Symposium on IFFs: Third World Approach to Economic Globalisation and Digitalisation of the Economy: Assessing Current Initiatives for Combating Tax and Commercially Related Illicit Financial Flows from Africa

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Introduction

Globalisation and digitalisation of the economy has radicalised tax administration and commerce in Africa. While there is still significant room for growth, there has been a paradigm shift in Africa's development policy landscape over the past three decades. Economic liberalisation measures aimed at opening up the continent to global market forces and attracting foreign direct investment have significantly replaced state intervention and public ownership in most African countries. There is a race amongst governments in the continent to optimise and harness the vast tax potential of both the digital economy and the emerging digital finance market involving trading in cryptocurrencies, Non-Fungible Tokens ("**NFTs**"), and other digital assets. They aim to embrace the regulatory complexities of both the digital economy and the emerging digital finance market with a view to making their countries fit for the digital age and to building a future-ready economy that works for the advancement of their people.

However, the rise of globalisation and digitalisation of the economy, including the economic liberalisation that followed, has (amongst other factors) allowed tax and commercially related Illicit Financial Flows ("**IFFs**") to thrive in Africa. IFFs from Africa are said to have assumed crisis proportions in recent times. Global Financial Integrity (2010) reportedly estimates IFFs from Africa between 1970 and 2008 alone at more than U$1 trillion, an amount that dwarfs the combined inflows of developmental assistance and foreign direct investments into the continent over the same period. Nigeria is also reported to have led other resource-rich African economies with this enormous outflow, put at US$217.7 billion, or 30.5% of the total IFFs from Africa within the relevant period. Africa is currently estimated to be losing more than US$50 billion to US$86.63 billion annually in IFFs.

IFFs have resulted in significant capital flight from developing countries in Africa to the developed world. These outflows are of serious concern, given inadequate growth, high levels of poverty, staggering debt profile, resource needs, and the changing global landscape of official development assistance to low-income countries. This trend has fundamentally limited the ability of developing (mostly African) countries to provide basic goods and services to their citizens, thereby necessitating initiatives for combating tax and commercially related IFFs from Africa. The Africa Initiative of the Global Forum on Transparency and Exchange of Information for Tax Purposes (the "Global Forum"), the African Tax Administration Forum ("ATAF"), and the African Commission Working Group on the Extractive Industries ("WGEI") have all proposed separate but closely related initiatives for combating IFFs from Africa with a view shoring up tax revenue for developmental growth in Africa.

While these proposed initiatives have the potential to address some of the concerns arising from tax and commercially related IFFs from Africa, they do not sufficiently address the problem in terms of the peculiarities of either globalisation and digitalisation of the economy or the emerging digital finance market. This analysis contends that tax and commercially related IFFs from Africa cannot be effectively addressed if the tax and regulatory challenges arising from globalisation and digitalisation of the economy, and the emerging digital finance market, are not addressed head-on by African governments in a coordinated fashion. Globalisation and digitalisation of the economy envisage tax and financial cooperation between African developing countries and the developed world to effectively combat tax and commercially related IFFs in Africa. African governments must also develop workable strategies to harness the multi-billion-dollar tax potential of the digital finance market and to regulate the said market in a manner that eliminates IFFs. Reliance cannot be successfully placed on any non-African-controlled international organisations or entities to proffer the required solutions to the problem of tax and commercially related IFFs from Africa.

Economic globalisation, digital economy, and IFFs: Conceptual and practical challenges

Over the past three decades and as a result of the process of economic globalisation, a global economy has gradually emerged at an ever-increasing speed, replacing the patchwork of national economies. While the concepts of ‘globalisation’ and ‘economic globalisation’ in particular appear unsettled, international trade law experts generally conceive the term ‘economic globalisation’ to essentially mean the gradual integration of national economies into one borderless global economy. It encompasses both (free) international trade and (unrestricted) foreign direct investment. It contemplates the practical but gradual unification of national economies into one global economy with a view to easing cross-border trade. Economic globalisation appears to have been driven by two main factors: (i) technology – which makes globalisation feasible; and (ii) liberalisation of trade and foreign direct investment to oil the wheels.

Due to technological innovations resulting in a dramatic fall in transport, communication and computing costs, the natural barriers of time and space that separate national economies have been disappearing across borders. As noted by Thomas Friedman in his 2005 book, 'The World Is Flat – A Brief History of the Globalised World in the Twenty-First Century': "*Clearly, it is now possible for more people than ever to collaborate and compete in real time with more other people on more different kinds of work from more different corners of the planet and on more equal footing than at any previous time in the history of the world – using computers, e-mail, networks, teleconferencing, and dynamic new software*."

The second driving force of economic globalisation has been the liberalisation of international trade and foreign direct investment. Over the last seven decades, most developed countries have gradually but significantly lowered barriers to foreign trade and direct investment. Over the last three decades, the liberalisation of trade and investment has become a worldwide trend, including in developing countries, although liberalisation still proceeds at different speeds in different parts of the world. In his book, 'Has Globalisation Gone Too Far?', Dani Rodrik, of the John F. Kennedy School of Government at Harvard University, observed with regard to this dimension of globalisation: "*Globalisation is not occurring in a vacuum. It is part of a broader trend that we may call marketisation. Receding government, deregulation, and the shrinking of social obligations are the domestic counterparts of the intertwining of national economies. Globalisation could not have advanced this far without these complementary forces*."

Technology as a driving factor of economic globalisation has led to the digitalisation of the economy or the rise of the digital economy. It has also led to the emergence of the digital finance market involving cross-border digital assets trading. The digital economy is composed of the digital industry (also referred to as digital industrialisation) and the digitalisation of industries (also referred to as industrial digitalisation). The digital industry mainly includes the telecommunication and internet industry, the software and information technology industry, and the electronic information manufacturing industry. The digitalisation of industries considers the output and efficiency improvement brought by other existing industries using information and telecommunications technology, as well as the emergence of new industries. The scale of the digital economy is the contribution of these components to the national Gross Domestic Production.

Flowing from the above, digitalisation can be compared to industrialisation based on its overall impact on economic and social institutions. As industrialisation places machine power at the centre of the economy, digitalisation makes digital intelligence its new fulcrum. The factory as the site of mechanised production was the central economic institution of the industrial age. In the digital age, it is sectoral platforms that reorganise entire economic activities in any sector based on data-based digital intelligence. Electronic commerce is an indicative but superficial way of designating this phenomenon. The digital economy involves digital intelligence services, which manifest in the operation of sector-wide platforms.

Technology as a driving factor of economic globalisation has also led to the emergence of the fast-growing digital finance market involving trading in cryptocurrencies, NFTs, and other digital assets. This development has further expanded and radicalised the scope of the digital economy. The complexity of the digital economy, including the volatility, unpredictability, and anonymity that is atypical of digital assets, have enabled IFFs activities to evolve faster than national governments around the world can quickly respond to and handle. This problem of scale is much more significant in African developing countries. There seems to be a lack of capacity (and sometimes political will) to deal with the technological advancements of digitalisation which have radicalised tax and commercially related IFFs from Africa.

While IFFs are of increasing concern to governments and policymakers around the world – especially in Africa, there is presently no universally agreed definition of IFFs. Current definitions of IFFs are not only diverse but are for the most part informed by the applicable context. According to the African Union ("AU") High Level Panel ("HLP") on IFFs from Africa, which was established by the Economic Commission for Africa in February 2012, IFFs constitute "money that is illegally earned, transferred, or utilised". The HLP concluded that Africa loses an estimated $50 billion annually in IFFs. More recent studies, however, show that Africa loses much more than this. The United Nations Conference on Trade and Development ("UNCTAD") has for instance put the incidence of IFFs in Africa at $86.6 billion per year. This estimate is based on the UNCTAD's definition and understanding of IFFs as "cross-border exchanges of value, monetary or otherwise, which are illegally earned, transferred, or used".

In the various forms in which they are perpetrated, IFFs in particular deny developing countries the opportunity to generate the revenues required to meet their recurrent expenditure needs and to fund long-term development plans. IFFs can drain foreign exchange reserves, affect asset prices, and distort competition, thereby undermining the capacity of affected countries to maintain economic and financial stability. Consequently, these countries become constrained in meeting commitments made under various regional and international frameworks. IFFs fundamentally limit the ability of developing countries to provide basic goods and services to their citizens. This has great implications for economic development in affected developing countries. If not addressed, IFFs may also be a cause of public dissatisfaction, social unrest, and conflict. Moreover, revenue deficits caused by IFFs are said to be partly responsible for the increased tendency amongst countries – especially those in Africa – to resort to borrowing on often onerous and predatory terms as a coping mechanism. Tax and commercially related IFFs are very prevalent in Africa.

Analysis of initiatives for combating tax and commercially related IFFs from Africa

IFFs are a shared problem between developed and developing countries. The broad categories of IFFs include tax and commercially related IFFs, IFFs arising from illegal markets, corruption related IFFs, and IFFs arising from theft and terrorism financing. All four categories have been exacerbated by globalisation and digitalisation of the economy, including the emerging digital finance market, and the radical economic liberalisation that resulted therefrom. This analysis will focus on the current initiatives for combating tax and commercially related IFFs from Africa, proposed by the Africa Initiative, ATAF, and the African Commission WGEI; with a view to identifying pitfalls and recommending options for improvement.

The focus of this commentary on tax and commercially related IFFs from Africa stems from the magnitude of its adverse effects on the continent's economy. The 2015 HLP Report found that in Africa, commercial practices constitute the largest source of IFFs and are responsible for 65% of all IFFs in Africa. This is followed by crime, which accounts for 30% of IFFs, while the remaining 5% emanates from corruption. It is noteworthy that commercial activities giving rise to IFFs from Africa mainly take the form of aggressive tax avoidance which occurs in the form of abusive transfer pricing, thin capitalization, exaggerated payments for use of intangible assets, and inflated management fees. These practices are broadly categorised as Base Erosion and Profit Shifting ("BEPS") strategies, which refer to aggressive tax planning strategies that exploit gaps and mismatches in national tax rules to make profits 'disappear' for tax purposes or to shift profits to locations where there is little or no real economic activity, but the tax rates are low or zero.

- **Africa Initiative Approach**

Recognising the high levels of IFFs from African countries, including the potential of tax transparency and exchange of information to raise resources for development, African members of the Global Forum established the Africa Initiative at a plenary meeting held in Berlin in October 2014. The Africa Initiative is an Africa-focused program of the Global Forum – a 163-member organisation working on global transparency to end tax evasion and bank secrecy. The Global Forum is specifically responsible for promoting and monitoring two key international tax and finance-related standards: (i) Exchange of Information upon Request ("EOIR"); and (ii) Automatic Exchange of Information on Financial Accounts ("AEOI"). These standards facilitate the exchange of information among countries while simultaneously ensuring deeper access to information held by financial institutions.

The objective of the Africa Initiative is to unlock the potential of tax transparency and exchange of information for Africa by ensuring that African countries are equipped to exploit the improvements in global tax transparency to better tackle tax evasion and BEPS activities. The regional focus of the Africa Initiative enables the identification of specific approaches and the provision of tailored support to address the needs and priorities of African countries with a view to growing their capacities in exchange of financial and other relevant information for tax purposes. The Africa Initiative's work fit into broader agendas, as tax transparency is believed to ultimately serve the purposes of stemming IFFs and increasing domestic resource mobilisation.

The Africa Initiative was launched as a partnership between the Global Forum, its African members, development partners, and a number of regional and international organisations. Initially set up for a period of three years (2015 to 2017), it was renewed for a second phase (2018 to 2020) in November 2017 at the Global Forum's plenary meeting which held in Yaoundé, Cameroon. A new three-year mandate (2021 to 2023) and a new governance were agreed during the Global Forum's 8th meeting of October 2020, and again, during its 14th meeting held in November 2023, for the period 2024 to 2026. With encouraging first results, additional development partners joined the Africa Initiative.

The Africa Initiative has benefitted from significant engagement at the ministerial level to ensure political buy-in and sustained momentum. This is reflected in the Yaoundé Declaration, which provides support to the fight against IFFs from Africa. The Yaoundé Declaration marks the beginning of the next stage in the effort to improve international tax cooperation to combat IFFs in Africa. Originally signed by four countries in November 2017, during the Global Forum plenary meeting held in Yaoundé, Cameroon, the Yaoundé Declaration encouraged the AU to begin a high-level discussion on tax cooperation, the fight against IFFs, and their link to domestic resource mobilisation. Less than five years later in 2023, 33 African ministers of Finance and the AU Commission now back the Yaoundé Declaration.

The African Initiative is specifically focused on promoting transparency and information exchange by and among African countries as part of the efforts to prevent tax evasion and aggressive tax avoidance and to stem IFFs from Africa. In light of this, the current focus of the Africa Initiative is to raise political awareness around tax transparency and EOIR as a tool for combating tax evasion and aggressive tax avoidance, enrolling countries into the AEOI, and building the capacity of African countries to utilise tax information. In terms of stemming IFFs, the Global Forum and the Africa Initiative have availed African governments of opportunities to access legal and beneficial ownership information, relevant banking information, and to understand the affairs of their taxpayers.

- **ATAF and the African Commission WGEI Response**

ATAF was established in 2009 with a mandate to (amongst other things) improve the capacity of African tax administrations to achieve their revenue objectives. Its membership consists of relevant African tax authorities. ATAF's mandate is to strengthen the capacity of relevant African tax authorities in revenue mobilization and administration and to ensure that these revenue authorities are accountable to the citizens of their various countries. In relation to IFFs, ATAF's work has involved the promotion of transparency and intergovernmental cooperation in tax and finance information exchange. ATAF is also playing a capacity-building role by offering training to officers from African tax authorities in diverse areas of taxation including customs management, transfer pricing, treaty abuse, and other harmful tax prices. Also, as part of this role, ATAF has supported the establishment of transfer pricing units in several African countries. ATAF also regularly releases regular studies on these subjects. These are all critical to stemming tax and commercially related IFFs from Africa.

ATAF's work on IFFs has also involved engagement with parliamentarians at the continental level. In October 2018, ATAF signed a Memorandum of Understanding with the Pan African Parliament to strengthen tax legislation in Africa to combat IFFs. At the global level, ATAF is a partner and one of the organisations behind the establishment of the African Initiative. To date, the ATAF has managed to mobilise up to 33 African countries to join the Africa Initiative.

At the regional level, there exists the State Reporting Guidelines on Articles 21 and 24 of the African Charter on Human and People's Rights Relating to the Extractive Industries, Human Rights, and the Environment. The Guidelines, which were developed by the African Commission WGEI, were adopted by the African Commission in May 2017. The Guidelines (amongst other things) provide guidance on steps that ought to be taken by state parties to the African Charter with a view to effectively combat IFFs in Africa. In this regard, the Guidelines enjoin African countries to adopt fiscal regulations that address IFFs through appropriate amendments of relevant tax laws and policies, rules on related party transactions, banking laws and policies, and those governing the financial sector. The Guidelines also emphasise to African countries the importance of developing and implementing robust and efficient tax collection systems with a view to addressing the challenges of IFFs from Africa. It is noteworthy that the Guidelines are legally binding on state parties to the African Charter.34 It is also noteworthy that the African Charter has been domesticated in Nigeria under the African Charter on Human and Peoples' Rights (Ratification and Enforcement) Act as required by the provisions of section 12(1) of the Constitution of the Federal Republic of Nigeria 1999 (as amended).

Analysis and Recommendations

The upside with the ATAF and African Commission WGEI response, the Yaoundé Declaration, and the Africa Initiative's general efforts at combating IFFs in Africa (altogether, the "Africa Solution"), is that they are all mainly focused on international tax cooperation as the panacea to the problem of IFFs in the continent. This seems relevant to addressing tax and commercially related IFFs, which make up about 65% of the IFFs-related capital flight from Africa. The Africa Solution's international tax cooperation efforts, which are primarily focused on transforming tax transparency and effective exchange of financial and tax information amongst African countries, will no doubt aid in combating IFFs of all categories in the continent – especially tax and commercially related IFFs.

Ironically, however, this focus on international tax cooperation amongst African countries appears to be a key limitation of the Africa Solution's efforts at combating IFFs from Africa. First is that the efforts are regional and therefore limited in scope. IFFs from Africa largely result in capital flight to non-African developed countries and not to other African developing countries. As such, international tax cooperation efforts aimed at addressing IFFs from the continent should actively involve developed countries across the world and should not just be limited to African countries. In any event, international tax cooperation amongst African countries (without more) is not enough to address the challenges of IFFs in the continent. This is also true of tax and commercially related IFFs which constitute the bulk of IFFs related capital flight from Africa. National tax administration deficiencies amongst African countries must also be addressed and taken seriously. While we admit that the ATAF is making some progress in this regard, the current inefficiency of the national tax administration systems across African countries is testimony to the fact that more has to be done in this regard. Increased international tax cooperation amongst African countries will be ineffective in addressing tax and commercially related IFFs in Africa (or indeed any other forms of IFFs in the continent) if the national tax administration systems in Africa remain prevalently inefficient.

What is more, the tax challenges presented by economic globalisation and the digital economy (which cannot be solved by international tax cooperation that is primarily focused on tax transparency and the exchange of financial information amongst African countries) must be addressed in any serious conversation dealing with combating IFFs from Africa in the digital age. Non-resident multinational entities are enabled by economic globalisation and the digital economy to engage in BEPS activities to the detriment of African developing countries. They digitally generate huge sums of income from African source countries where they have no physical presence, which they shift (tax-free) to so-called tax havens or, in some cases, to their host developed countries where they pay taxes. In addition, the emerging digital finance market caught African countries technologically unprepared to handle the volatility, unpredictability, and anonymity atypical of digital assets which enables crypto asset traders to illicitly move funds offshore and undetected from African developing countries.

Tax and regulation concerns relating to cryptocurrencies, NFTs, and other digital assets must be critically addressed. IFFs have now been complicated by the movement of funds in cryptocurrencies and other digital assets which are difficult to track due to their anonymous nature. Clearly, initiatives for combating IFFs from Africa which are hinged on international tax cooperation amongst African countries alone cannot be effective in this digital age because governments can only share tax and financial information to which they have access. Most African countries lack the technological capacity to effectively regulate and tax the emerging digital finance market involving cross-border digital assets trading. Deliberate efforts must be made to overcome this challenge if Africa hopes to win the fight against tax and commercially related IFFs from the continent, in this digital age. In this regard, it is heartwarming to note that on December 23, 2023, the Central Bank of Nigeria lifted its long-standing ban on crypto assets transactions in the country, while noting that global trends have shown a need to regulate such activities rather than prohibiting them.

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