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Nigeria: The Origin of Illicit Financial Flows in Africa

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Abstract

The article examines the genesis and persistence of the pernicious losses of resources earned on the African continent in the form of illicit financial flows. Several ways by which these illicit flows occur are dilated upon revealing the phenomenon to be not uniquely but predominantly African in nature. The complicity of actors on the African continent is also underlined and the hydra of corruption is roundly implicated. Even more intractable does the problem seem when both criminal and legitimate influences converge to bleed the continent of her hard earned wealth. A vicious cycle ensues when these resources are loaned back to impoverished nations on the African continent with prohibitive consequences for development. The article also identifies the Nigeria situation as the most significant exemplar of this problem due to the abundance of resources at the mercy of these losses. The developmental impact of these losses is also identified. Finally, the Tax Service was suggested as the key agency capable of checking these loopholes by bringing the illicit flows into the light of transparency and accountability through supervising improvements in interagency cooperation.

Keywords: Illicit financial flows, mispricing, corruption

Introduction

For many years, Africa has laboured under the epithet of "Dark Continent", which condenses all that her people have had to endure in terms of exploitation, disempowerment and underdevelopment. The bane of underdevelopment in particular has been attributed to many factors some of which are enabled by actors on the African continent, while others are actively facilitated from abroad. Ever since the resolutions reached at the Berlin conference in 1884 and the eventual scramble for and partition of Africa, it would seem that the direction of the flow of the continent's resources has always been outward. In recent times however, this outward flow has taken on different ramifications ranging from the illegal trade in arms financed by African diamonds, the theft of national resources and the facilitation of oil bunkering by corrupt officials of government, to white collar crimes such as commercial tax evasion and money laundering. All these activities which culminate in the outward flow of value from the African continent are encapsulated under the rubric known as illicit financial flows.

Illicit financial flows are not specifically an African problem but these flows of value are likely to thrive best in economic climates riddled with poor structures and considerable volatility. The fact that they are all illicit does not make them all illegal; it only speaks to the intentionality of an action or a set of actions with potentially deleterious consequences for the most vulnerable segments of the population in the countries from where these flows emanate. These losses when aggregated, are significant enough to potentially jumpstart the actualisation of significant capital investment and infrastructural development, the elimination of external debt and the provision of some form of social welfare for Africans in peril of utter privation.

Reality suggests that many existing laws may not be robust enough to stem this crimson tide of the continent's lifeblood since the perpetrators could claim that they have not broken any laws. In other instances of illicit financial flows, the activities are outright illegal and are carried out with the complicit knowledge of some officials in the regulatory bodies tasked with preventing these occurrences.

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Illicit financial flows occur from a multiplicity of sources on the continent several of which are of grave consequence to the economic future of several African nations. This problem can be likened to a person who bleeds from multiple wounds, most of which are arterial while others are subdermal irritants. Fighting this battle against illicit financial flows may be difficult but not impossible. The first step is usually to identify what constitutes these financial flows; this is done in the next section.

The Underpinnings of Illicit Financial Flows in Africa

A holistic definition of illicit financial flows may be ambitious at best and impractical at worst but it is possible to identify the key components of this issue. For the sake of clarity, illicit financial flows will be defined as: Money that is illegally earned, transferred or utilized. These funds typically originate from three sources: commercial tax evasion, trade misinvoicing and abusive transfer pricing; criminal activities, including the drug trade, human trafficking, illegal arms dealing, and smuggling of contraband; and bribery and theft by corrupt government officials. Global Financial Integrity (2014)

The phenomenon of illicit financial flows has been the subject of extant research and has since been grouped into three broad categories. According to Kar and Cartwright-Smith (2010), illicit financial flows are estimated to be composed of commercial activities (65%), criminal activities (30%) and corruption (5%). These estimates are based on existing data and informed approximations but it is believed that the actual breakdown of illicit financial flows should reveal a greater percentage contributed by corruption especially in countries like Nigeria. Each of these drivers of illicit financial flows will now be considered in turn.

Commercial activities

This component arises from business related activities. There is also a measure of complexity here because clearly delineating between the exploitation of existing policies ethically, and the use of the same policies in a way which could eventually prove inimical to the system or business environment, is not without its challenges. Businesses can successfully engage in legal brinkmanship because they have both the will and the resources to retain the best minds in legal and financial matters who can employ their skills in interpreting the law to exploit loopholes and secure lucrative advantages for their clients. The end result is that these organisations are able to avoid compliance with several regulations to the detriment of the country where they engage in business.

By virtue of their commercial pursuits, companies such as multinational corporations are prepared to understate their profits, aggressively avoid taxes or outrightly evade them. Such actions lead to an erosion of the tax base and could constitute worrisome capital flight and profit shifting. These companies declare the majority of their profits in economic environments where taxes are negligible even though these profits which emanated from an African country, should legally be taxed where they were earned. Other ways by which illicit financial flows occur from commercial activities in Africa include:

a. *Abusive transfer pricing*: This occurs when a multinational corporation uses it presence in multiple business environments and its ownership of multiple subsidiaries to move its profits across several tax jurisdictions. It is not a crime for different subsidiaries of a multinational corporation to trade with each other if they trade at comparable prices to what they would have agreed with other unrelated companies. A fair and comparable price would ensure that they are not guilty of tax base erosion and profit shifting. For instance, a multinational could decide to get a subsidiary in a low tax jurisdiction to purchase at heavily inflated prices from another subsidiary in a higher tax jurisdiction. This would ensure that the more heavily taxed subsidiary declares losses because most of their profit was moved to low or zero tax environments under the cover of unrealistic transactions. Several cases of abusive transfer pricing have been reported on the African continent. The Tax Justice Network (2014) and the AU/ECA Conference of Ministers of Finance (2013) identified the case of an African country in which a multinational corporation had operated for over 20 years without paying any taxes because the corporation always reported losses every year.

It was eventually inferred that profit shifting was responsible for this anomaly because if the corporation had been in existence for over 20 years, then the losses must have been fictitious and contrived since no business would continue to operate in an economically inclement environment where they sustained continued losses. Another multinational corporation in South Africa had avoided taxes worth $2 billion by claiming that most of its business occurred in UK and Switzerland who had lower taxes for their line of business.

On closer investigation it was observed that the physical presence of the corporation in these countries was composed of small offices with non-essential staff and business functions. These small offices had never even interacted with the merchandise shipped by the multinational and all the company's customers were in South Africa. The corporation had to enter into an agreement with the South African government to pay reparations over a period of time.

It is a regrettable fact that very few African countries have official monitoring capacities to identify illicit financial flows from abusive transfer pricing and are therefore particularly vulnerable to this problem. A Tax or Revenue Service with a well-trained transfer pricing unit is usually the first step in confronting this problem.

b. *Trade mispricing*: This refers to the distortion of the facts about the quantity, quality and price of traded goods. Often, this mispricing is done to evade custom duties or to transfer foreign exchange abroad. The understating or underinvoicing of exports is one side of the problem in which a natural resource being exported is declared to be far less in value than it actually is so as to ensure that the taxes on such sales are considerably reduced. Overinvoicing of imports on the other hand, occurs when a local business or individual desires to ship foreign exchange out of Africa by claiming to have paid far more than the actual price for the importation of the goods. The payment for these imports are usually handled by a subsidiary or a shell corporation who would have prearranged with the importer to secrete the difference in payment into an international account of his choice. Sometimes, this mispricing occurs alongside the transfer pricing earlier mentioned. A colossal loss of value results for the originating country of these resources. For instance, a report by Chatham House pointed out that Nigerian crude oil is being looted on a large scale by the use of trade mispricing to the extent that up to 100,000 barrels leave Nigeria daily without a commensurate payment for the value (Katsouris & Sayne, 2013). A key reason identified for the ease with which exporters execute this mispricing manoeuver is that many countries in Africa do not have independent means to verify the quantity of resource obtained from their shores and simply depend on the figures reported by the exporter. This approach is not sustainable because the goals of the exporter are hardly consonant with the interests of the resource rich country.

c. *The misinvoicing of services and intangibles*: This occurs simply because no real standards exist to evaluate services such as management fees and intellectual property such as the value of brand names. Services now constitute a burgeoning share of global trade and the absence of comparative price information for these intangibles has given conglomerates and multinationals the leeway to engage in arbitrary overpricing of these services. Such overinvoicing could transfer huge sums away from the tax base of the countries where these services were delivered to low tax jurisdictions elsewhere. One instance of this practice occurs in the telecommunication industry in Africa where operators illegally divert international calls by transforming them into local calls. It is now commonplace to receive international calls for which a local number would be displayed as the caller. When this occurs, the tax payable to government is reduced since international calls attract a larger tax percent than local calls. According to the AU/ECA (2013), some African countries lose up to $90 million every year through this racket. A reason for the persistence of illicit financial flows through services is that most governmental regulatory agencies in Africa lack adequate information and the expert capacity to be assertive in their dealings with these defaulters who are almost always multinationals.

d. *Unequal contracts*: Many concessions and licenses for the exploration and extraction of natural resources in Africa are often the product of some shady backroom deals which result in an official payment of a mere fraction of the true value for the license, and several unofficial gifts and compensations to the officials of the agency issuing the license. The extracting multinational corporation is usually fully aware of the true value of the resource license but very often, the resource-rich country is poorly informed. These exploitative contracts could occasionally be a product of stark need and desperation on the part of the African nation; for instance, countries who are recovering from a long period of conflict or who have a history of political volatility are usually at the mercy of these foreign multinationals who negotiate from a superior position.

The corporations who secure these deals capitalise on the absence of infrastructure and the risk of the venture to demand outrageous concessions. Conversely, the government officials who agree to these deals are not prepared to hold out for the best deal possible since their emphasis is on personal financial concerns and short term gains. The extractive company could also be partly owned by someone in government or someone who is close to an important member of government.

The AU/ECA (2013) reports that the government of Guinea signed a 20-year concession to a multinational for the extraction of iron ore for $165 million in 2008 when the estimated worth of the iron ore mining license in Guinea was close to $140 billion for the same period. This multinational then turned around to resell half of the rights to the mine to another multinational for $2.5 billion. When a new government came to power in Guinea and found out about this deal, the original license was immediately terminated and re-awarded to three firms to the tune of $20 billion. The amount of monies lost to illicit financial flows before this issue was identified does not bear imagining.

Criminal activities

While some of the commercial activities by which illicit financial flows occur can be said to lie just within the law, other outward financial flows are clearly the product of criminal enterprise. Africa has been a fertile breeding ground for all kinds of smuggling activities as well as trafficking of people, drugs and arms. The recent international outcry against the brutalization of immigrants in Libya placed this trafficking in persons at the front of national consciousness especially in Nigeria. White collar crimes such as money laundering, stock market manipulation, blatant forgery and financial sector fraud also contribute to the criminal dimension of illicit financial flows. Some of these include: a. *Money laundering*: This is the process of funnelling monies obtained from criminal activities into legitimate commercial ventures or other forms of businesses acceptable within the law so as to enable these funds to be moved anywhere from financial institutions without raising any red flags. The international community has shown interest in this issue due to the tendency of laundered money to find its way to terrorist organizations for the financing, recruitment and radicalization of extremists. Rayner (2012) reports that some banks in Lebanon and the United States were indicted for their role in helping to launder drug money from Lebanon. This money was shipped in second hand cars through many West African countries to Europe and Lebanon. The UK authorities also identified a former governor of a state in Nigeria as a classic example of money laundering through his use of multiple bank accounts and shell corporations to launder ill-gotten wealth even though this governor was acquitted of all charges of financial fraud in Nigeria (Rayner, 2012). The failures of governance are fingered in the persistence of this problem in Africa.

b. *Organized crime*: As is the case in many parts of the world, criminal syndicates exist in Africa who are big players in the trade of counterfeit goods and the evasion of custom duties. Although their principal activities in the trafficking of people, drugs and arms may not be directly considered illicit financial flows, their income and the attempts to hide it would eventually drive outward flow of money since these finances join the bulk of huge sums being laundered through the financial institutions around the world.

Corruption

Corruption can be said to be the glue which holds the system of illicit financial flows in place. Although it is possible that the contribution of corruption to illicit financial flows may be overestimated due to the publicity and attention such issues generate, many experts believe that since many instances go unreported, they may actually exceed even the most liberal estimates (ECA, 2013). For example, Kar and Cartwright-Smith (2010) believe that Africa is a true anomaly when it comes to cases of corruption because corruption and abuse of power by both elected and appointed officials of government may be a bigger driver of illicit financial flows than previously assumed. The efforts at stolen assets recovery has been long and challenging for many African nations especially Nigeria, and the tax havens around the world who employ secrecy jurisdictions are motivated to be uncooperative due to the influx of foreign exchange these illicit financial flows constitute for them. It is expected that corruption will continue to hobble the strides of underdeveloped countries in Africa except government displays the political will to greatly increase the costs of corrupt behaviour and the likelihood that corrupt officials will get caught (Kar & Freitas, 2011).

Illicit Financial Flows from Nigeria

Nigeria has the unenviable position as the biggest loser in terms of IFFs in Africa. The Global Financial Integrity Report (2014) estimates that Nigeria was ranked the 7th biggest loser globally and the first in Africa. Between the years of 2000 to 2014, Nigeria lost a minimum of $140 billion to illicit financial flows. The biggest culprits were crude oil and commercial activities mispricing followed by corruption and over invoicing of services and contract fees. Nigeria has struggled over decades from a lack of concerted infrastructural development which makes the haemorrhaging of valuable resources particularly deleterious. Illicit financial flows in Nigeria used to be conflated with capital flight but a distinction between the two is necessary. Capital flight can occur when a corporation moves funds abroad due to unfavourable changes in the business climate of the country where these funds were earned.

For instance, policy changes which constrict the business environment and reduce returns are likely to drive investors away for clearly rational reasons and these types of capital flight are totally justified. It is however doubtful that all capital flight occurs or these reasons. Olaniyan (2014) reports that the huge capital outflows from Nigeria can neither be explained nor justified as due to harsh economic realities because investment opportunities are on the rise and conditions for business speculation are particularly favourable. The only valid explanation for these financial movements can be found in ostensible attempts to evade tax. These issues of illicit capital flight cannot be addressed simply by enacting policies to stimulate foreign direct investment.

In fact, the activities of these corporations moving money out of the economy could actually trigger the adverse economic situations which are the very conditions for justified capital flight by the legitimate players in the economy.

The Organisation for Economic Cooperation and Development (OECD) actually takes a stronger position on the issue of illicit financial flows by insisting that they are "…methods, practices and crimes aiming to transfer financial capital out of a country in contravention of national and international laws" (OECS, 2011). This position reduces the scope of illicit financial flows because profit shifting within a firm though not illegal, can be termed as aggressive tax avoidance and therefore illicit financial flow. These movements of profit simply constitute an exploitation of the loopholes in regulations and the Nigerian system of tax laws is particularly vulnerable to this (Ayodele & Bamidele, 2017). In Nigeria, illicit financial flows can be best seen in term of outcomes as any financial flows which have a direct or indirect adverse impact on the long term economic growth of the country where the finances originated (Okonjo-Iweala, 2014).

Developmental impact of illicit financial flows in Nigeria

Nigeria has displayed considerable vulnerability to illicit financial flows especially from the oil and gas sector which is the mainstay of the economy. The United States Energy Information Administration estimates the Nigerian reserves to be between 37 and 38 billion barrels (USEIA, 2010). However, the Nigerian government has perennially struggled with transparency on the actual figures since many competing political and economic interests within the sector are motivated to distort the actual values. Nonetheless, Nigerian reserves are the 10th largest in the world and the 2nd in Africa (Ayodele & Bamidele, 2017). The CBN Financial Stability Report (2014) estimated oil bunkering to be responsible for 35% of illicit financial flows in Nigeria. Another 60 % of illicit financial flows emanate from tax evasion, money laundering, aggressive tax avoidance and misinvoicing mainly by multinational corporations. Although the contribution of corruption is put at 5%, experts acknowledge that this estimate is unrealistic since corruption is the common denominator in all other forms of illicit financial flows, and most corrupt deals go unnoticed since they are very difficult to track. The difficulty of financial monitoring is exacerbated by the growing popularity of *hawala* deals among the majority of perpetrators. *Hawala*refers to an informal system of money transfer between parties in different countries. It is characterised by handshake dealsor agreements with counterparts in other countries to move moneywithout physically transferring funds across borders or using bank transfers. This eliminates both paper and electronic trails necessary for tracking and monitoring. Consequently, Nigeria's loses to illicit financial flows are over $140 billion annually, an amount which far exceeds the official development assistance from foreign creditors (CBN Economic Report, 2014). In addition, the annual infrastructure financing gap is estimated to be at least $31 billion and it is reasonable to surmise that the loss of domestic savings and foreign exchange is worsening the prospect for international development in Nigeria. A clear implication of a potential reduction in illicit financial flows is that it would obviate the need to frequently make recourse to the so-called Bretton Woods institutions for aid.

Nigeria's inability to fully maximise its gains from crude resource wealth could be mainly attributable to illicit financial flows. For instance, royalties from the extractive industry are affected by volume underreporting, value underestimation and avoidance of fee payments. Corporate income taxes are sorely affected by mispricing and overinvoicing even as multinationals misreport on value and quality while consistently inflating operational costs. Government officials also contribute to underdevelopment by actively participating and colluding with multinationals for personal benefit at the expense of the disadvantaged and impoverished majority of the population (Ayodele & Bamidele, 2017). It has also emerged that illicit financial flows actually catalyse the pursuit of more and more foreign aid because by limiting the resources available for capital expenditure, government is forced to seek help from abroad. Debt service payments are another source of resource haemorrhaging which add no real value to the debtor nation.

As such, domestic savings and hard currency reserves are severely depleted by both the antecedents and the consequences of illicit financial flows; this puts resource mobilisation at risk because a significant fraction of resources leaves the system. The Ministry of Finance once estimated that the GDP of Nigeria would have been 34% higher if not for the impact of illicit financial flows (WYEF, 2012). Such constriction of national potential is just a part of what these outward flows have inflicted on Nigeria.

Another concern in the Nigerian socioeconomic milieu is the institutionalisation of corruption. Nigeria has always scored poorly on corruption indices despite the efforts of agencies like the Economic and Financial Crimes Commission (EFCC) and the Independent Corrupt Practices and other related Commission (ICPC).

Despite the various institutions and their efforts aimed at curbing illicit financial flows and related problems, the magnitude of the challenges experienced by these institutions overwhelms their implementation capacities. Most of these institutions face problems such as poor capacity, absence of funding, and in some cases, inadequate support from the judicial system. In addition to these constraints, the situation is further complicated by a lack of harmony between the institutions, the duplication of responsibilities among the different agencies, and inadequate capability to deal definitively with the illicit financial flow problem. The perpetrating corporations themselves actually prefer an economic climate in which they pay a fraction of their obligations in kickbacks to unscrupulous officials instead of remitting the full sum to the national coffers. It is also quite damaging that despite the preponderance of evidence proving the adverse impact of illicit financial flows, several state governments whose leaders currently benefit from the status quo have constituted obstacles to the curtailing of this issue (Premium Times, 2015). This problem is currently a many headed hydra with worrisome ramifications for the future of Nigeria's economy and time is fast running out on the nation to find the hint of a solution (Ayodele & Bamidele, 2017).

Conclusion: Safeguarding our Resources

It is evident from the foregoing that the spate of losses of the valuable resources in Nigeria cannot continue unabated. The following measures could serve as a tourniquet to these outflows:

- The first step in revenue collection and the arresting of illicit flows is to ensure that all corporations, big and small, are registered for tax purposes. In addition to existing registration requirements, no company registration should be allowed to take place without proof of tax registration. In several countries of the world, it is not possible to open a business bank account without proof of registration for tax and Nigeria would do well to adopt and monitor this strategy. The relevant agencies must have adequate capacity to process such registrations quickly and efficiently to avoid unnecessary delays. If the databases of the Corporate Affair Commission (CAC) and the Tax authority could be linked, it would facilitate a more robust and seamless process of documentation

- The practice by which multinational corporations shift profits to subsidiaries in low-tax or secrecy jurisdictions is one of the principal sources of illicit resource outflows. In many cases, these subsidiaries exist only on paper, with not more than two employees, while the majority of the activities of the corporation occur in another country. Nigeria must institute costly consequences for corporations who flout anticorruption laws or who evade taxes with impunity. The government could look into banning such corporations from any future government procurement agreement no matter who the culprit is, how important the technology the offending organisation has to sell is, or how many jobs would be at risk. Nigeria can only successfully prevent illicit financial flows if government musters the political will to drive stringent policies to stem this adverse tide.

- Transparency of ownership and control of companies, partnerships, trusts and other legal entities that can hold assets and open bank accounts is critical to the ability to determine where illicit funds are moving and who is moving them. Government through its watchdog agencies, should require that beneficial ownership information is provided when companies are incorporated or trusts registered. This information must be updated regularly placed on the public record. All parties seeking government contracts must declare their ownership of any interests that could prove beneficial to them. Furthermore, all those seeking government appointments must compulsorily declare their assets and any false declarations should result in stiff penalties.

Other measures to prevent the avoidable losses from these financial outflows include increased regional cooperation among customs and tax authorities on the African continent and an equitable platform for the sharing of information. In the not too distant future, illicit financial outflows would be more manageable than they are today.

This would then provide the much needed economic reprieve this nation currently requires to catalyse sustainable development.

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