



**High Level Conference on Illicit Financial Flows:
Inter-Agency Cooperation and Good Tax Governance in Africa
Organized In Cooperation with United Nations Office on Drugs and
Crime**

Address by Minister of Finance, Mr Pravin Gordhan

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Introduction

Ladies and Gentlemen, welcome to all of you who have travelled from all corners of our continent and thank you for the invitation to address this High Level Conference on Illicit Financial Flows and Good Tax Governance.

Tax crimes, money laundering and illicit flows are part of a complex phenomenon which is undermining good governance, ethical politics, government and civil society programs intended to promote inclusive growth, reduce inequality and improve the standard of living of the poor and lower middle classes on this continent and elsewhere in the world.

I am pleased that you are looking at this matter from an African continental perspective, because our continent is one where illicit flows from and between African countries pose a significant threat to the developmental agendas of our countries. Indeed, in recognition of the matter, the African Union prioritised the need to identify, stop and eliminate these flows out of Africa, giving effect to the sterling work done by the Mbeki High Level Panel on Illicit Financial Flows from Africa¹.

¹ Report of the High Level Panel on Illicit Financial Flows from Africa, Commissioned by the AU/ECA Conference of Ministers of Finance, Planning and Economic Development.

This project recognises the link between tax crimes and the proceeds gained from all manner of criminal activities – organised crime, money laundering and corruption being amongst them. Good tax governance and strong cooperation between law enforcement agencies and tax authorities are essential elements in effectively countering corruption, bribery, and illicit flows. But this requires society to nurture and sustain strong, capable and independent institutions led and operated by public officials who are ethical, public-service oriented and allowed to act without fear or favour against these crimes and those committing these crimes.

The program that you are initiating must ensure that, both in Africa and outside of Africa, in the public but also in the private sector, there is an unimpeachable effort to build ethical, resilient institutions and officials whose integrity is beyond question. A task, I admit, easier to articulate and talk about but difficult to implement. Nonetheless, we can never relent in our efforts, we must all ensure that the right things are done whatever the evil and extractive forces in the private and public domain might be doing in order to sabotage genuine people-oriented democracies and just and fair development across the world.

BACKGROUND

The danger of illicit flows and money laundering is not new to South Africa. It was in fact identified as a priority integral to a tranche of laws which were passed by Parliament almost immediately after the birth of our democracy and was seen as critical. These laws were to enable our integration into the world economy and to ensure that the integrity of the South African financial system was protected from being abused for criminal objectives. The first administration of President Mandela and the first Minister of Justice of the democratic South Africa, the late Dullah Omar, recognised that illicit flows and money laundering pose a “danger that should be taken very seriously by all countries” and failure by countries “to take action against it face not only massive potential financial losses, but a terrible threat to the entire fabric of society.”

Minister Omar characterised money laundering as “the hiding of money, that is, the salting of illicit income in different banks or real estate investments, and the cleaning of money that involves concealing the source of money in various ways”. He gave effect to the recommendations of a 1996 report by the then-SA Law Commission, under the chairmanship of the late Justice Ismail Mahomed, to put South Africa firmly on the road to taking action against money laundering.

South Africa joined the Financial Action Task Force (FATF) in June 2003, along with Russia and became part of the international effort to set common global standards to counter money laundering and the funding of terrorism.

This required that our banks and other financial institutions play a strong role in countering money laundering, including through introducing measures such as ‘know your customer’ requirements for all their clients. South Africa expected the same of attorneys, estate agents and gambling institutions, amongst others, in the country.

Unfortunately, money laundering was not a new experience for Africa as a continent. The late dictator General Sani Abacha is known for, amongst other things, looting at least \$4 billion of public funds in Nigeria during his five year term of office from 1993. Bank secrecy rules were used to hide the proceeds of his crimes with banks in the UK and Switzerland. Unfortunately he was not an exception, but merely dwarfed many others from other countries who engaged in similar activities. As a result, the General Assembly of the UN adopted the UN Convention Against Corruption (UNCAC) in 2003, focusing on those who abuse their office to steal public funds, and recommending an enhanced due diligence and know your customer standards for banks and other financial institutions. South Africa strongly supported this convention and signed up to it immediately in December 2003.

How big is the problem of illicit flows?

The IMF noted in March this year that money laundering, the financing of terrorism and related crimes, can significantly undermine the integrity and stability of financial institutions and systems, discourage foreign investment and distort international capital flows².

² IMF Factsheet, *The IMF and the Fight Against Money Laundering and the Financing of Terrorism* (March 21, 2016).

It noted that such crimes pose a threat to a country's financial stability and macroeconomic performance, with significant spillover effects to other countries in an increasingly interconnected world.

The recent leakage of the Panama Papers, which covered over 11.5 million leaked documents for more than 200 000 off-shore entities, once again demonstrated how wealthy individuals are able to conceal their personal wealth.

Illicit flows are, by their very nature, difficult to quantify with any great certainty. Despite the commitment to action since the early 2000s, if we are to go by reports such as that of the High Level Panel³, illicit flows have increased substantially both in Africa and elsewhere. The continent continues to lose money annually which the Panel estimates at \$50 billion every year, including as a result of tax evasion and the mispricing of trade and services by multi-national companies.

Tax evasion and avoidance

An area in which improvements can make a significant difference to the problem of illicit flows and the focus of much of this conference, is that of tax and customs administration. There should be a focus on increasing the capacity of tax and customs agencies, and on strengthening tax legislation to better address the abuse of the tax system between countries, which takes place through transfer mispricing and other practices. These practices result in a substantial erosion of a country's tax base. This has a significant impact on the fiscal capabilities of governments and their ability to improve their economies and standards of living of their citizens.

Building the capacity to counter transfer mispricing can be a long and sometimes difficult journey, as the South African experience demonstrates. South Africa's transfer pricing legislation was first introduced in 1995 and we are still building our capacity in this regard some twenty years later. The journey has had its successes, with several adjustments to transfer prices in excess of R1 billion each. These are successes we aim to build on, learning from international dialogue and experiences of others through these sort of conferences and other interactions.

³ Report of the High Level Panel on Illicit Financial Flows from Africa, Commissioned by the AU/ECA Conference of Ministers of Finance, Planning and Economic Development.

Several items of the G20/OECD BEPS Action Plan relate to transfer pricing and measures to ensure that profits are taxed where value is created. A report on BEPS Action 11⁴ estimates the magnitude of revenue at between 4 per cent and 10 per cent of global corporate income tax (CIT) revenues, i.e. USD 100 to 240 billion annually. The report notes that "Given developing countries' greater reliance on CIT revenues, estimates of the impact on developing countries, as a percentage of GDP, are higher than for developed countries."

The UN has released a practical manual on transfer pricing for developing countries. These organisations, together with the IMF and World Bank, are also co-operating to provide toolkits and build capacity around transfer pricing. We in Africa need to take advantage of the progress being made internationally and give effect to emerging international standards, including initiatives led by the Global Forum on Transparency and Exchange of Information for Tax Purposes.

The use of complex ownership structures is now the most commonly-used means of hiding ownership and control of assets. It is in the interest of Africa that we quickly develop our capacity to implement the concept of beneficial ownership. Establishment of beneficial ownership is fundamental to detecting and preventing illicit financial flows, amongst other malpractices. This goes hand-in-hand with the elimination of "secrecy jurisdictions".

Non-tax illicit flows

The problem of illicit flows, however, is much wider than just tax evasion. Customs procedures should be improved and modernized in order to reduce the scope for mispricing of transactions. The illicit economy adds another element, ranging from drug and human trafficking to wildlife poaching, bribery and fraud, the attempt to ultimately conceal the proceeds of such crimes give rise to money laundering problems. This problem goes beyond just domestic economies – the easier it is to move illegal proceeds through neighbouring countries and globally, the greater the incentive to commit such crimes.

⁴ Measuring and Monitoring BEPS, Action 11 - 2015 Final Report, OECD, October 05, 2015

HIGH RISK CATEGORIES OF INDIVIDUALS

Certain categories of occupations in both the public and private sector public have come to be recognised as posing a heightened risk for bribery, embezzlement and corruption. This notion evolved out of the collective experiences over the past two decades of a number of instances where people in powerful positions (I must emphasize in both the public and private sector) amassed extreme unexplained personal wealth, kept in financial institutions in the Western world.

Corruption and bribery have two sides to it – those being bribed and those doing the bribing. It captures both the public and the private sector. In South Africa, we recognise that both aspects must be covered in our legal framework, hence our attempt to cover both high-risk individuals in the public and private sectors.

Challenges facing Africa

Amongst the challenges that are facing South Africa is that the African developmental agenda requires the flow of investment and trade between African countries and with the rest of the world. However, illicit money that leaves our continent reduces the amount of resources available to Africa to invest in order to generate jobs and provide critical social services to our citizens and our economies. Illicit flows are not only those flowing out of Africa, but can also be between African countries as well. They may not be restricted to actual money flows, but can also take the form of illegal trading in diamonds or under-pricing of mineral resources amongst others.

Africa must move swiftly to ensure that we have the right legislation in place, updated for the most recent developments and circumstances. We must also ensure that we build capacity, not only of our tax and customs authorities, but of our policing and prosecution services as well.

Effectively dealing with the problem also necessitates that authorities within a country work better and more co-operatively amongst themselves. Strong, effective interagency co-operation between key players like tax authorities, anti-money laundering agencies, and law enforcement agencies is absolutely vital.

This co-operation needs to also extend to co-operation between countries, as illicit activities tend to exploit legal or tax differences between countries.

THE CHALLENGES AHEAD

Let me outline in conclusion some of the challenges we face as countries in Africa, and other countries, in the public and private sector:

1. Firstly, Government is expected to put in place the relevant laws to deal with corruption, the proceeds of crime, and money laundering. Linked to this is the need to ensure that Governments must spend effectively, efficiently and transparently, and take care to build confidence in their economies and amongst their people and improve tax morality. Those who are benefiting from these criminal activities don't want governments to be effective, don't want effective institutions, don't want people of integrity to operate in these institutions. And so each of our societies, each of our countries, is faced with difficult choices to make sure that on the one hand the institutions which are necessary to serve the public interest are viable, sustainable, credible, not interfered with and those who have intentions of undermining these institutions must be controlled in some way.
2. However, no matter how well-drafted and well-intending our laws are, it is utterly useless if we do not have capacity or will to enforce such laws. This is one of the lessons. Even with the political will and capacity, enforcement is not easy – we have to deal with sophisticated crimes or abuses which can be committed by highly connected people with extensive resources.
3. It must be recognised that the lack of legislation that meets the expected standards of FATF recommendations, or poor enforcement, will in all likelihood expose domestic banks and other institutions to significant punitive action including massive fines (e.g. BNP Paribus was fined \$8.9 billion by the USA authorities in 2014).

4. Enforcement systems must have dedicated personnel focused on these complex crimes, to achieve higher conviction rates. One of the challenges is that there is hardly any convictions taking place, and if there are no serious attempts at prosecuting people who are engaging in this activities – who will take us seriously? – Because there are no consequences, there is no deterrence, there is no risk actually taking place.
5. Coordination is key - do not work in silos. Enforcement agencies must coordinate and communicate, domestically and internationally, on financial crime and abuses.
6. Domestic enforcement agencies must take care not to fall into the trap of silo-approaches and territorial battles.
7. Multinational companies must work on improving their business culture and commit to a code of good tax practice, and take active steps to stop aggressive tax structuring practices, and pay their fair share of taxes in the countries where they generate their profits.
8. The OECD's Common Reporting Standards for example, facilitates global transparency and the exchange of information for tax purposes. Enforcement agencies that work well together and present a united front against crime make it very difficult for persons to hide their illegal activities.
9. Critical for international standards to be effective is that all countries, irrespective of power, size or influence must adhere to these standards. We can't have double-standards, where rules are imposed from one part of the world but that part of the world chooses to exempt itself from those rules, either by law or through practice. So the application of the law is absolutely crucial.
10. Developed countries must show more resolve to dismantle all tax havens and disallow their territories and little islands from engaging in such practices. But this is an important point ladies and gentlemen, that we have more and more prescriptive rules being generated in different parts of the world but not

everyone abide by them, and there is no point in having these meetings and conferences.

11. Advanced economies must play their part in ensuring that their companies, Governments and citizens do not abuse their influence and resources when they deal with smaller countries, and this is typical, especially among the 54 countries which we have on the African continent.

Conclusion

Let me conclude by saying, the advent of globalisation and a highly integrated world has meant that economies and their citizens could potentially benefit from easy flow of information and knowledge, goods and services, and human capital. This has the continued potential to lift people from poverty, give people a sense of belonging by being global citizens, which reduces conflict between nations.

But I think we all are learning some lessons about this phenomenon of globalization and more recently, de-globalisation. Whilst we thought we were building a common global citizenship, the lesson from Europe and Brexit is that citizens don't quite identify with the globalization phenomenon. An integrated world also introduces challenges. Our interconnectedness also means that problems in one country can also spill over to other countries, as we saw with the global financial crisis of 2008. Integrated financial systems mean that people and companies can easily and quickly move illicit gains, and thereby hide their origin and nature.

I want to quote Professor Dani Rodrik, as I end:

“As an emerging new establishment consensus grudgingly concedes, globalization accentuates class divisions between those who have the skills and resources to take advantage of global markets and those who don't” (The Abdication of the Left, Dani Rodrik, July 11, 2016).

Thank you very much.