Third World Network - Africa

BRIEFING NOTE*

ILLICIT FINANCIAL FLOWS AND AFRICA

Beyond the Mbeki Report

The ***Report of the High Level Panel on Illicit Financial Flows from Africa*** (Mbeki Report), which was presented to and adopted by the 24th African Union Summit in Addis Ababa, is a key forward step in the age-old struggle of African countries to power their sustained and equitable economic transformation and social development from their own resources. However, further progress in this struggle would require critical improvement on the basic framework of the report.

In its broader contextualisation of the question of "illicit financial flows" (IFFs), the Mbeki report highlights the important fact that Africa is "a net creditor to the rest of the world, even though, despite the inflow of official development assistance, the continent had suffered and continues to suffer from a crisis of insufficient resources for development."

In this regard, the report is almost unique among many discussions of IFF. For it places firmly on the agenda the net transfer of investible resources from Africa to rest of world as the underlying problem of Africa's ability to mobilize resources for development. The report goes even further. It calls for re-balancing capital flows around the objective to bolster and strengthen domestic resource mobilisation. This involves simultaneously stopping the negative outflow from Africa, as well as further inflows to supplement Africa's own efforts.

Unfortunately, however, in its the fundamental discourse -- from the basic understanding of illicit flows to the set of policy recommendations that flow therefrom -- the Mbeki report draws back from the full logic of these observations.

In this sense, the report may be said to have failed to assuage the concerns expressed by many groups and individuals in Africa on different occasions during the work of the Mbeki Panel as to the basic paradigm of IFF adopted in mainstream discussion, as well as by the Panel itself. One such occasion was a consultation hosted in Accra in November, 2014 by the Third World Network-Africa.

That consultation was motivated by the concern that in its mainstream conceptualisation, discussions on IFF ran the risk of diverting attention from, even de-legitimising, the broader and more fundamental question of the net transfer of investible resources from the African continent. The arguments advanced at that meeting merit a revisit.

According to the organisers of the TWN-Africa encounter, the basic drawback of the mainstream paradigm is the centrality of the notion of illegality to the definition of IFF. As re-echoed even more forcefully in the Mbeki report, IFFs are "money illegally earned, transferred or used … In other words, these flows of money are involved in the

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violation of laws in terms of their origin, or during movement or use, and are therefore considered illicit."

The introduction to the report emphasises that, "we felt that it was important to distinguish IFFs from capital flight because capital flight, which is sometimes driven by macroeconomic and governance factors, ***could be entirely licit"*** (emphasis added).

In what appears to be a concern avoid too strict a dichotomy between the legal and the illegal, the report adds that "we also felt that the term "illicit" is a fair description of activities that, while not strictly illegal in all cases, go against established rules and norms, including avoiding legal obligations to pay tax." Even here, however, the unmistakable reference point is to 'rules and norms'.

While there are understandable motives for, as well as advantages to, this definition of illicit flows, the drawbacks and their limitations are fundamental.

The Mbeki report itself clarifies one such motivation for this choice of definition. "We placed emphasis on illegality across all stages of such outflows to show that a legal act in one geographical location does not nullify the intent and purpose of such outflows, which is to hide money even if legitimately earned."

As was acknowledged at the TWN-Africa meeting, there are additional "tactical" advantages to the focus on "illegality". Focusing on (il)legality makes the question of IFFs an issue of concern for all law-abiding people, wherever they are. This thereby also makes it an issue for every country, rather than simply put the burden and blame on Africans while others, typically outside the continent, enjoy the benefits. Above all, by focusing on the issue of law and law enforcement, it brings back to the table the issue of the regulatory capacity of the state in Africa as a legitimate problem, after decades of the misguided policies of structural adjustment that undermined and/or dismantled African state institutions.

However, the costs of these "tactical" advantages are strategic. There are three clusters of issues in this regard. The first is policy coherence. The focus on the violation of the law brings with it the lumping together of different types of activities some of which are difficult to characterise as ***financial transfer*** from Africa, and to which a policy of ***recouping*** the ***financial loss*** can legitimately be applied.

Such are the cases of human trafficking, drug trafficking and such, which form the main components of criminal activity, itself routinely cited as the second most important form of IFFs. As many have argued, the only appropriate way to deal with drug and child trafficking is to stop those activities themselves, together with the financial returns that they generate. But this correct policy of eliminating the very creation of illicit finance can hardly be applied to what is acknowledged as the largest source of illicit flows, that is, economic malpractices like transfer mispricing, tax dodging, etc. Here the policy objective must be to recapture the moneys lost through such dealings.

In effect, the definition of IFFs as "money illegally earned, transferred or used" leads to lumping together such widely different phenomena, with such widely varying policy objectives. This is hardly helpful in policy terms. The Panelists may have been aware of these difficulties, as they tried to place emphasis on economic/trade malpractice as the primary category to be tackled, while relegating criminal activity and corruption more or less to enablers. However, this comes across more as a case of admirable pragmatism with little overall strategic rigour or focus.

Related to this, the focus on illegality provides no sound basis for the inclusion of certain practices for action which lead to negative outflows of finance, but which are perfectly legal. A case relates to tax incentives/concessions to foreign companies, which can lead and have led to huge losses of finance to Africa. Whether they are abused or not, the tax incentives are very legal, and the losses that occur arise at most from unwise policy choices by African governments, and/or lack of supervision. To its credit, the Mbeki report only draws attention to the need for these incentives to be better organised. But even then, their inclusion among sources of illicit financial flows is hard to justify when the operative definition is "illegality". Furthermore, although the report itself avoids it, this lack of rigour has unfortunately led to some civil society advocates to regard the very principle of tax incentives and concessions as so unacceptable as to be eliminated. In this perspective, the revenue-generation function of taxation is emphasised to the unjustifiable exclusion of others, including its functions as a tool for economic re-engineering and structural transformation.

A second set of problems arises from the fact that the focus on (il)legality leads to a concentration of policy response on the terrain on governance, whether as an issue of transparency or regulatory capacity or both. And yet it is quite clear (as shall be elaborated below) that governance is only one aspect of the implication of the state in the processes of net resource transfers from Africa. More fundamentally, the character of the state in Africa, its functions and limits, have been shaped by the place of the state in capital accumulation in Africa, the role of foreign investment in this process, and the orientation of the state in this regard. The Mbeki report draws tangential attention to this when it refers to the need to rebalance the relationship between foreign and domestic resource mobilisation in the process of development. Given that over the past three decades, the role of the state and the nature of state institutions in Africa have been framed around a primary and/or privileged relationship to foreign investment, it may be that what is required is a basic re-orientation of the state and institutions, and not simply one of governance and regulatory capacity.

This leads to the final set of difficulties raised by the definition of IFFs around illegality. To begin with, the impression is created of a separate sphere of the "legal/licit", where practices exist that do not cause (or are not directly implicated in) net resource transfers out of Africa. The problem is not simply that there is no such neat dichotomy between the licit/legal and the illicit/illegal when it comes to the net ***appropriation*** of capital from Africa. It is that, in fact, the amounts of money/capital transferred legally from Africa, through legitimate business and economic practices, dwarf the $60billion or so that is calculated as annually lost through (illegality-based) IFFs; and that the central challenge of (domestic)/(primary) resource mobilisation for Africa's development is how to manage these legal transfers, so that as much of it as possible is re-invested in the continent's economies.

To appreciate the significance of this, it is necessary to understand that the primary basis of domestic resource mobilisation is the availability for investment in Africa's economies of the economic surplus deriving from economic activity in these economies. As a result of the structure of Africa's economies, and place that foreign investment has occupied in its strategic sectors since colonial times, the question of investible surplus has always been an issue of contestation between the investment imperatives of the host African economies and the scale of profit repatriation and demands by foreign investors and economic operators.

In colonial times when the "African" state was simply a transmission belt for pumping wealth out of Africa, the extensive scale of profit repatriated included even what should have gone to the workers in the mines, plantations and factories.

In the immediate/"nationalist" phase of the post-independence period, African governments adopted different measures in an attempt to minimise the share of profits repatriated, and to maximize what is retained in the economies as a basis for investment. These took direct forms, such as levels and forms of taxes on foreign investment and profits, as well as when and how frequently profits can be repatriated. It also took indirect forms such as capital and foreign exchange controls. Most radically, it took forms of direct government participation in the economy, where state enterprises were inserted in economic activities formerly run by foreign companies especially in trade and import-export so that they could capture the profits that would otherwise have accrued to foreign capital, or in joint-ventures with foreign capital, so that they coud have direct shares of the profits.

It is interesting to note that most of the practices that are now associated with commercial malpractice were earlier adopted by foreign companies, especially transnational companies, in response to the attempts by nationalist African governments for a better share of the investible surplus. Writing of the attempts by African governments to nationalise mines in the 1970s, Lanning and Mueller (***Africa Undermined***) observed that "as long as the day-to-day management remains the prerogative the mining companies, ***much of the investible surplus needed in Africa for development continues to leave the continent***. In the company accounts ***this surplus sometimes appears profits, but often it is disguised as inflated 'head office charges', 'management and consultancy fees', machinery costs', 'shipping and handing charges', and 'marketing commission'***." Today these same foreign mining companies are in the fore-front with some of the most "innovative" mechanisms to resist even the minimal tax takes to which African governments have been reduced.

Needless to say, many challenges arose with some or all of the approaches and mechanisms adopted by the nationalistic African governments. But the focus of domestic resource mobilisation for development was rightly on the central issue – the allocation of the economic surplus between domestic investment and foreign profit repatriation. Besides, whatever the difficulties, it is arguable that the various methods adopted by the post-colonial governments availed them of far more substantial resources than they would have had today and that made it possible for them to undertake the impressive investments then undertaken in health, education, infrastructure, etc.

The onset of World Bank/IMF inspired structural adjustment programmes from the mid-1980s brought a systematic dismantling of these policies, instruments and institutions. Whatever the high-minded economic justification given, this was essentially a question of what some have called a fetishism of foreign investment. Here under the guise of freeing the economy from the inefficiencies of African states, the entirety of economic development was gradually and systematically subordinated to the profit-making dictates of the foreign investor.

The erosion of trade taxes, capital controls, controls on repatriation of profits; the handing over of state enterprises to foreign operators; the dismantling of development financial institutions --- all this has meant that essentially the only instrument left with the African people and their states to partake in the allocation of economic surplus has increasingly become income taxes, corporate and individual. Even then these have been set at unconscionably low levels in order to attract the foreign investor, something that has been found to have been unnecessary.

All these issues, processes and institutional options are hidden from view when the question of domestic resource mobilisation and the related issues of net resource transfer are reduced to the question of illegal tax practices by transnational corporations, drug and human trafficking and corruption. Important as they are, policy around these concerns can best serve Africa's developmental needs if they are located within processes that displace the "primacy" of the interests of the foreign investor in Africa's economic development programmes.

Appendix

TAKING THE MBEKI REPORT FORWARD – AN ADVOCACY STRATEGY

A key outcome of the three-day consultative meeting on Illicit Financial Flows and Africa hosted by TWN-Africa (10-12 November 2014) was an indicative strategy for African civil society advocacy around the outcomes of the Mbeki Panel, which was then working.

The strategy was influenced by two basic considerations. One the one hand there was consensus among participants that the work of the High Panel, as well as the outcomes of that work -- as indicated then in the interim report and subsequently affirmed in the final report -- constituted a welcome intervention in the policy processes around illicit flows and in the broader question of net- resource transfers form Africa. It was necessary for this work and its outcomes to be politically affirmed.

On other hand, however, participants noted that the Panel's work, as indicated its interim report, suffered from a basic conceptual drawback, and that this draw-back was likely to result in the discussion of illicit financial flows obscuring the much broader issue of the overall net-capital transfer from Africa which has undermined domestic resource mobilisation. Analysis of the final report shows that the basic limitation has been carried over into the final outcome of the Panel's work, some say even reinforced. (See Attached).

The concern was thus how to promote the work of the Panel and its outcome, while working to mitigate its limitations and thereby broaden its effectiveness. The result is the four-prong strategy that follows.

The strategy calibrates different but inter-related objectives and actions to four different but inter-related geo-political cites/spaces of governmental decision-making over policy, and of related civil society advocacy. These are the: (a) global inter-governmental space, in particular as represented by such structures as the G20, G8, and so on; (b) the Africa-wide space of pan-African inter-governmental institutions, like the AU, the ECA, the ADB, etc; (c) the regional space, in particular as occupied by the Regional Economic Communities (RECs) and (d) the national spaces of individual African countries.

At the **level of the G20**, the participants agreed that, its limitations notwithstanding, the Mbeki Report represents a key African intervention. Whatever improvements to the report can be made at the African level, and should not detract from the need for G20 members to take the report seriously, and begin to integrate it. Thus a strategic objective at this level is a demand for G20 members to politically accept the Mbeki Report as a key African intervention to stop illicit flows, and to take action on its recommendation, and in a manner consistent with the spirit of the report, which is to contribute to redress the net transfer of capital from Africa.

At the **level of pan-African institutions**, the key concern is to avoid the all-too familiar pattern of African inter-governmental bodies taking decisions that they fail to follow-up, or which they fail to operationalise by creating the appropriate and commensurate mechanisms. Thus a strategic objective here is to hold governments up to following up with their own decisions. For a start participants agreed that it was important for the AU Heads of State to adopt the Panels report, and commit formally to its implementation. Now that this has been done, the other elements of the participants view come to the fore. These include how the various bodies, ECA, ADB, give concrete expression to the report.
At this Pan-African level, participants agreed that opportunities that arise should be taken to see how to improve the report and mitigate its basic drawback, even though they did not think it was strategic priority at this level.

At **regional level**, participants agreed that, especially the **Regional Economic Communities**, involved as they are in (re-)organising economic and trade relations to improve Africa's location in the global economy, constitute a feasible and necessary space to insert the question of illicit flows in broader issues than was made possible with the narrow horizons adopted in the Mbeki Report. Here the objective is to move beyond the Mbeki Panel's definition of illicit flows around the narrow concept of (il)legality and begin a boarder conversation about reinvestible economic surplus, capital transfers and domestic resource mobilisation, and explore the range of trade and investment, as well fiscal, monetary, etc, instruments that need to be activated in this regard.

This objective is to be reinforced and extended at the **level of national government** in various African countries.

Particular packages of activities from a menu of options – research, capacity building, lobby, public mobilisations – can be carried out at different levels, in relation to a particular combination of a set of target constituencies – policy makers, civil society organisations, socio-economic constituencies, etc.