Symposium on IFFs: Investigating the Impact of Illicit Financial Flows on Unsustainable Debt Burdens in Africa and the Quest for Tax and Debt Justice

By:

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Introduction

In recent years, Africa has seen a gap in its development financing, which hampers its efforts to address the impacts of climate change and achieve its infrastructure and other development goals. The Nationally Determined Contributions or national commitments for carbon emission reduction and climate adaptation of African countries alone are projected to require around USD 2.8 trillion in financing between 2020 and 2030, which is more than 93% of Africa's GDP. According to UNCTAD, the continent's sustainable financing gap until 2030 is around USD 1.6 trillion. To meet the Sustainable Development

Goals (SDGs) by 2030, the continent would need an additional USD 194 billion in annual funding. The continent is unquestionably confronted with substantial development financing needs, which are further exacerbated by two independent, yet interrelated problems that are depleting the already scarce resources: illicit financial flows (IFFs) and a growing burden of unsustainable debt. To effectively tackle the complex challenges of Africa's development; including achieving the SDGs, combating the effects of climate change, and resolving human rights issues; it is imperative to address IFF by promoting tax justice and to confront unsustainable debt through debt justice.

While unsustainable debt and IFFs significantly deplete the continent's resources, they are insufficiently linked in legal and policy dialogues. One of the few links between these two issues is evident in the mandate of the 'Independent Expert on foreign debt, other international financial obligations, and human rights'. The Independent Expert is tasked not only with examining the issue of debt burdens in developing nations but also with examining the impact of IFFs on the fulfillment of human rights. Strengthening the link between these two areas is critical, as is intertwining the solutions targeted at tackling these challenges. Furthermore, African policymakers and external stakeholders dealing with these issues must enhance communication and coordination among themselves. Building robust connections between these topics and encouraging a more cohesive dialogue among African policymakers and stakeholders is crucial for their effective resolution.

Given the importance of establishing this link, this blog post delves into the challenges and nexus between IFF and unsustainable debt and provides high level policy recommendations.

Unmasking the Drain: The Scale of IFFs in Africa and Africa's Unsustainable Debt

There is currently no internationally agreed on definition of IFF, however it broadly refers "to the movement of money across borders that is illegal in its source (e.g. corruption, smuggling), its transfer (e.g. tax evasion), or its use (e.g. terrorist financing)". As is evident from this description, there are three main categories of IFFs—acts that are illegal; funds that are the results of illegal acts or funds that are used for illegal purposes. These may take different forms, such as tax evasion, money laundering, corruption, and trade mispricing, among others. Quantifying the precise volume of IFFs either regionally or globally is a daunting task because of their clandestine nature and the fact that there is no international methodology to monitor flows. Nevertheless, studies do provide alarming statistics that underscore the severity of the problem. UNCTAD highlights that annually, an estimated USD 88.6 billion, equivalent to 3.7% of Africa's GDP is lost to IFFs. The magnitude of the problem has resulted in the view that Africa has been a net creditor to the world.

The region's debt statistics are also very alarming as African countries have high borrowing rates for debt that is not only more expensive due to high interest rates, but also denominated in foreign currency thus exposing them to foreign currency risks. Sub-Sahara's total external debt stock, for instance, more than doubled in a decade from USD 322 billion in 2010 to USD 790 billion in 2021. This proliferation of unsustainable debt has become a pressing concern across multiple African countries, representing a troubling trend that was already apparent prior to the COVID-19 pandemic. This surge in indebtedness is detrimental to the continent's development and human rights. It is widening the gap in necessary financial resources to tackle these issues, and yet, today it is more difficult to restructure already accumulated sovereign debt.

The Nexus Between IFFs and Sovereign Debt

The correlation between IFFs and Africa's increasing debt load is a significant factor impacting economic dynamics on the continent. Firstly, the convergence of these occurrences creates a cyclical loop, in which the consequences of IFFs play a substantial role in exacerbating the continent's growing debt issue. The link between the two arises from reduced government revenue due to weakened domestic resource mobilization, that leads to more borrowing. Specifically, the illicit activities associated with IFFs result in a significant diversion of financial resources from public investment, leading governments to rely on debt, which worsens vicious cycle of borrowing that becomes increasingly challenging to break. Further, is the heavy reliance on foreign debt sources, which only worsens debt dependency. An added layer of complexity is the possibility that lenders may increase interest rates or apply more stringent conditions on loans when they perceive a greater risk of illicit financial activity in a country. As such, this may result in higher borrowing costs, further leading to a cycle of increasing debt burdens.

Secondly, the illicit practises linked to IFFs erode governance and debilitate governmental institutions, resulting in a lack of transparency, accountability, and effective regulation. In this context of inadequate governance, effectively addressing unsustainable debt levels becomes challenging due to the greater inclination to engage in opaque and illicit sovereign borrowing practises, resulting in the failure to negotiate more favourable debt terms. Several African countries, including Mozambique, have accrued secret debts. This situation extends to countries like Kenya, Ghana, Uganda and Zambia, where the details and terms of some loans for infrastructure projects and power-purchase agreements were undisclosed to the public.

Breaking the Cycles of IFFs and Unsustainable debt

Tackling the problem of IFFs requires a comprehensive strategy that encompasses international collaboration, legislative overhauls, and bolstering of institutions. To address the issue effectively, it is crucial to focus on two key actions. Firstly, enhancing tax systems and policies by expanding the tax base and minimising tax evasion. Secondly, it is essential to establish strong legal frameworks to monitor, retrieve, and return stolen financial assets. Given the connection between IFFs and unsustainable debt, it is also important to prioritise responsible borrowing practises and ensure transparency of borrowing terms to avoid debt traps. These actions may not seem unique; yet their relevance remains as pronounced today as they have been in the past and they need to be reiterated. Building on these, below are policy recommendations aimed at addressing both IFFs and unsustainable debt:

1. Enhancing domestic resource mobilization:

African governments should prioritize domestic resource mobilization to reduce reliance on external borrowing. One way to do this is by lowering leakages by expanding the tax base, improving tax administration capacity and enforcement, and conducting anti-corruption initiatives. Furthermore, in light of the increasing prevalence of digital financial services, it is crucial to build regulatory frameworks to prevent illegal financial flow via online platforms.

In order to prioritise the mobilisation of domestic resources, governments should also consider exploring innovative financing models, such as well-structured and bankable public-private partnerships, as well as alternative methods to attract private capital. These approaches will help attract much needed resources for development efforts. However, the contingent liabilities associated with these funding models should be carefully assessed as they may have unanticipated debt related consequences.

2. Enhancing debt management capacities and promoting responsible borrowing and lending practices

Reducing Africa's debt levels requires negotiating debt restructuring and debt relief which can provide much-needed breathing space to a country. This involves engaging with creditors to restructure debt repayment terms, which may include lowering interest rates, lengthening the duration of the loan, or even possibly requesting debt forgiveness. Additionally, tackling IFFs is also another approach that would free up more resources to meet the development and budgetary needs of a country. This could have the domino effect of less reliance on debt, especially foreign debt. Nevertheless, debt will always be an important part of how countries fund their development and as such there should be an enabling environment promotes sustainable borrowing and debt management practices.

Enhancing debt management capabilities of the public sector is essential to tackling unsustainable debt. However, it falls on both borrowers and lenders to take accountability for debt transactions as they both have due diligence obligations, to varying degrees. From the sovereign borrower's perspective, it is essential to use prudent borrowing practices, which includes closely monitoring debt levels, completing thorough assessments of debt sustainability prior to acquiring more debt, guaranteeing transparency in all debt-related activities and broadening the range of funding sources used. Lenders, on the other hand, need to thoroughly evaluate the borrower's capacity to repay and should aim to provide loans with appropriate financial and repayment conditions.

3. Enhancing governance and promoting transparency:

Enhancing governance and strengthening government institutions is a crucial measure in addressing both IFF and imprudent borrowing, which are both exacerbated by governance gaps. This entails improving transparency, ensuring accountability, and strengthening the commitment to the rule of law.

When it comes to IFFs, there is both a need to enhance the capacity of government institutions such as tax authorities and financial intelligence units, as well as a need to improve the supervision and regulation by financial institutions and regulatory authorities, ensuring they possess adequate resources and skills to efficiently monitor financial activities. In addition to this, African countries should strengthen transparency and accountability measures to also encourage responsible and beneficial borrowing. This requires ensuring that parliament and even offices of the attorney general can help to prevent illicit financial activities. The supervision of debt levels; debt transactions and their legality and terms, as well as IFFs require regular audits, stress testing, risk assessments, rigorous anti-corruption measures, strong financial reporting requirements, and the guarantee of the public availability of information.

Enhancing accountability can also occur by enhancing civil society and public engagement on issues such as IFFs and debt. The case of Mozambique's secret debt is a prime example of how civil society played an integral role in uncovering illicit debt transactions that had a profound impact on the economy. It also demonstrates the power of public interest litigation. Civil society organisations, such as Tax Justice Network which has an IFF Vulnerability Tracker and AFRODAD which is engaging on issues relating to IFFs, are also increasingly playing an important role when it comes to IFFs. Governments need to provide a supportive atmosphere so that civil society organisations in Africa may actively monitor and publish illegal cash flows. This enabling environment additionally requires facilitating access to information and preserving the right to free expression.

Concluding remarks

IFFs have become a major hindrance to the financing of development in Africa, worsening the problem of unsustainable debt on the continent. Both IFFs and unsustainable debt are impeding economic progress, increasing poverty, and negatively impacting the achievement of the SDGs. The interconnection between IFFs and Africa's mounting debt burden poses a substantial obstacle to the economic development of the continent. Addressing the interconnection between IFFs and sovereign debt is critical for Africa's economic development.

This challenge requires comprehensive and multi-faceted approaches, as well as collaborative action by African countries, international organisations, and the global community.

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