



## Independent Expert Meeting on Finance, Monetary Affairs, Economic Planning and Integration

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9-10 April 2018, Africa Union Commission Head Quarters, Addis Ababa, Ethiopia

### Introduction

The Africa Union Commission (AUC) in partnership with the Africa Development Bank (AFDB) and the Friedrich Ebert Stiftung (FES) are organising an Independent Experts' Meeting on **Mobilisation of Domestic Resources: Fighting against Corruption and Illicit Financial Flows**. This meeting is meant to provide a forum for independent<sup>1</sup> experts from Africa and beyond to articulate challenges and propose solutions concerning three thematic areas: domestic resource mobilization, the fight against corruption and the fight against illicit financial flows (IFFs).

### Background:

In 2015, the African Union Assembly of Heads of State and Government adopted Agenda 2063, which outlined the continent's aims for its socio-economic transformation over the succeeding 50 years. This document expresses many of the same aims as the United Nations Sustainable Development Goals, to which African countries also agreed in 2015. As outlined in these two frameworks, one of the main methods that Africa has decided to use to finance its development is through increased mobilization and use of domestic resources. It is widely accepted that the realisation of the goals spelt out in the two development Agendas, will depend on the ability of the continent to mobilise the substantial financial resources required for their implementation; indeed, analysis by AUC, ECA and others has underlined that domestic resources have a number of advantages compared to foreign financing (such as greater predictability and reliability in terms of the level of flows, and avoiding aid dependence); moreover, only greater mobilization of domestic resources can meet the continent's current funding

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<sup>1</sup> I.e. not from Government

gap for its development objectives. Most donors fail to live up to the long-standing commitment to deliver 0.7% of GNI as aid even in good times. There is also a sense that donor views on the purpose of aid are constantly shifting and there is increasing scepticism about the utility of aid given over decades and development results achieved. Moreover, the global economic crisis has brought aid budgets in many countries under pressure. In tough times, aid is unfortunately an easy line item for cuts. East Asian economies, and more recently China and India, followed a growth path, underpinned by very high levels of domestic resource mobilization (DRM). Indeed, there is no case of a high investment path not backed up by high domestic savings. Foreign aid comes with conditionality or policy strings, attached, not to mention procurement restrictions that accompany “tied aid”.

Interest for more domestic resources mobilization efforts for development has grown since the Monterrey Conference in 2002. Enhanced DRM reinforces the sustainability of development objectives such as the SDGs. This results from the need for greater policy space and ownership by developing countries, from synergies between DRM and state building, from the fact that DRM is less volatile than external resources. Moreover, high rates of domestic savings and investment underpins the high growth rates such as those experienced by Asian countries.

In this context, mobilising additional domestic resources is widely accepted to be a key policy priority for Africa. Political scientists have long emphasized the fact that taxation is fundamental to state building and forms the foundation of the social contract between state and citizen. Without taxation, there can be no viable state. In this context, there is growing concern that heavy reliance on resources other than broad-based domestic taxation can be a disincentive to develop institutional capacity, accountability to citizens and ultimately promoting prosperity. Governments that derive the bulk of their resources from donors, for instance, may be more responsive to donor than domestic priorities (where the two differ).

Domestic resource mobilisation is the generation of savings from domestic sources and their allocation to economically and socially productive investments. Domestic resources can come from two sources: private and public. Domestic tax revenue is an essential source of financing for development in addition to the fact that an effective tax system leads to greater ownership of the development process. Public sector revenue mobilization is crucial to strengthen the capacity of the state to deliver public goods and services. Private sector revenue mobilisation is crucial to create employment, incomes, and sustainable livelihoods. There are several ways to promote greater mobilization of domestic resources. These include: broadening the tax base and reforming the structure of taxation to make the most of revenue sources that remain relatively untapped to date; strengthening administrative procedures in taxation and public financial management, and building

capacities of tax offers, to combat domestic and foreign sources of tax base erosion. They also include mobilising greater domestic private finance for priority investments, through reforms to the efficiency of the financial system and through the innovative use of instruments such as public-private partnerships to mobilise additional domestic private finance for public projects.

Efforts by African governments to harness domestic resources however face various severe domestic and international constraints. Key among these constraints include:

- Weak national laws and legislation and institutions that undermine DRM and encourage resource leakage
- Corruption and related poor governance
- Haemorrhaging of public resources resulting to Illicit financial flows

### **Domestic Resource Mobilization: (Domestic legislation and institutional capacity)**

As noted earlier in the present document, domestic resource mobilization will be essential to filling Africa's financing gap and has several advantages when compared to relying on external resources (due to the unreliability of funds and avoidance of aid dependence). In addition, financing public expenditure through tax revenues has important, positive effects on governance (as compared to simply relying on natural resources or aid). In Africa, some of the steepest challenges to DRM are encountered due to various challenges linked to weak domestic legislation, poor institutional capacity and a financial sector that has performed poorly in intermediating savings to investment and could still bring more persons into the formal financial system. These constraints have resulted, on the public finance side, in low tax to GDP ratios, poor public financial management, the granting of unnecessary tax incentives, harmful tax competition and the exploitation of tax loopholes. In addition, there has been an imbalanced tax mix between direct and indirect taxes with majority tending to depend more on indirect taxes which are often regressive leading to increased inequality. Further, issues of administrative and economic efficiency need to be addresses in many tax systems in African countries. It is important that taxes are inexpensive to administer and collect, and that the tax system does not interfere with the efficient allocation of resources in the economy. In terms of the performance of the financial services sector, the result has been in low savings rates, investment financing gaps.

As such, Africa's policies on domestic resource mobilization need to be revisited. The meeting will discuss various aspects of Africa's policies on domestic resource mobilization and make recommendations as to how they can be improved. The focus will be to discern:

- The significance of cross-cutting structural bottlenecks, including high level of informality, lack of fiscal legitimacy and huge administrative capacity constraints.
- How significant is the erosion in the tax-base from the excessive granting of tax concessions and exemptions, inadequate taxation of informal and agricultural activities and inability to address abuses such as transfer pricing?
- How balanced is the tax mix?
- How efficient is tax policy administration?
- Good practices across Eastern Europe and Asian on taxation policies, administration and enforcement?
- How to further improve tax compliance?
- How to create a capable organisation to sustain tax reforms?
- How to improve saving and credit management?
- How the existing and savings instruments could be strengthened and the potential to introduce new saving instruments?
- How to develop capital markets?

Regarding the private sector, the following issues should also be considered: Is there a potential for private saving to expand? What are the basic impediments for low private savings? What are the basic preconditions for scaling up private savings? What are the main reasons for illicit capital outflows? What are the basic lessons from African and Asian countries regarding the reform for an enhanced private saving?

An important part of this revision to Africa's policies on domestic resource mobilization is the need to tackle corruption and illicit financial flows, to which the present concept note now turns.

### **Fight against Corruption:**

Corruption is widely regarded as one key factor contributing to the continued poverty and stunted economy of African states. It has been identified as one of the major hindrances to improved domestic resource mobilization in Africa. Corruption also undermines tax compliance. Corruption in all its forms (embezzlement, bribery, nepotism, etc.), adds to already weakened institutional capabilities to not only acquire the necessary funds but also to protect these resources and channel them towards projects and investments aimed at facilitating economic growth.

Domestic-resource mobilization- centred reform cannot occur by simply improving the ability of a country to raise additional tax and revenue from its citizens without accountability and proper management of the collected tax resources. The continent is now intensifying efforts to tackle corruption also by the African Union announcing the Anti-corruption year 2018 and committing to

continued efforts towards achieving those goals. In this context, the meeting will discuss how Africa's anti-corruption policies can be strengthened, both through improved domestic measures and through greater international co-operation among African countries and with partners outside the continent.

### **Fight against Illicit Financial Flows (IFFs):**

Illicit financial flows represent a powerful drain on Africa's domestic financial resources for development. Estimates of the continent's losses through these flows vary, but all seem to agree that the continent loses tens of billions of dollars each year; the High-Level Panel on illicit financial flows from Africa concluded that the continent was losing in excess of \$50 billion to illicit financial flows. Beyond the first-order financial losses, such flows undermine governance (as corrupt officials attempt to retain a cut of the flows), threaten conflict (by undermining public trust and facilitating the financing of terrorist or rebel groups), lead to environmental degradation (through facilitating the sale of illegally exploited natural resources, inter alia) and worsen the income distribution.

The problem has several different facets. One important one is related to tax avoidance or evasion by multinational corporations. So-called 'base erosion and profit shifting' by multinational corporations continues to deprive African countries of sums estimated to be in the tens of billions of dollars every year; recent estimates, for example, put revenue losses for Africa (excluding North Africa) alone to exceed around \$35 billion. While the OECD's Base Erosion and Profit Shifting actions and efforts to promote transparency and information sharing represent a concerted effort to tackle the problem, these actions were designed by a limited group of countries, with few outside of the OECD and G20 involved in the process. As a result, they do not effectively address some of the most important concerns for African countries related to multinational tax, such as the granting of non-strategic tax incentives and harmful tax competition. Africa needs to articulate its own response to these activities.

Another important aspect is related to motivations to hide illicitly-accumulated wealth or launder the profits of organised crime or corruption. There are several techniques available to effect hidden transfers or to store wealth in jurisdictions where it is difficult for African governments to obtain information about accounts held by their nationals. Capacity among African institutions tasked with preventing such flows is often insufficient.

Responding to the threats posed by illicit financial flows (IFF) from the African continent, the African Union commission (AUC) jointly with the established a high-level panel on illicit flows from Africa chaired by Thabo Mbeki. The panel was tasked to study the continent specific challenges to IFF and develop recommendations for implementation. The report whose recommendations has since been

adopted by all heads of state and governments in Africa represents a major milestone in the continent's efforts to curb illicit financial flows.

In this context, the meeting will discuss how Africa can best tackle the problem of illicit financial flows, including how to implement the recommendations of the High-Level Panel on Illicit Financial Flows from Africa.

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## **Format and Structure**

The independent experts meeting will take the structure of:

1. Presentations followed by Panel discussions
2. Networking sessions
3. Preparation of Recommendations

## **Sessions**

The meeting will include the following sessions:

### **Segment on domestic resource mobilization**

Session 1: improving tax policy and administration and public financial management. Three dimensions of the tax system will be covered: laws, tax policy and tax administration.

- Laws will be described only as required to complement the description of the other dimensions of the tax system. Particular attention will be paid to the core principles of the tax laws, the relevant aspects of the regional legal environment and non-tax laws (e.g. the Constitution).
- Tax policy includes performance and development objectives, and the types of taxes and the rates applied (broken down by sector and type of tax payer).
- Tax administration will cover, but will not be limited to, the organizational structure, the mandates and governance structures of the different tax institutions, the contractual relationship between government and revenue authority, their strategy, main processes, information systems and capacity.

Session 2: mobilising private investment in public projects: public-private partnerships, government debt, social impact bonds etc.

Session 3: strengthening the financial system for development: tackling excess liquidity and excess risk aversion of financial institutions (including boosting lending to MSMEs), boosting financial inclusion

### **Segment on tackling corruption**

- Session 4: domestic policies for tackling corruption: strengthening relevant institutions and accountability
- Session 5: international co-operation on tackling corruption

### **Segment on illicit financial flows**

- Session 6: tackling tax-related illicit financial flows
- Session 7: anti-money laundering, counter financing of terrorism and tackling trade mis-invoicing

### **Concluding session**

- Session 8: adoption of the meeting report
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## **Objectives**

This meeting will seek to provide a platform to multiple stake holders and policy actors drawn from CSOs, research and academia and other relevant players to deliberate on the thematic areas outlined above. The meeting will also provide opportunity to take stock of the success made so far and challenges facing African states/governments.

Recommendations will be prepared as an outcome of the meeting and will subsequently be presented at the member states expert meeting.

## **Dates and Venue**

The dates for the meeting are 9th to 10th April 2018 in AUC Compound, Addis Ababa, Ethiopia.

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### **Partners**

1. Department of Economic Affairs, Africa Union (AUC)
  2. African Development Bank (AFDB)
  3. Friedrich Ebert Stiftung, AU Cooperation office (FES)
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## **Contact persons**

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