed definition of IFFs. However, for statistical purposes, UNCTAD and UNODC published, in March 2022, a Conceptual Framework for the Statistical Measurement of Illicit Financial Flows, which defined IFFs:

- "Financial flows that are illicit in origin, transfer or use, that reflect an exchange of value and that cross country borders" (UNCTAD and UNODC, 2020).

07 DEFINITIONAL & MEASUREMENT ISSUES

- The statistical definition falls within the "broad" definitions, which include the AU HLP on IFFs definition.
- Following on the work of UNCTAD & UNODC, pilot studies to measure illicit financial flows are being conducted in Africa. Workshops providing training to enhance data collection and analysis (statistical capacity) of African governments to define, measure and disseminate statistics on IFFs are ongoing as of date of this report.
- The definition allows global comparability in statistics on IFFs, thus shedding light on activities, sectors and channels prone to illicit flows, and illuminating on where actions can be undertaken to curb these flows.
- The debate on the definition did not however hamper the ongoing effort on the implementation of the recommendations of the Panel. The AU HLP Secretariat is highly engaged in this.

08 DEFINITIONAL & MEASUREMENT ISSUES

- The measurement methodology employed in the AU HLP was the Partner Country Method (PCM+). There are two main ones that suit Africa's data issues.
- **Partner Country Method**: This method compares trade statistics between two countries. A discrepancy between the import data of one country and the export data of its partner country can indicate an illicit flow, as legitimate deviations should be limited to shipping and insurance costs.
- **Price Filter Method**: This approach involves analysing price discrepancies in bilateral trade data. Over-invoicing or under-invoicing of goods on customs declarations can be identified as a method to transfer money illicitly, evade taxes, or launder money
- This report recommends these methods for measuring IFFs in Africa. The PCM methodology, together with the Price Filter Method (PFM) are the recommended given the data challenges Africa faces.

09 IFFS AND DOMESTIC RESOURCE MOBILISATION

- The Mbeki Panel Report, as with the UN's Monterrey Consensus and subsequent UN Financing for Development Conferences URGE/ recommends that Africa MUST find ways of self financing. This recommendation is informed by three main reasons:

  - The net transfer of financial & other resources to the Global North from Africa;
  - The high debt burden resulting from the use of Global North financial resources;
  - The IFFs to the North due to the use of Global North finance for development.

- Due to the preponderance of neoclassical or neoliberal thought and practice in the UN institutions (IMF, World Bank etc), OECD, Western capitals, etc debate on IFFs and DRM tend to reflect this bias.

- Therefore, as a solution to self-financing of Africa's development, including meeting the SDGs, the dominant prescriptions from the UN, the OECD and Africa's own western aligned experts insist on DRM that focus on:

  - Modernisation of tax regimes & fiscal discipline (more taxes to finance dev);
  - Use of market mechanisms to raise finance (debt) for development;
  - Cooperation with "partners" (Western govts & their firms).

Coalition for Dialogue on Africa

Track it! STOP IT! Get it!

10 IFFS AND DOMESTIC RESOURCE MOBILISATION

- Furthermore, they prescribe to Africa, an institutional architecture that is consistent with the current “**outdated, dysfunctional and unfair**” international financial architecture.
- Policy recommendations by the Bretton Woods institutions, linking domestic resource mobilisation and IFFs tend to reorganise financial systems & structures in Africa towards the dangerous and fragile market-based finance (Gabor 2016).
- The current economic governance architecture (monetary, taxation, financial etc), makes it not only difficult for discussions, efforts to address the root cause of IFFs from an African perspective, but also hinder the creation and mobilization of stable and long-term domestic finance necessary for structural & ecological transformation and achievement of SDGs.
- Therefore, Africa is deliberately boxed in a never-ending cycle of debt, net flow of resources to the West, increasing IFFs, and endless macroeconomic instability.
- As its contribution to helping curb and/oraltogether root out the main source of IFFs, the Secretariat of the AU HLP on IFFs proposes, for IFFs, DRM and Financing for Development agendas, an approach grounded in heterodox economics.

https://www.un.org/sg/en/content/sg/speeches/2023-09-18/secretary-generals-remarks-the-high-level-political-forum-sustainable-development

IFFS & DOMESTIC RESOURCE CREATION & MOBILISATION

- The Addis Ababa Action Agenda (UN F4D) 2015, enshrined global DRM aspirations that placed Taxation at the centre of financing development in Africa.
- Resource" in DRM refers to financial resources:
  - tax revenue (business/individuals, property) : Priority
  - non-tax revenue (fees, licenses and fines)
  - borrowings: Loans taken by govt from domestic or international sources.
  - Private Sector Investment

  (Emphasis is on fiscal austerity, tax compliance and financial deepening through market-mechanisms).
- The theoretical roots of the Addis Ababa agenda on DRM is in the classical and neoclassical (mainstream) economics.
- Implicit in the Addis Ababa agenda on DRM is the idea that governments, face an ex-ante challenge to locate financing for their spending plans. Therefore must "mobilise"!
- This view is thoroughly rejected by heterodox economists, and recently overwhelmingly supported by all major central banks, including the IMF, which surprisingly continues to advocate the discredited approach to financing for development. This conventional DRM Framework perpetuates colonial patterns of underdevelopment, financial dependency and by extension, IFFs.

12 IFFS & DOMESTIC RESOURCE CREATION & MOBILISATION

- The alternative approach to financing development (investment in infrastructure, mining etc) domestically and thus eliminating the dreaded foreign money and thus commercial IFFs (64-70%) is through the creation of domestic financial resources through a domestic banking system. No need for foreign banks. Banks as fiscal agents.
- Financial resources are created ex-nihilo (by govt, or domestic private sector banks as licensed by the state), when financial institutions give out money as loans for investment etc. Domestic resources are thus created. There may be need to mobilise existing ones, but it can't be the first thing to do.
- This implies that the domestic monetary system has an inherent potential for expansion which can be leveraged for financing a large-scale transformation.
- This approach to financing development is not necessarily new. It is what we see in China today, and been applied in Europe, US etc during their developing phases. This means that "Taxes for Revenue are Obsolete" (Ruml, 2046). However, taxes remain crucial!
- The theoretical foundations for this is the endogenous money doctrine.

13 IFFS & DOMESTIC RESOURCE CREATION & MOBILISATION

- Beyond financing development from domestically created resources, this approach introduces a new dynamic related to the design of a new domestic monetary and financial architecture.
- The creation of own resources for development by economic sovereigns entails significant changes to Africa's monetary and financial institutional structures. This has, in turn, implications on the global economic governance architecture.
- Leveraging both domestic financial and natural resources along with an intra-continental payment system would reduce, considerably, risks associated with IFFs.
- Through domestic resource creation and mobilisation, a new financial architecture designed to weaken the balance sheet link with centres of global capital (foreign money) would slowly be unraveling.
- For this to happen however, an all-Africa approach is required. An AU agenda on this matter is urgent. The war on Commercial IFFs would have been partly won.

ASANTE SANA

አመሰግናለሁ

For more information on the work of the HLP,

visit: https://codafrica.org/iffs/