

# Strategies for Addressing Capital Flight\*

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## Abstract

This paper discusses strategies to stem capital flight from African countries. It emphasizes the importance of the distinction between licitly and illicitly acquired capital, and the need to tailor strategies to the specific type of capital flight concerned. Policies to prevent the illegal export of honestly acquired capital and strategies to address both trade-related capital flight and transfer pricing are examined. The paper discusses strategies for preventing asset theft and for tracking and repatriating stolen assets. It discusses the burden of odious debts and the role of debt audits in addressing this problem. Finally it maps the contours of a global compact for the prevention of capital flight and tax evasion.

**Key Words:** Capital flight; illicit financial flows; Africa; sub-Saharan Africa; trade misinvoicing; transfer pricing; odious debt; debt audit.

**JEL Classifications:** G11; O16; O55; H63

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## 1. Introduction

Capital flight and other illicit financial flows constitute a major constraint to development financing in Africa, a continent that continues to lag behind in most measures of human development (Ajayi and Ndikumana, 2014). Compared to other regions, capital flight from Africa represents a more severe problem, causing heavy losses in government revenue, forgone investment, and lost output (Ndikumana et al., 2014). Moreover, the financial hemorrhage from capital flight is exacerbated by pervasive tax evasion (Kedir, 2014).

The evidence in the literature suggests that there are multiple causes of capital flight, including domestic as well as external factors (Ndikumana et al., 2014). On the African side, capital flight is associated with the embezzlement of national resources, including external borrowing and extractive industry revenues, and with corruption and political instability. But external agents and institutions also contribute to capital flight from the continent. Capital flight is facilitated, in particular, by the opacity of the international banking system and by inadequate enforcement of rules on financial transparency and corporate accountability. Trade misinvoicing, an important mechanism for both capital flight and tax evasion, is made possible by inadequate exchange of trade information between African countries and their trading partners. This implies that efforts to stem and prevent capital flight must be organized on both domestic and international fronts.

This paper draws on the analysis and evidence in the literature and from the chapters in Ajayi and Ndikumana (2014) and distills key elements of a global strategy to address capital flight. The paper is organized as follows. Section 2 discusses the importance of the distinction between licitly and illicitly acquired capital, and the need for strategies tailored to the specific type of capital flight concerned. Section 3 discusses policies to prevent the illegal export of honestly

acquired capital. Section 4 presents strategies to address both trade-related capital flight and transfer pricing. Section 5 turns to strategies for preventing asset theft and for tracking and repatriating stolen assets. Section 6 discusses the burden of odious debts, and the role of debt audits in addressing this problem. Section 7 maps the contours of a global compact for the prevention of capital flight and tax evasion, and Section 8 concludes.

## **2. Tailoring policy interventions to the type of capital**

### **2.1 Legal vs. illegal capital**

Private capital stashed abroad by Africans is not a homogeneous pool of resources. Some of it is clean capital, licitly acquired and licitly transferred, but a substantial part is illicit by virtue of its mode of acquisition and/or transfer.

As can be seen in Table 1, African private wealth held abroad includes some capital that was honestly acquired in Africa and legally transferred abroad as capital outflows duly recorded in national statistics in the country of origin. This is *clean capital*. Some legally acquired capital is transferred abroad by clandestine means, however, circumventing regulations and reporting requirements on the cross-border movement of capital. The motivations for such transfers include tax evasion, as well as more legitimate concerns about the security of property rights or illegitimate taxation. We refer to this as *smuggled capital*.

Illegally acquired capital originates from corruption, theft, bribery, counterfeit, trafficking of illegal goods and services, and other illicit transactions. The perpetrators of these economic and financial crimes have two additional motives for moving their stolen assets out of the country: to conceal evidence of their crimes, and to hide the proceeds where they are less likely to be recovered by legal authorities and more accessible, should they find it prudent to move abroad

themselves. In some cases, stolen assets find their way into the country’s legal financial system, either by taking advantage of the laxity of controls or by corrupting the officials responsible for verifying the origins of the funds. This *laundered capital* may then exit the country using legal routes. In this case, the outflows are recorded in the official statistics—despite the illicit origins of the funds—and do not enter into measured capital flight. Although domestic money laundering makes it easier to move funds out of and back into the country, it entails risks and transaction costs, and it exposes assets to the view of tax authorities. For these reasons, most illegally acquired capital that leaves the country of origin does so clandestinely. This is what we call *dirty capital*. The strong correlations between capital flight and external borrowing, and between capital flight and natural resource extraction, suggest that dirty capital constitutes a substantial fraction of total African capital flight.

**Table 1: Legal and illegal capital held abroad**

Transfer \ Acquisition	Legally acquired	Illegally acquired (stolen assets)
Legally transferred	<i>Clean capital</i>	<i>Laundered capital</i>
Illegally transferred (capital flight)	<i>Smuggled capital</i>	<i>Dirty capital</i>

Strategies to reduce capital outflows must be cognizant of the differences among these forms of capital held abroad, as the owners of these assets are likely to respond in differing ways to various incentives and regulatory measures. Strategies for stemming outflows of clean capital should be part of a broader package of policies aimed at encouraging domestic investment and private capital inflows. These policies will help keep capital at home and encourage Africans to repatriate their capital held abroad. They are also relevant to strategies to prevent capital smuggling, since it is important to understand why African holders of honestly acquired wealth may prefer foreign assets over domestic assets. Another strategy, again relevant to both clean capital and smuggled capital, is the use of capital controls.

Illegally acquired capital, in contrast, requires a completely different approach. Measures focusing on investment incentives and portfolio choice are ill-suited for addressing the problem of capital that is fleeing the scene of its criminal origins. For such capital, the strategies must instead use legal measures to deter illicit acquisition of capital and to seize and repatriate stolen assets. These require international cooperation among banking, law enforcement, and judicial authorities as well as national efforts.

## *2.2 Tax evasion and transfer pricing*

Whatever the motives that lead Africans to move capital abroad, tax evasion enters into the mix whenever a wealth holder fails to report external asset earnings to their domestic tax authorities. Needless to say, such earnings are seldom, if ever, reported in the cases of smuggled capital and dirty capital, and they often go unreported for clean and laundered capital, too.

Because the failure to report taxable income is a violation of the law, apart from any other offenses committed in relation to the acquisition or transfer of capital, strategies to combat tax

evasion can complement strategies to combat capital flight. It is worth recalling, in this connection, that the notorious American gangster Al Capone, the leader of a Chicago-based crime syndicate in the 1920s, was ultimately sentenced to prison for tax evasion, not for the criminal activities by which he acquired his wealth.

*Tax evasion* is distinguished in the legal literature from *tax avoidance* on the basis of whether or not existing laws are broken or merely circumvented. Tax evasion involves the deliberate misrepresentation or concealment of relevant information; tax avoidance involves the manipulation of tax laws to reduce tax obligations. The line between the two can be rather fuzzy. Indeed the ability to manipulate tax laws—including, in some cases, the ability to influence the drafting of the laws themselves—is not only more subtle but also more potent as a form of tax noncompliance than outright tax evasion. From the standpoint of the public treasury, both result in lost revenues.

In Africa, as elsewhere, *transfer pricing* by multinational firms is a ubiquitous tax-avoidance practice. Transfer pricing is the manipulation of prices assigned, for accounting purposes, to intra-firm trade in goods and services so as to park corporate profits in low-tax (or no-tax) jurisdictions. Examples of transfer pricing practices by multinational corporations operating in Africa are provided in (Barry, 2014) and (Kedir, 2014). The beer manufacturer SAB Miller has been reported to pay less tax than an operator of a beer kiosk in Ghana (Action Aid, 2010). Mopani, the Zambian branch of Glencore, declared zero profits in its copper mining in Zambia thanks to transfer pricing (Barry, 2014). These cases are only illustrations of a pervasive practice by multinational companies in the manufacturing and resource extraction sectors in African countries.

Transfer pricing is sometimes confused with trade misinvoicing, but the two are quite different. Trade misinvoicing can be detected by comparing the invoices submitted to customs authorities in the exporting and importing countries on either side of a given transaction. In principle, the quantity and value of the goods should match on both invoices, so that country A's recorded exports to country B are the same as country B's recorded imports from country A. In practice, however, there are often systematic discrepancies between the two, as discussed by Ndikumana et al. (2014). Exporters may understate quantities or values, or importers may overstate them, as a means for capital flight. Conversely, importers may understate quantities or values—or, in the case of pure smuggling, not report them at all—to evade customs duties.

Transfer pricing, in contrast, does not entail the submission of different information to the exporting country and the importing country. The same quantities and the same values—computed on the basis of the same transfer prices—are invoiced at both ends of the transaction. But the prices assigned for this purpose differ greatly from those that would have been paid in an arms-length transaction between different firms. Hence the scale of transfer pricing cannot be ascertained by trading partner data comparisons of the type used in capital flight measurement. Because strategies to combat both trade misinvoicing and transfer pricing relate to international trade, and they often will involve international cooperation, we consider them together in Section 4.

Table 2 lists a number of important strategies for combating different types of capital flight as well as transfer pricing. These are discussed in the sections that follow.

**Table 2: Strategies for combating capital flight and tax evasion**

<b>Problem</b>	<b>Strategies</b>
Smuggled capital	<ul style="list-style-type: none"> <li>- Policies to encourage home bias in investment</li> <li>- Capital controls</li> <li>- International banking transparency and accountability</li> <li>- Automatic exchange of tax information</li> <li>- Policies to curtail trade misinvoicing</li> </ul>
Dirty capital	<ul style="list-style-type: none"> <li>- Procurement transparency and accountability</li> <li>- External debt management transparency and accountability</li> <li>- Extractive industry transparency and accountability</li> <li>- Debt audits and odious debt repudiation</li> </ul>
Transfer pricing	<ul style="list-style-type: none"> <li>- Arms-length or fixed-margin pricing principles</li> <li>- Formulary apportionment</li> <li>- Country-by-country reporting</li> <li>- Thin capitalization rules</li> </ul>

**3. Addressing illegal export of honestly acquired capital**

*3.1 Strategies to encourage home bias in private investment decisions*

In designing strategies to stem capital flight, a starting point is to understand why even honest African savers may prefer foreign assets over domestic assets. The mainstream economics literature suggests several plausible motives: higher risk-adjusted returns, hedging against exchange rate fluctuations, higher security of capital held abroad, lower tax on investment income, and higher capital gains. Empirical evidence is mixed on the actual importance of these factors in driving African capital flight (Ndikumana et al., 2014), but paying attention to them can be justified as part of a broader strategy for encouraging domestic investment. The development of profitable investment opportunities not only helps keep capital onshore, but also can help attract private capital held abroad, including remittances from the African diaspora.

Strategies to encourage home bias investment decisions include policies that reduce the cost of capital as well as policies that raise the returns to investment. In the case of African countries,



there is considerable scope for reducing the costs of production and trade through increasing the quantity and quality of infrastructure—especially power, transportation, and communication. In other words, a key pillar in strategies to encourage investment is to reduce the large infrastructure deficit faced by African countries.

Measures to accelerate the development of domestic and regional financial markets could also help to shift African investors' preferences in favor of domestic markets. Domestic-currency government infrastructure bonds, for example, have provided an important source of financing for public infrastructure in Kenya (Brixiova and Ndikumana, 2013). Such instruments also help to keep Kenyan private capital at home, offer long-term savings opportunities, and provide the government with a mode of infrastructure financing that does not expose the country to exchange rate risk.

Many African countries have resorted to fiscal incentives to promote domestic investment. These include tax allowances on capital investment, tax exonerations on investment-related imports, and generous tax holidays for major investment projects. A major drawback of this strategy, however, is that it can entail significant tax revenue losses in a continent where most countries face large financing gaps. A second problem is that the implementation of investment tax incentives is plagued by corrupt practices that result in an inefficient allocation of investment as well as excessive foregone revenue. A third concern is that tax incentives often are skewed in favor of foreign direct investment, putting domestic investors at a competitive disadvantage. Foreign direct investment should be considered as a complement to domestic investment, not a substitute for it. Indeed, by serving as a signal of an environment that is conducive for investment, a strong record of domestic investment can help to attract foreign investment. To the

extent that preferential treatments for foreign investment are considered, they should be used very selectively to advance specific national strategic objectives, such as the promotion of carefully identified sectors and activities, and there should be a clear timeline for phasing out such incentives. In China, for example, the government has gradually phased out past incentives for FDI with the aim of establishing a level playing field for domestic investors (Devonshire-Ellis, 2010).

### *3.2 Role of capital account controls*

A second set of strategies for stemming capital flight is the use of capital controls to increase the transactions costs and legal risks for capital smuggling (Fofack and Ndikumana, 2014). The effectiveness of capital controls depends critically on the broader macroeconomic policy framework as well as the regulatory environment. Capital controls work best when they are seen as an integral component of macroeconomic and industrial policy, rather than a measure of “last resort” instigated by financial crisis (Epstein, 2012; Gallagher, 2012), and when they are used to achieve well-specified goals. Even if they are temporary, they can signal that the government is ready and capable of utilizing them when circumstances dictate it. Capital controls are less effective if they are seen as coercive measures arbitrarily imposed by the government.

Traditionally, capital account controls have been used to address four main problems, sometimes referred to as the “four fears” (Magud and Reinhard, 2007). Three of these relate to capital inflows rather than outflows. The first is the “fear of floating,” the fear that large capital inflows will cause undesirable appreciation of the national currency, damaging the country’s tradable goods sectors (Calvo and Reinhard, 2002). African governments may want to attract capital inflows, but there can be situations where there is too much of a good thing. The second is the

fear of “hot money,” speculative short-term capital flows that are subject to massive and sudden reversals, symptomatic of what Magud and Reinhard (2007, p. 647) call the “fleeting affection” of foreign investors. For example, East Asian countries suffered the consequences of excessive exposure to such capital during the financial crisis at the end of the 1990s. One response to concern about speculative financial flows was Tobin’s proposal for a securities transactions tax aimed at disciplining such flows (Tobin, 1978).<sup>1</sup> The third fear is that large capital inflows can have disruptive consequences for financial markets and the economy, promoting asset bubbles and excessive risk-taking by banks in the presence of high levels of liquidity.

The fourth fear is the loss of monetary policy autonomy that may accompany unrestricted inflows and outflows. Under the “impossible trinity” axiom (Frankel, 1999), a country can achieve only two of three important and interrelated goals: a fixed exchange rate, monetary policy autonomy (especially control over the interest rate), and unrestricted capital mobility. To achieve any two of these, the third must be sacrificed. For most countries, it arguably makes most sense to sacrifice full capital mobility, given the critical role of monetary policy for managing aggregate demand and responding to exogenous shocks, and the critical role of exchange rate policy for international competitiveness and macroeconomic stability.

The main conventional objectives of capital account controls, therefore, have been to limit the volume of capital flows, influence the composition of capital inflows by tilting the balance towards long-term flows, minimize exchange rate pressure from capital flows, and protect monetary policy autonomy. The historical evidence shows substantial variations in the effectiveness of capital controls across countries, over time, and by the type of controls. For the

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<sup>1</sup> Tobin’s proposition was inspired by Keynes’s idea that introducing a transactions tax on all stock market dealings would increase the costs of access to the stock market and reduce speculation (Keynes, 1936, Chap XII, pp. 104-105).

sake of our discussion, two results stand out from cross-country comparisons (Epstein, 2012; Gallagher, 2012; Magud and Reinhard, 2007). First, capital controls have successfully influenced the composition of capital flows in favor of long-term capital. Second, capital controls have increased monetary policy independence. These two results are especially important for African countries as they seek to attract growth-enhancing foreign capital and manage aggregate demand.

Capital controls can also be useful in curtailing capital flight. The empirical literature does not offer much by way of country evidence on this issue, as most studies have focused on controls on inflows rather than controls on outflows. But the limited available evidence suggests that capital controls can be an effective instrument for stemming capital flight. In the case of Chile, for example, controls were effective in reducing net capital outflows, especially short-term capital outflows (De Gregorio et al., 2000; Reinhart and Smith, 1998). This was also the case in Brazil and Colombia (Reinhart and Smith, 1998).

Empirical evidence on the effectiveness of capital controls in the case of African countries is sparse. Ndikumana et al. (2014) present evidence suggesting that capital account openness in the continent has been associated with somewhat higher capital flight. In the case of South Africa, lax capital account management often has been blamed for destabilizing capital outflows and for vulnerability contagion from crises in other countries. It has also been argued that capital controls were an effective tool in curbing outflows arising from political uncertainty during the transition from South Africa's apartheid regime (Wood and Moll, 1994).

### *3.3 Transparency of international banking operations*

The saying that “it takes two to tango” holds for capital flight. Most of Africa's capital flight is domiciled in what are commonly referred to as offshore financial centers. The most important of

these are not tropical islands, but rather New York, London, and other European banking centers (Shaxson, 2011).<sup>2</sup> Capital flight is facilitated and perpetuated by the complicity of banks in these countries that systematically turn a blind eye to suspicious transactions by Africa's political and economic elites. The outcome is fully incentive compatible, in the sense that both the perpetrators of capital flight and their bankers benefit from breaking the law: African actors are able to conceal their wealth, while their bankers earn profit from banking fees and a "secrecy premium" in addition to expanding their envelope of loanable funds.

In this context, strategies to stem capital flight must include efforts to improve transparency in international banking operations. This involves two broad policy actions: strengthening and enforcing existing banking laws in western countries, and closing gaps and loopholes arising from inconsistencies and inadequate harmonization of laws across countries. Regarding the first area of policy intervention, the onus is on western governments, legislative bodies, and specialized agencies to strengthen and enforce their own laws. In the United States, for example, since the 2001 terrorist attacks the government has strengthened regulations to track banking transactions that may be associated with the financing of terrorism, and more recently the government has made greater efforts to track down tax evasion. The International Money Laundering Abatement and Anti-terrorist Financing Act of 2001 requires financial institutions to "implement reasonable procedures for verifying the identity of any person seeking to open an account, to the extent possible and practicable."<sup>3</sup> The compliance program of the Bank Secrecy Act requires each financial institution operating in the U.S. to file a Suspicious Activity Report (SAR) whenever it believes that it has been "used to facilitate a criminal transaction," and

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<sup>2</sup> Also see Barry (2014).

<sup>3</sup> Customer Identification Programs for Banks, Savings Associations, Credit Unions and Certain Non-Federally Regulated Banks. *Federal Register*, 68(90), Friday, May 9, 2003 / Rules and Regulations, p. 2113.

whenever it knows or has reason to suspect that “the transaction involves funds derived from illegal activities, or intended or conducted in order to hide or disguise funds or assets derived from illegal activities, as part of a plan to violate or evade any law or regulation.”<sup>4</sup>

A weakness of existing U.S. legislation is that it is left to the discretion of the financial institution and individual bank officers to make a judgment as to whether an activity is suspicious and to decide whether or not to file a SAR. Baker and Joly (2009) , leading authorities on illicit financial flows, report that “U.S. Treasury Department officials estimate that 99.9 percent of the money that U.S. law prohibits from entering the country is accepted for deposit the first time it is presented to a U.S. bank.” For the specific goal of combating capital flight, a further limitation of this legislation is that neither the U.S. government nor financial institutions are under the obligation to share the information on suspicious transactions with the government of the depositor’s country of origin. If western governments are seriously committed to eradicating financial crime, they must walk the next mile and commit to systematic sharing of information from Suspicious Activity Reports with their partner African countries. Failure to do so amounts to abetting capital flight from Africa.

The second area of policy intervention is the harmonization of legislation on banking secrecy and financial transparency across countries. Corporations and individuals are able to exploit gaps and inconsistencies in legislation across countries as well as loopholes in national legislation to move money across borders and conceal the identity of the owner of assets from African national authorities. The United Kingdom, for example, is generally considered to be a step behind the United States in anti-tax evasion and anti-corruption legislation and enforcement. Regulatory

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<sup>4</sup> Electronic Code of Federal Regulations, Title 12: Banks and Banking, § 21.11 Suspicious Activity Report, p.2.

inertia, which is partly a result of vigorous lobbying by the banking sector, has made the UK “a soft touch for the tax avoidance industry” (Mitchell and Sikka, 2013, p.10). For Africa to make progress in fighting capital flight, its western counterparts need to commit to combating complacent banking and tax evasion. It is quite possible that helping African countries to keep their wealth onshore could generate substantially higher returns than much official development assistance.

### *3.4 Tackling tax evasion*

Tax evasion by individuals, national businesses, and multinational enterprises operating in Africa is a major impediment to domestic resource mobilization for infrastructure investments and social expenditure (Kedir, 2014; OECD, 2013b). As in the case of tracking capital outflows, tackling tax evasion requires a collective effort between African countries and the international community.

A central focus of such efforts is the cross-country exchange of information on investment income, including interest, dividends, and capital gains. In addition to financial data, this requires information on beneficial ownership, so that the recipients of income are not able to conceal their identities behind shell companies and trusts. Banks and other financial institutions, including brokers and insurance companies, would be required to report this information to their own governments, who could then share it with the governments of the income recipients. Recent years have seen considerable progress on the information-exchange front. In 2009, the exchange of information upon request became the international standard, monitored by the Global Forum on Transparency and Exchange of Information for Tax Purposes. While this gave tax authorities

access to information on offshore investment income, it put the onus on them to identify specific individuals or firms in order to request this information.

In April 2013, in response to advocacy efforts by civil society organizations and a number of well-publicized cases of tax evasion, the G20 Finance Ministers and Central Bank Governors endorsed automatic exchange of information—rather than exchange upon request—as the new international standard (OECD, 2013a). Steps are now underway to implement this strategy. Initial bilateral agreements—for example, between the United States and European countries—are laying the foundation for multilateral cooperation.

These international developments create new opportunities for African governments to tackle tax evasion. An example is the Global Forum on Transparency and Exchange of Information for Tax Purposes, a G20 initiative dating from 2004, which can especially benefit resource-rich African countries. African countries can also leverage support from existing international civil society coalitions that work against corporate sector corruption and for greater transparency in the financial sector. Examples include the London-based Tax Justice Network, launched in 2003 to oppose tax evasion, tax avoidance, and tax havens, and the U.S.-based Financial Accountability and Corporate Transparency coalition, launched in 2006 by 26 civil society organizations. These and other non-governmental organizations have called for the elimination of loopholes in tax systems, automatic exchange of tax information, and measures to combat transfer pricing by multinational corporations.



## 4. Combating trade-related capital flight and transfer pricing

### 4.1 *Curbing trade misinvoicing*

A substantial amount of capital flight from African countries occurs through the underinvoicing of exports and the overinvoicing of imports (Ndikumana et al., 2014). When a firm understates the price and/or quantity of exports on invoices submitted to the African authorities, it can retain abroad the difference between the true value and the declared value, rather than surrendering the full amount of its foreign exchange earnings to the central bank in return for local currency. When a firm overstates the true value of its imports, it can obtain extra foreign exchange to send abroad, and again retain the difference in foreign accounts.

The desire to evade customs duties on imports provides another motive for trade misinvoicing, though in this case it takes the form of import underinvoicing (rather than import overinvoicing as in the case of capital flight). When a firm understates the value of imported goods on invoices submitted to African authorities (technical smuggling), or fails to report them at all (pure smuggling), the government is deprived of tariff revenue. In Africa, this often is an important form of tax evasion, as evidenced by the fact that in many countries import underinvoicing for tariff evasion substantially exceeds import overinvoicing for capital flight (see Ndikumana et al. (2014)).<sup>5</sup>

Strategies to curb trade misinvoicing must include interventions on both sides of trade transactions; that is, both in Africa and in trading partner countries. As a first step, African governments need to strengthen trade regulation and exchange control mechanisms to better

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<sup>5</sup> A fourth type of trade misinvoicing—the overinvoicing of exports—is relatively uncommon, but this can occur in response to export incentive schemes.

track international trade. This involves strengthening capacity and regulatory oversight in the relevant departments in trade ministries and central banks as well as commercial banks. Second, the governments of Africa's trading partners need to cooperate in enforcing transparency in international trade and combating corporate sector corruption. The automatic sharing of invoice data submitted to trading partners' customs authorities would make it possible to identify discrepancies in the prices and quantities recorded on both sides of trade transactions. In addition, the African trader who files a falsified invoice often has a cooperating partner overseas who may corroborate inaccurate information and remit the hidden funds to designated accounts. Africa's trading partners can assist the continent by establishing and enforcing regulations and laws that make such complicity costly. The bribery and anti-corruption legislation in trading partner countries can also be potentially useful tools in this respect, if properly enforced.

Some sectors may be more exposed to trade misinvoicing than others. This is the case for extractive resources, given the sheer volume of the transactions, their complexity, and the large size of the multinational corporations operating in the sector. But other sectors, such as the services sector, are also subject to trade misinvoicing. Africa's ability to make progress in tackling trade-related capital flight requires genuine cooperation by its trading partners in combating corporate sector corruption.

#### *4.2 Tackling transfer pricing*

Transfer pricing poses a different set of challenges, since it cannot be detected by the comparisons of invoices submitted to the customs authorities of the originating and receiving countries. Instead, the same fictive price is recorded at both ends of the transaction, so as to relocate profits to low-tax or no-tax jurisdictions, thereby lowering the firm's overall payments

of taxes. To conceal profits from African tax authorities, for example, a multinational firm may report inflated payments for royalties, patent rights, or consultant services to subsidiaries elsewhere. Similarly, the firm may report artificially low prices received for goods or services exported from Africa to subsidiaries in other countries (Barry, 2014; Kedir, 2014).

The problem of transfer pricing has received considerable attention in the international community, in part because the practice is used to avoid taxes around the entire world, in both industrialized and developing countries (United Nations, 2013). Here we briefly discuss four of the main strategies that have been advanced for combating transfer pricing: the use of alternative prices by tax authorities; formulary apportionment of tax payments across countries; country-by-country reporting of firm balance sheet data; and thin capitalization rules to address transfer pricing in intra-firm finance.

Since transfer prices differ from the prices that would apply in market transactions between independent firms, one strategy is for tax authorities to develop a more realistic set of prices and to apply these alternative prices in tax assessments. In this vein, the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD, 2004) has recommended the use of "arms-length" prices based on market data for similar transactions across unrelated firms. Critics contend, however, that the OECD guidelines are "faulty in theory" and "generally unworkable" in practice (Spencer, 2012, p. 36). Given the enormously complex range of goods and services in international commerce, and the large share of intra-firm transactions in total trade for many of them, it can be difficult or impossible to find comparable

prices to use for arms-length comparisons.<sup>6</sup> An alternative approach used in some countries, notably Brazil, is to use fixed margins to calculate alternative prices (United Nations, 2013, ch. 10).

A second strategy, known as “global formulary apportionment,” is to allocate the worldwide profits of multinational firms across the jurisdictions in which they operate on the basis of a formula based on the distribution of the firm’s assets, sales, employment, or other operational indicators. Formulary apportionment has been used by a number of states in the U.S. to assess the tax liabilities of national firms for more than a century. Although the international application of this strategy has been discussed for several decades, it has yet to win adoption (Avi-Yonah and Clausing, 2007). In part, this is because global formulary apportionment would require, or at least be greatly facilitated by, international agreement on the formulae to be used (Morse, 2010). There is also scope for hybrid methods that use alternative prices to determine profits from specific activities and use formulary apportionment to allocate all other profits (Sullivan, 2010).

At present, multinational enterprises are not required to disclose, in their audited annual reports, their total profits and taxes paid in all the jurisdictions in which they operate. This lack of information makes it much more difficult for tax authorities to detect tax avoidance and tax evasion. Country-by-country reporting, the third strategy for combating transfer pricing, would require the firm to report for each country in which it operates:

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<sup>6</sup> This problem has arisen in the case of the African Tax Administration Forum (ATAF), an OECD-sponsored initiative to promote tax administration specifically in Africa, which aims to assist African efforts to combat tax evasion, including transfer pricing. While ATAF has substantial potential to help African countries build stronger and more transparent tax systems and to increase revenue, especially from resource sectors, the Forum’s reliance on the “arm’s-length principle” for addressing transfer pricing has constrained its effectiveness (Clausing and Avi-Yonah, 2007; Le Billon, 2011).

1. The name of the country;
2. The names of all of its companies that operate there;
3. Sales, purchases and financing costs, split in each case between intra-firm and other transactions;
4. Number of employees and labor costs;
5. Pre-tax profits;
6. Tax charges;
7. Gross and net assets; and
8. The cost and net book value of physical fixed assets.

As of this writing, efforts are underway in the U.S. and the European Union to mandate country-by-country reporting for extractive industries (Murphy, 2012). The extension of country-by-country reporting to multinational firms in general, regardless of the sectors in which they operate, would greatly facilitate African countries' efforts to monitor and combat transfer pricing.

The fourth strategy is to implement thin capitalization rules, which specifically address the use of interest payments on intra-firm loans as a vehicle for transferring profits across jurisdictions (Arezki et al., 2014). In this case, transfer pricing involves the price of capital. A "thinly capitalized" firm is one that relies heavily on debt, as opposed to equity, for its capital. Whereas returns to equity are taxed as profit, interest on debt is deducted as a business expense, and interest payments can be channeled to subsidiaries in locations where they are subject to low taxes or none at all. To combat this problem, thin capitalization rules put a ceiling on the amount of interest payments that can be deducted for tax purposes (OECD, 2012).

These four strategies for combating transfer pricing are not mutually exclusive. There is scope for hybrid approaches that use some combination of the arms-length pricing principle, the fixed-margin principle, and formulary apportionment. The efficacy of these would be enhanced, in turn, by country-by-country reporting and thin capitalization rules.

## **5. Stolen assets: Prevention, recovery, and repatriation**

Illicitly acquired wealth that has been transferred abroad can be recovered and repatriated via the legal process known as “stolen asset recovery.” In the period from 1995 to 2010, approximately \$5 billion was recovered and repatriated in this manner worldwide. Although this is a modest amount compared to the total magnitude of capital flight and illicit wealth, the sums involved are by no means inconsequential for the authorities who have successfully recovered stolen assets. For example, Switzerland has repatriated to Nigeria \$700 million of assets held in Swiss bank accounts by former military ruler Sani Abacha. While only a fraction of the \$2 billion to \$5 billion that Abacha is estimated to have embezzled in total (UN Office on Drugs and Crime and World Bank, 2007, p. 11), this is a substantial sum. Legal proceedings against Abba Abacha, son of the former ruler, may result in additional asset repatriation from Switzerland. Under the terms of the asset recovery agreement between the governments of Switzerland and Nigeria, the World Bank has been requested to review the use of the repatriated funds. In addition, the Swiss have funded a project of a NGO network to monitor the use of recovered funds in development projects executed by Nigerian agencies (Hodel, 2012).

The importance of stolen asset recovery efforts go beyond the amounts successfully recovered. These efforts can have a demonstration effect, acting as a deterrent against future capital flight. They may encourage voluntary repatriation of some flight capital, and even payment of attendant tax penalties, if this alternative comes to be seen as preferable to the outright seizure and forfeiture of the entire amount of assets in question. Similarly, the “naming and shaming” that accompanies asset recovery can have a deterrent effect on banks and other institutions that collaborate in the illicit transfer and sequestration of stolen funds.

The international environment for stolen asset recovery is considerably improved from what it was in the Cold War era, when influential foreign governments and international institutions frequently turned a blind eye to grand corruption on the part of favored political allies. The climate of that time was aptly summed up by former Zairian ruler Joseph Mobutu when he remarked, “It takes two to corrupt—the corrupter and the corrupted.”<sup>7</sup>

In the past two decades, the international community has taken major steps to build an institutional infrastructure that can assist African countries in efforts to recover stolen assets. The United Nations Convention against Corruption (UNCAC) of 2003, which has been ratified by 165 parties (individual governments and international bodies such as the European Union), includes articles on asset recovery and on bilateral cooperation under the rubric of mutual legal assistance (MLA). The Stolen Asset Recovery Initiative (StAR), launched by the United Nations Office on Drugs and Crime (UNODC) and the World Bank in 2007, provides technical advice and serves as a forum for sharing best practices in the identification and tracing of stolen wealth, asset seizure and confiscation, and procedures for enlisting international cooperation, including MLA. The International Centre for Asset Recovery (ICAR), established at the Basel Institute for Governance in 2008, works with governments to strengthen capacities in financial investigation, asset tracing, and international cooperation related to cases of corruption and money laundering.

Many countries have established Financial Intelligence Units (FIUs) to investigate transactions related to criminal activity. Anti-money laundering legislation in many countries requires banks and other financial institutions to file reports on suspicious transactions and activities with the FIUs in their jurisdictions. National FIUs can share this and other information with each other

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<sup>7</sup> Quoted in Bob Geldof, “A Different Crusade: Africa Needs More than European Platitudes,” *Sunday Herald*, 22 May 2005.

through the Egmont Group, an international network that takes its name from the Egmont Palace in Brussels, Belgium, where the FIU network was established at a meeting in 1995.

When investigators identify substantial foreign holdings of politically exposed persons (PEPs), and in some cases others suspected of criminal activity, the owners can be required to prove that the assets were acquired legitimately (Brun et al., 2011). Failure to prove this can lead to confiscation and repatriation, and pending the outcome of the legal proceedings, the assets can be restrained (meaning that their nominal owners cannot withdraw or move them) or seized (transferred to state custody).

These significant changes in the international environment have been supported by civil society organizations around the world. Prominent examples of these organizations include Transparency International, a Berlin-based NGO that monitors and publicizes political and corporate corruption in international development; Global Financial Integrity, based in Washington, DC, which promotes national and multilateral policies and agreements aimed at curtailing the cross-border flow of illegal money; the Tax Justice Network, an international advocacy group that works to expose and curtail tax evasion, tax avoidance, and bank secrecy; Sherpa, a Paris-based NGO that seeks to protect victims of financial crimes; Global Witness, a London-based NGO that exposes the misappropriation of extractive resource revenues that denies citizens their rightful share in their countries' natural wealth; and the U4 Anti-Corruption Resource Centre in Norway, which provides training and resources for development practitioners.

The two-track growth of official commitments and civil society mobilization augurs well for the success of future asset recovery efforts. If \$5 billion could be recovered in the past fifteen years,



it is readily conceivable—indeed, we think likely—that substantially more will be recovered in the next fifteen.

## **6. Tackling the revolving door and odious debt**

Research on the relationship between inflows of external borrowing and outflows of capital flight has established that there is often a close connection between the two. An analysis of annual data from 33 sub-Saharan African countries for the period 1970–2004 found that roughly 60 cents of every borrowed dollar flowed out as capital flight in the same year—a relationship suggestive of widespread debt-fueled capital flight (Ndikumana and Boyce, 2011b). Subsequent estimates for 39 African countries in the period 1970–2010 indicate that 63 to 73 cents on the dollar flows back out within a five-year window (Ndikumana et al., 2014).

While some fraction of the borrowed money departs through the “revolving door” as capital flight, African countries may still come out ahead in the short run, since the remaining fraction can be used for investment or consumption. The result would be a positive net inflow, were it not for subsequent outflows of debt service. Debt service is supposed to be paid on the entire loan, not only on the fraction that remains in the borrowing country. Once debt service closes the loop, debt-fueled capital flight ultimately results in a net resource drain from African economies.

Debts that fuel capital flight, instead of being used to finance domestic investment or consumption, can be regarded as “odious” under international law. By limiting the diversion of scarce public resources into external debt service, the selective repudiation of odious debts can be an important complement to strategies to combat capital flight. By altering the incentive structure for creditors, odious debt repudiation also can improve the quality of future lending and thereby curb debt-fueled capital flight.

## 6.1 Definition of odious debt

Odious debts are sovereign liabilities—loans contracted by governments—that were contracted without the consent of the public, from which the public did not benefit, in circumstances where the creditors knew or should have known these conditions to hold.<sup>8</sup>

Of course, not all external debts are odious. Some are virtuous, yielding public benefits that exceed the costs of repayment. Others are merely imprudent; while the benefits in the end do not justify the costs, this is attributable to inefficiency, ineptitude, or unforeseen circumstances, rather than to deliberate misconduct.

Odious debt can be divided into two sub-types. The first is “criminal debt,” defined as money borrowed by governments that was then “stolen by government officials, their families, and associates” (Winters, 2002, p. 107). The second is “despotic debt,” defined as money borrowed by governments that is used to suppress popular discontent and maintain the power of an authoritarian regime.<sup>9</sup>

Determining which loans genuinely served legitimate development purposes and which are odious can be a daunting task. A well-organized and systematic audit of external debts can help to establish which debts are legitimate and which offer objective grounds for repudiation. Where there is widespread evidence of fraudulent use of borrowed funds, the burden of proof can be placed upon the creditors to demonstrate that their loans were used for *bona fide* purposes.

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<sup>8</sup> Some legal scholars maintain that the absence of benefit along with the reasonable presumption of creditor knowledge are sufficient for a finding of odious debt, regardless of whether public “consent” is considered to have been absent by virtue of the non-democratic nature of the government (Luddington et al., 2010). Many African debts can be classified as odious even under the more stringent definition provided here in which all three conditions are held to be necessary.

<sup>9</sup> For further discussion, see Ndikumana and Boyce (2011a, chapter 5).

## 6.2 *Odious debts or odious governments?*

Some economists have proposed that rather than seeking to establish that certain debts are odious, based on how they were used, it would be easier to designate certain governments as odious, with any subsequent lending to such governments being subject to repudiation by successor regimes (Kremer and Jayachandran, 2002). Indeed, successor governments could be required to repudiate loans to odious predecessors as a condition for new lending, so as to prevent the new loans from being dissipated in odious debt service.

Such an *ex ante* approach to odious debt would leave untouched the burden of past debts, which are the legacy of irresponsible borrowing and complacent lending. Moreover, this strategy could exacerbate the moral hazard problem in that loans to regimes not (or not yet) designated as odious would be safe from legal challenge, regardless of their actual use. At the same time, the all-or-nothing character of the designation would deter lending to odious governments, even for legitimate purposes.

The *ex post* strategy for dealing with odious debts—selective repudiation of loans that were diverted into private pockets or used to finance despotic repression—avoids these pitfalls. Presently, odious debt claims must be handled in courts in the political jurisdictions specified in loan documents, and these are typically located in the creditor countries. This is not an ideal arrangement for ensuring impartial arbitration of disputes. In 2005 the Norwegian government called for the creation of an “international debt settlement court” charged with the task of adjudicating questions of debt legitimacy.<sup>10</sup> In 2009 a United Nations commission of experts, chaired by Nobel laureate Joseph Stiglitz, similarly called for the creation of an “international

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<sup>10</sup> See the Soria Moria Declaration on International Policy, October 2005; available at <http://www.dna.no/index.gan?id=47619&subid=0>.

bankruptcy court” that could consider, “where appropriate, partial debt cancellation” (United Nations, 2009, paras. 47-48). Referring to this proposal as an International Debt Restructuring Court, the IMF notes that such a body “could also determine what debts could be considered ‘odious’” (IMF, 2013, para. 57). The creation of such an international forum, which could be seen as a financial counterpart to the International Criminal Court, would not only strengthen judicial independence, but also could reduce legal costs.

The legal principle that, where chronic misuse of borrowed funds has taken place, the burden of proof can be placed upon creditors to demonstrate the legitimacy of past loans, is found in both international law and U.S. domestic law (Buchheit et al., 2007). Applying this principle, African governments could declare that debts will be treated as legitimate if, and only if, the creditors can provide good evidence that the loans were used for *bona fide* purposes. In cases where malfeasance was endemic and the fate of the borrowed funds cannot be traced, the arbiter can infer that the loan was diverted into the private pockets of individuals connected to the former regime. If so, the liability for the debt should lie not with the current government, but rather with the individuals whose personal fortunes are the real counterpart to the debt. If the creditors want to recover their money, they should seek redress from those individuals, not from the government.

Creditors may threaten to retaliate against governments that challenge odious debts by refusing to lend to them in future years. But history shows that banks have short memories. Moreover, such threats may prove to be paper tigers for three reasons. First, the selective character of the *ex post* strategy means that legitimate loans will be repaid. Second, for countries experiencing negative net transfers on debt, the benefit of halting debt service would exceed the cost of foregone new lending. Finally, lenders who truly want to promote development can be expected

to welcome steps to ensure that their money goes into productive investment rather than being used to service odious debts.

### *6.3 Debt audits*

Systematic debt audits can help to provide an objective and transparent basis for the repudiation of odious debts. Debt audits seek to distinguish between debts that are legitimate and those that are not, on the basis of legal, ethical, procedural, and developmental criteria (Boyce and Ndikumana, 2012). In 2007–2008 an external debt audit was conducted in Ecuador by the Public Debt Audit Commission, an independent entity established by the government for this purpose. The Commission found numerous grounds for challenging the legitimacy of specific debts, including the misuse of funds by the country's erstwhile military dictatorship and irregularities in subsequent debt restructurings. On this basis, the Ecuadoran government unilaterally defaulted on more than \$3 billion in global bonds. After negotiations with the foreign creditors, the government ultimately reached an agreement to buy back more than 90 percent of its defaulted debt at 35 cents on its face value.<sup>11</sup> The result of the audit, repudiation, and subsequent negotiation was a substantial reduction in the country's external debt service payments.

More recently, the Tunisian government has challenged the legitimacy of debts inherited from the Zine el-Abidine Ben Ali regime.<sup>12</sup> In June 2012, President Moncef Marzouki refused to endorse a proposal for an increase in Tunisia's quota share in the IMF (by about \$370 million), pending passage of a bill to audit the debts incurred under the Ben Ali regime. The bill would authorize an investigation to determine whether these debts were used in the interest of the

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<sup>11</sup> *The Economist*, Ecuador's winning strategy, June 17, 2009.

<sup>12</sup> Isabelle Madraud, La Tunisie Refuse les Dettes Héritées de la Dictature, *Le Monde*, July 17, 2012.

country or as an “instrument of dictatorship and repression,” in the words of the new President.<sup>13</sup> If Tunisia follows through with an audit of the Ben Ali debts, this will set a historic precedent for Africa.

On the lender side, the Norwegian government has announced plans for an independent audit of all its bilateral debt owed by seven developing countries (Kvangraven, 2012). Norway has been in the forefront of efforts to address issues of odious debt. The countries whose debts to Norway will be audited include Egypt, Somalia, Sudan, and Zimbabwe. The aims of the audit are to promote financial transparency and to test the new UN Principles on Responsible Lending and Borrowing, which were launched by the United Nations Conference on Trade and Development (UNCTAD) in 2012. It can be hoped that other donors and lenders will emulate this example.

## **7. A global compact against capital flight and safe havens**

Capital flight from Africa is not just a national problem. Nor is it only a continental problem. It is a global problem, and as such it requires a global solution. Institutional reforms at the national level are critically needed to discourage capital flight and tax evasion, but these will not be fully effective unless supported by international efforts to tackle corporate sector corruption, banking secrecy, and other dodgy business practices in the global trading and financial systems. In other words, the solution to capital flight requires a global compact among governments, civil society organizations, and international institutions.

### *7.1 Strategies at the national level*

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<sup>13</sup> Anouar Ennouri, Tunisian President Moncef Marzouki Refuses to Increase Investment in IMF, *Tunisia Live*, June 28, 2012.

While African countries have undertaken a number of efforts to combat corruption, money laundering, tax evasion, and illicit financial flows, the scope of these efforts and their degree of effectiveness remain uneven. Even where relevant agencies have been established, they often face serious financial, technical, and human capacity constraints. Moreover, efforts often are spread too thinly across a multitude of agencies, with little systematic coordination and few synergies among them.

The first step, therefore, is to integrate the various existing institutional mechanisms that have relevance for capital flight, money laundering, illicit financial flows, and tax evasion. African governments need to establish a framework of collaboration among anti-corruption agencies, anti-money laundering agencies, financial intelligence units, and specialized offices across other branches of government including the central bank, the police, customs services, immigration services, mining and trade ministries, and company registries. They also need to equip their foreign missions (embassies and official representations at multinational institutions) to operate as centers for collection and dissemination of information on financial crime. This cross-agency coordination needs to be organized along the entire length of the “information value chain,” from the detection of suspicious activity to investigation, all the way to prosecution. At present, efficiency is often hampered by rigid specialization and the compartmentalization of responsibilities and agency mandates. For example, it is often not clear whether the role of the tax authorities is restricted to investigating the offense of tax evasion, or whether it extends to the investigation of associated crimes such as money laundering and the predicate offenses that generated the funds. This lack of clarity on institutional mandate hampers effective deterrence and prosecution of financial crime.

Each stage of the process, from discovery of suspicious activity to prosecution, requires incremental information. At the same time, each stage is associated with risks of leakages and contamination of information, as well as corruption and active obstruction of the process through patronage and political influence. This implies that effective mechanisms aimed at tracking and prosecuting financial crime require firm support and commitment from the highest authorities. In this respect, there is strong merit to regular rotation of management across institutions, and on a broader level, to fixed terms in office for national leadership. As Charles Goredema puts it, “longevity in office tends to be accompanied by high levels of patronage and emasculation of institutions that should control abuse of power and corruption” (Goredema, 2011, p. 8). Ultimately, mechanisms for combating financial crimes must be part of the broader agenda for improving economic and political governance in the continent.

The effectiveness of mechanisms for combating financial crime is contingent on the quality of information and the capacity to generate and manage this information. Such capacity is in short supply in the majority of African countries. Most countries lack an adequate stock of qualified forensic statisticians, investigators, and financial crime prosecutors. They also lack adequate supply of specialized technology and equipment for collecting, processing, and storing specialized information on financial crime. African governments therefore need to invest in capacity building in the investigation and prosecution of financial crime. The donor community can make a substantial impact by providing support to this initiative. Thus far, funding for capacity building for agencies involved in financial crime prevention and prosecution has been *ad hoc* and limited. Yet a dollar of aid invested in this area can have large multiplier effects, as the returns to human capital development are magnified by gains in public resources generated and retained onshore.



## *7.2 Strategies at the continental level*

The effectiveness of national initiatives in combating financial crimes is often hampered by inadequate coordination, harmonization, and cooperation across African countries. National legislations do not always agree on what is considered a prosecutable financial offense, and this opens avenues for agents to evade taxes, move money illegally across borders, and launder it in banking systems. For example, a case study on Botswana, Tanzania, and Zambia found that, while Zambia recognizes abusive transfer pricing as a crime, the other two countries do not (Goredema, 2011, p. 14). Such discrepancies are widespread across the continent. The harmonization of legislations across countries is necessary to close avenues for “criminal arbitrage” across national boundaries.

Continental-level conventions offer a framework to work towards the harmonization and coordination of national initiatives. The most comprehensive existing framework is the African Union Convention on Preventing and Combating Corruption (African Union, 2003). The most recent initiative is the High-Level Panel on Illicit Financial Flows by the United Nations Economic Commission for Africa, established in 2012 following a resolution of the 4th Joint Annual Meetings of the ECA/AU Ministers of Finance, Planning, and Economic Development in Africa in March 2011. The mission of the High-Level Panel is to mobilize political attention in the continent on the issue of illicit financial flows, and to propose strategies that African countries can take individually and collectively to stem these flows and to repatriate stolen assets.<sup>14</sup> Going forward, African countries will need to develop mechanisms that grant effective enforcement capacity to continental-level initiatives to complement enforcement at the national level.

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<sup>14</sup> <http://uneca.africa-devnet.org/content/illicit-financial-flows-africa#>

### *7.3 Strategies at the global level*

Stemming capital flight, recovering Africa's stolen assets, and curbing tax evasion must be seen as part of a broader global agenda for establishing a transparent international financial system and a fair tax system across countries. Success on this front can contribute greatly to increasing the overall effectiveness of external development financing, especially by reducing leakages of public debts. The global coalition against capital flight and tax evasion can leverage existing international conventions, legislations, and partnerships, including the United Nations Convention against Corruption, the Stolen Asset Recovery Initiative, the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes, and the UNCTAD-sponsored Principles on Responsible Lending and Borrowing. To be effective, however, these global initiatives will need to be more than talking shops: they need to be granted adequate enforcement capacity. At the moment, global conventions do not have the legal capacity to hold individual governments accountable for the implementation of relevant dispositions; their rules are not binding at the national level.

To succeed, the global compact against capital flight and tax evasion requires strong and sustained commitment by national leaders in major advanced economies. National legislations in advanced countries that specifically target financial crime, corporate corruption, and tax evasion include the U.S. Foreign Corrupt Practices Act, the US Banking Secrecy Act (especially the Suspicious Activity Report) and the UK Bribery Act, among others. It is also important that individual donor countries emerge as champions of particular causes related to financial transparency. The example of Norway is particularly noteworthy in this regard. By implementing a voluntary audit of its loans to developing countries, Norway has set a powerful precedent for responsible lending practices, one that other lenders and donors should follow if they, too, are

committed to financial transparency and anti-corruption. The donor community can also advance the fight against capital flight and tax evasion by allocating more resources to institutional capacity building in Africa, including the establishment and strengthening of financial intelligence units, the provision of specialized technological infrastructure for tracking and monitoring illicit financial transactions and tax evasion, and training in forensic financial investigation and other specialized techniques.

Global networks of civil society organizations dedicated to financial transparency and accountability can play a major role in supporting Africa's efforts to combat capital flight and tax evasion. To be effective, these networks need to work more closely with local civil society organizations in Africa, create local branches and strengthen those that already exist, and establish more effective mechanisms for systematic and rapid exchange of information. At the moment, actions by these global networks on the ground in Africa remain *ad hoc* and disparate. Much still needs to be done to coordinate activities and institutionalize collaboration among networks so as to maximize their impact on the campaign against capital flight and tax havens.

## **8. Conclusion**

The evidence in the literature has established that capital flight is a critical challenge to economic development in African countries. The problem is serious and won't go away on its own. It is urgent, therefore, to mobilize political capital around strategies to prevent further financial hemorrhage from Africa by curbing capital flight and repatriating the continent's stolen assets. This effort ought to become an integral part of national and global policy debates, especially in the design of the post-2015 sustainable development agenda.

As emphasized in this paper, “making capital flight history” will require concerted and coordinated actions across national, regional, and international levels. Progress has been made in recent years, but much still remains to be done. Going forward, the focus in general should be less on creating new institutions and frameworks and more on increasing the effectiveness of existing ones. At the national level, actions should be aimed at breaking the vicious cycle of high capital flight and bad governance, and establishing an environment that fosters a virtuous cycle where good governance and low capital flight reinforce each other. The focus should be on the enforcement of mechanisms and institutions of transparency and accountability. This would involve strengthening the capacity of specialized entities, such as financial intelligence units, to enable them to effectively track down, collect, and process information on financial crimes, as well as strengthening legal structures for their prosecution. The effectiveness of official institutions in fighting corruption and preventing capital flight is contingent on the existence of a dynamic network of civil society entities committed to financial transparency and accountability. Civil society needs to be given ample space to operate as a counterbalancing force to executive power. In turn, civil society must take advantage of the increasing attention to the problems of capital flight and tax havens at the continental and global levels, leveraging the opportunity to consolidate action plans in the fight against illicit financial flows.

The design and implementation of the various strategies proposed in this paper will be particularly challenging in countries with weak institutions and high political instability, including so-called “fragile states”. These countries face a relatively higher risk of capital flight. Moreover, the leadership in these countries often has neither the will nor the capacity to undertake effective anti-capital flight reforms, as these would undermine its own political and economic interests. Progress in such settings will require strong involvement on the part of the

continental and global community to support institutional and political reforms as well as capacity building in relevant areas of governance.

At the continental level, with the African Union Convention on Preventing and Combating Corruption as the institutional anchor, the High-Level Panel on Illicit Financial Flows created by the United Nations Economic Commission for Africa in 2012 must lead the way in mobilizing political awareness on the problem of illicit financial flows and coordinating knowledge generation and policy dialogue aimed at supporting the fight against capital flight and tax evasion at the national level. African governments and their development partners need to commit adequate resources to support the AU and the High-Level Panel in their mandate to root out corruption and prevent illicit financial flows from the continent. African civil society, in turn, needs to rally behind these continental initiatives to ensure that they deliver on their mandates and do not get bogged down with political interference or hijacked by interest groups, especially politically exposed persons.

The global environment has changed substantially in the past decade, and today it offers fertile ground for pushing the agenda on combating capital flight and illicit financial flows from Africa. Here again, efforts must center on strengthening the operational effectiveness of existing institutions and conventions. In addition, the establishment of a body to adjudicate questions of debt legitimacy would add an important missing piece to the current international financial architecture. The coordination and harmonization of regulatory frameworks and enforcement mechanisms are critical to increase effectiveness in preventing illicit financial flows and tax evasion, and in facilitating stolen asset recovery. The emergence of champions of transparency and accountability in international lending and borrowing is a welcome development. In this

context, Norway's decision to institutionalize the audit of its loans to developing countries is a path-breaking initiative. If other donor countries and multilateral institutions are truly committed to promoting good governance and supporting developing countries in their quest for financial independence and sustainable development, they, too, must embrace the systematic audit of public loans and grants to foster transparency and accountability in public resource management. At the same time, the developed countries should exert concerted efforts to pierce the veil of secrecy in international financial transactions. A more transparent international financial system will benefit developing and developed countries alike.

In sum, the challenges posed by capital flight and tax havens are great, but so are the opportunities for progress in building a more effective and accountable global financial system.

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