

Illicit financial flows and the extractives sector on the African continent: Impacts, enabling factors and proposed reform measures

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Abstract:

This article is based on research in the literature on illicit financial flows (IFFs) in the context of the African extractives sector. It summarizes the adverse economic, political, and environmental impacts of IFFs and identifies key gaps in current legislation and policy and weaknesses in national tax systems. Specific actions to strengthen the effectiveness of current legal and regulatory measures are proposed.

Legislative and policy gaps and weak taxation systems in African countries have allowed legislation to be circumvented or interpreted by mining companies or governments in a way that perpetuates IFFs, for example through manipulation of local content requirements or transfer mispricing. Weak taxation systems mean that mining companies do not pay tax commensurate with earnings. Where beneficial ownership full disclosure is not implemented, complex corporate structures lead to lack of transparency and linkage to politically exposed persons open to corruption.

To address these shortcomings taxation systems must be strengthened by improving the quality of human resources in taxation agencies. Beneficial ownership requirements should be strengthened, and local content requirements reformed and implemented effectively.

Keywords: Illicit Financial Flows, Money Laundering, African Extractive Industries, Beneficial Ownership Disclosure.

Definition of Illicit Financial Flows

There are different definitions of illicit financial flows (IFFs). As per the normative interpretation, IFFs comprise 'capital taken abroad in a hidden form, perhaps because it is illegal, or perhaps because it goes against social norms, or perhaps because it might be vulnerable to economic or political threat' (cited in Reuter, 2017, Literature Review IFFs). IFFs can also be defined as 'money illegally earned, transferred or utilised,' including corruption and its proceeds, money laundering,

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tax evasion and tax avoidance (cited in Le Billon, 2011, p.2). In this essay the term 'illicit financial flows' is intended to encompass all of the activities noted in the definitions above.

IFFs and sustainable development

Illicit financial flows and measures to combat them are complex areas of international and national economic, development, security, and rule of law policy. They affect, and are affected by, many wider policy objectives and involve many disparate actors across a variety of governmental and non-governmental policy disciplines. Therefore, there is a risk that policies with regard to IFFs might be confusing or badly coordinated and that their implementation may result in lack of sustainability, unintended consequences, or competing priorities. Consequently, IFFs are a priority area for policy coherence regarding sustainable development (OECD, 2014a).

The negative effect of IFFs on development is recognised in the Sustainable Development Goals, which include among their targets the significant reduction by 2030 of IFFs, along with the strengthened recovery of stolen assets and the combating of all forms of organised crime.² Additionally, while IFFs are related directly only to one target, they are relevant to many other targets that are central to the sustainable development agenda.

IFFs and the African continent extractives context

Numerous instruments have been adopted at the international, national, and regional level targeting the extractive industries sector as well as addressing IFFs. However, the effectiveness of these instruments remains limited, as revealed by recent scandals that have tarnished this sector (Lemaître, 2019). Mining companies and government officials are creative and innovative in circumventing legislation designed to combat these illicit practices. Manipulation of the rules in this sector is made possible not only through the support of intermediaries but also the weaknesses in the existing legal systems (African Union Commission, 2019). This implies that although there are existing legal systems, in practice they are not effective.

About 80 countries have abundant prized natural resources such as oil, minerals, forests, or precious stones. These countries often base their economic development on the export of these resources, which represent significant revenues for their economies. In some countries, these resources may account for more than 90% of total exports and 60% of total government revenue (IMF, 2012). The extraction of natural resources can lead to exceptional profits. Well managed, these revenues could represent a great opportunity for the economic and social development of producing countries. However, natural resources are often located in countries with a low human development index, a high level of corruption, and weak legal frameworks and law enforcement (UNDP, 2015). Revenues generated from mining rarely benefit the general population, including indigenous people and local communities, and the exploitation of natural resources is often associated with IFFs (Oxfam, 2009; Williams & Le Billon, 2017).

IFFs represent billions of dollars in lost revenues for countries all over the world. For Africa, lost revenue from IFFs has been estimated as equivalent to the average official development

² See Sustainable Development Goals. Goal 16: Promote just, peaceful, and inclusive societies. Target 16.4. <https://www.un.org/sustainabledevelopment/peace-justice/>

assistance (ODA) and dedicated assistance budget each year (UNECA, 2015). This level of lost revenue dramatically reduces the resources available for essential public services such as education or health, which may undermine achievement of the Sustainable Development Goals.

IFFs within the extractive sector can be explained by numerous factors: the involvement of multiple actors (public officials, national and multinational corporations, intermediaries); the exceptional profits generated; opacity and secrecy; and weak governance (Kolstad & Søreide, 2009). In addition, these resources are located in only a few countries, while most economies heavily rely on oil, gas, and mining products to function. For example, the European Union (EU) imports over 90% of its oil, 60% of its gas, and 40% of its uranium, while China is the second largest importer of oil (European Commission, 2014; IEA, 2016). Therefore, these resources are essential and of major strategic interest to many countries.

According to a study conducted by the Organisation for Economic Co-operation and Development (OECD), the extractive industries (oil, gas, and minerals) sector is the one most prone to foreign bribery (OECD, 2014b). Transparency International's 2017 Corruption Perceptions Index seems to show a link between corruption and the extractive sector: numerous oil, gas and mineral producing countries are at the bottom of the ranking each year. In 2017, out of 180 countries, Angola ranked 167th, the Republic of the Congo 161st, Uganda 151st and Nigeria 148th (Transparency International, 2017).

Corruption in this sector takes the form of petty bribery, grand corruption, extortion, undue influence, embezzlement, profiting from unclear rules, manipulating the law, or turning a blind eye to illegal activities. Corruption takes place at all stages of the value chain: from allocation of licences, negotiation of contracts or procurement of goods and services to revenue collection and monitoring of operations (OECD, 2016). Tax evasion and tax avoidance in the oil, gas and mining sector are also prominent and constitute manipulation through transfer pricing, inflated costs of goods and services, under-reporting of production volumes, underestimation of the value, or treaty and law shopping (Hubert, n.d.). For example, over the period 2000-2009, 56% of trade mispricing from Africa came from the extractive industries sector (UNECA, 2015). Numerous mechanisms and systems, including the use of tax havens, secrecy jurisdictions, legal/regulatory havens and specially designed corporate vehicles, enable the hiding of proceeds from corruption and tax avoidance.³

Some multinational companies are arguably at the heart of cross-border capital movements, in some instances using their power and connections to conceal illegal activities or evade taxes. It has been estimated that over 60 percent of total illicit flows are derived from legal commercial transactions (Baker, 2005). Motivation for IFFs may also be linked to a country's own internal investment risks, such as the threat of expropriation or confiscation of private property, economic and political uncertainty, financial repression, or devaluation. However, the enormous capital outflows from Africa can no longer be explained solely by domestic risks factors (UNECA, 2018). Besides, the local investment opportunities sufficiently outweigh the risks of doing business.

³ 'The term "secrecy jurisdiction" is used instead of tax haven to refer to jurisdictions that specialise in enabling individuals to hide their wealth and financial affairs from the rule of law, more than in enabling multinational corporations to shift tax out of the countries where they operate in order to pay less tax.' Tax Justice Network. <https://taxjustice.net/topics/tax-havens-and-secrecy-jurisdictions/>

According to the OECD, in 2015 all the 54 African countries combined had a joint consolidated tax revenue to GDP ratio of about 19%, whereas Latin American and Asian countries had an average of about 22% and 15% respectively. By comparison, in OECD states the average was 34%.⁴ The OECD notes that a variety of factors affect the ability of countries to generate tax revenues: “the presence of large informal and subsistence sectors, narrow tax bases, and dependence on volatile export commodities.”⁵ Kar and Spanjers (2015) estimate that in 2013, developing countries lost US\$1.1 trillion through IFFs. They note that this estimate is highly conservative because it overlooks movements of bulk cash, the mispricing of services, and many types of money laundering. They further state that about 45% of capital flight ends up in secret financial jurisdictions, and 55% ends up in developed countries. The movement of IFFs from developing to developed countries, where most of the stolen funds and assets are hidden, demonstrates why this is a global problem that requires holistic global efforts and approaches.⁶ The promotion of strong international architecture that is ready to combat and fully eliminate the problem is of prime importance.

African countries are yet to develop country-specific working definitions of IFFs with practical application in the mining sector. The definition provided by the High Level Panel on Illicit Financial Flows provides a useful building block for country-and sector-specific definitions of IFFs (UNECA, 2015). The report’s emphasis on illegality along the leakage chain makes it highly focused, tracking flows that violate laws in the source countries through the transfer process, and their motivation and use (UNECA, 2017). The term illicit is flexible enough to accommodate strictly legal aspects and practices that go beyond established norms, including tax avoidance.

Impact of Illicit financial flows on the mining sector in Africa

Economic impact

The status of domestic resource mobilization in Africa is improving, albeit slowly. Owing to sustained economic growth, revenue collection has increased over the last ten years. Overall, public revenues mobilized internally grew from 17.5 per cent of GDP in 1980 to 22.3 per cent in 2010 (UNECA, 2017). The progress has been underpinned by the improvement of institutions. According to the recent Mo Ibrahim Index of African Governance (Mo Ibrahim Foundation, 2019), public management as an aggregate score increased over the last five years at 1.5 per cent over the period.

This progress, however, masks the damaging institutional impact of IFFs. African economies bear a disproportionate brunt, with the highest IFF to GDP ratio in Africa at 5.7 per cent. Like a vicious circle, IFFs erode the tax base of most African countries, and weakened fiscal

⁴ Radha Kulkarni. “Taking global action against illicit financial flows: The scope of the issue and how can the international community act in support of the 2030 Agenda.” UNDP Blog, October 22, 2018.

<https://www.undp.org/content/undp/en/home/blog/2018/taking-global-action-against-illicit-financial-flows.html>

⁵ Ibid.

⁶ Seleman Yusuph Kitenge. “The Global Dilemma of Illicit Financial Flows: Time for Collective Action.” African Union Development Agency (AUDA-NEPAD), March 27, 2020.

<https://www.nepad.org/news/global-dilemma-of-illicit-financial-flows-time-collective-action>

bases in turn allow the acceleration of illicit practices. Considered on a per capita basis, tax collection has diminished across the continent. “In the EAC and SACU, tax revenue to GDP increased steadily - at a much faster pace in the latter group, largely a South Africa effect. The resource sector played a very minor role in this development, and none in EAC, which is the only group among the five not to report resource revenues “(Mansour, 2014, p. 14).⁷

While natural resource endowment affords opportunities for fiscal transformation, resource-rich Africa remains unable to take advantage of this wealth. In fact, resource-rich African countries have not performed any better than their resource-poor counterparts with regard to revenue mobilization (Ndikumana & Abderrahim, 2010). Several reasons may account for this gap, including the damaging effects of IFFs on institutions. Due to limited fiscal revenues, mineral-rich countries are unable to build the type of capacity necessary to negotiate contracts that place effective restraints on IFFs, formulate policies that are effective and create an efficient tax administration to mobilize fair tax collection from their natural resources (UNECA, 2017).

Mineral-rich Africa is not only collecting less revenue from its natural resources than it should but is also unable to support other sectors of the economy effectively. A negative correlation is observed between resource revenues and non-resource (aid) revenues, even though increased resource revenues may outweigh the loss. For example, the Democratic Republic of the Congo, with an illicit outflow to tax revenue ratio of 373 per cent (Spanjers & Foss, 2015), had an increase in the resource revenue-to-GDP ratio from an average of 17 per cent in the early 1980s to 32 per cent in the late 2000s. During that period, the non-resource revenue ratio dropped from 15 per cent to 7 per cent (Ndikumana & Abderrahim, 2010). During the same time in Equatorial Guinea, with a capital outflow to tax collection ratio of 138 per cent, the resource revenue-to-GDP ratio increased from zero to 35 per cent, while the non-resource revenue ratio dropped from 20 to less than 2 per cent (UNECA, 2017).

If efforts to curb the over \$50 billion in IFFs leaving Africa were successful, the continent would be more than able to meet its infrastructure needs, a binding constraint to economic growth (UNECA, 2015). UNECA projects that by targeting readily attainable objectives in terms of modernizing tax administration, governments could generate an additional 50 billion in tax revenues within the next five years alone (UNECA, 2017). All countries including African countries have no option but to look inward, making every effort to seal capital flight gaps as aid levels dwindle and become relatively marginal for meeting the seventeen Sustainable Development Goals. Notably, it will cost the world over \$4.5 trillion in state spending to meet the endorsed SDG 169 targets. This is 33 times the total overseas development assistance for a year (UNECA, 2017).

Political

The corresponding relationship between IFFs and governance is complex. IFFs impact both strong and weak states, albeit to varying degrees. However, there appears to be a weak correlation between degrees of IFFs and common governance barometers, including the Fragile

⁷ The five groups referred to are “...the East African Community (EAC), the Economic Community of West African States (ECOWAS), the Economic and Monetary Community of Central African States (CEMAC), the Southern African Customs Union (SACU), and the West African Economic and Monetary Union (WAEMU).” Mansour, 2014, p.14, footnote 12.

States and Corruption Perception Indices, as well as the World Bank's Country Policy and Institutional Assessment (CPIA) (Spanjers & Foss, 2015). The "the paradox of plenty"- the great mineral wealth which exists side by side with pervasive poverty in Africa and the need to push for continent-wide legislation on access to data and statistics from revenue and profits analysis on this has been in discussion for a long time at the African Union level.

This suggests that IFFs constitute an African and global problem. IFFs undermine political governance in African countries rich in natural resources as well as the destination countries. Capital flight from mineral-rich states provides an avenue for the breakdown of lawfulness and opens an enabling environment for corruption and its devastating impacts on domestic revenue collection institutions. Laundered money often reroutes its way back into the political system, eroding trust in the judicial system, as well as politics. Over 80 per cent of mineral-rich African countries associated with high IFFs underperformed in the areas of the rule of law and government effectiveness, according to the recent Natural Resource Governance Index (NRGI), an accountability and transparency tool for the mining sector (NRGI, 2017). More than 50 per cent of the poorly performing countries were from Africa (UNECA, 2017).

Environmental

The boom in extractives and exploration of natural resources in Africa poses major risks of environmental degradation and a source of corrupt practices leading to lack of transparency and an increase in IFFs.

The criminal component of IFFs also results in widespread and systematic degradation of the environment. While it is difficult to establish clear causation, it is reasonable to assume that the under-pricing of African minerals will accelerate their depletion. Under-reporting the timber exports from a country like the Democratic Republic of Congo, for example, accelerates the deforestation of one of the world's critical ecosystems (Greenpeace, 2008; UNECA, 2017). Abusive transfer mispricing of minerals may also under-price the environmental cost of mine closures, leaving the state to assume the liability, with a lasting impact on the population's health and safety (UNECA, 2017).⁸

Conditions that enable the persistence of IFFs in the extractives sector

Gaps and unintended consequences of legislation and policy on IFFs

In the last decade, innovative legislation has been introduced at the national, regional, and international level to reduce opacity, combat IFFs and promote the sound management of the extractive industries sector. However, in some instances, legislation has been modified or interpreted in a way that allows mining companies or governments to continue to perpetuate IFFs, as highlighted by recent scandals that tarnished the sector (Lemaître, 2019). Modifying the rules of the game is achieved through the support of middlemen and the existence of weak legal systems and tools (African Union Commission, 2019).

⁸ The underpricing of mine closures means less funds are available to meet the cost of mitigating the adverse environmental impacts of the mining process and the abandoned mine sites.

Most countries lack a consistent whole-of-government policy framework, and while there is increasing awareness of multinational companies' practice of avoiding tax in the sector, no clear working definition of capital flight exists in any of the mineral systems (UNECA, 2017). Some countries have incorporated various anti-avoidance measures into their policies, laws and regulations, targeting precise features of IFFs including transparency and accountability, corruption, money laundering and financing of terrorism. In the meantime, business investment initiatives created to attract overseas direct investment in the sector are excessive and not aligned with domestic resource mobilization objectives. Due to tax exemptions in the sector, tax authorities in countries like Zambia are losing over \$1.6 billion annually in foregone tax revenue (UNECA, 2017).

Beneficial ownership disclosure in the extractive sector- 'a path fraught with pitfalls'

Knowing who really owns a company has been a key advocacy theme for civil society organisations combatting secrecy and opacity within the extractive industries sector (see for example NRGI, 2016). Disclosing beneficial ownership is a great deterrent to IFFs, because knowing who really owns a company is important when, for example, revenue collection authorities wish to check whether a company has paid its taxes commensurate to earnings. Complex corporate structures have enabled both public and private actors to hide who directly or indirectly ultimately owns a company, which may contribute to concealing suspicious activities. Transparency of beneficial ownership makes it possible to determine whether the company is linked to politically exposed persons open to corruption.

In the last couple of years, the issue of beneficial ownership disclosure has been at the forefront of the Extractives Industry Transparency Initiative's (EITI) work to improve the transparency of the extractive industries sector. In 2013, the EITI Standard was revised to include, among other things, a provision on beneficial ownership, (EITI, 2015a, Requirement 3.11, pp. 24-5). EITI also launched a pilot project that was conducted between 2013 and 2015 to assess the feasibility of requiring beneficial ownership disclosure. Eleven countries took part in the pilot project (Burkina Faso, the Democratic Republic of the Congo, Honduras, Kyrgyz Republic, Liberia, Niger, Nigeria, Tajikistan, Tanzania, Togo and Zambia). Lessons learned from the pilot project led to a series of recommendations to revise the EITI Standard, and in February 2016 a new measure was introduced requiring implementing countries to disclose beneficial ownership information in their EITI report from 1 January 2020 (EITI, 2015b; EITI, 2017, Requirement 2.5, pp. 19-21).

According to the EITI Standards, "[a] beneficial owner in respect of a company means the natural person(s) who directly or indirectly ultimately owns or controls the corporate entity" (EITI, 2016, p. 3). Hence, a beneficial owner is never a corporation but always an individual or individuals.

Most implementing countries have not adopted legislation on beneficial ownership, and this lack of suitable legal instruments has made it difficult to enforce beneficial ownership requirements. For example, in the Democratic Republic of Congo (DRC), although Congolese law does not define beneficial ownership, a non-binding definition was proposed by the national multi-stakeholder group in charge of the EITI, hence the reason beneficial ownership is not fully

effective on its own, since it lacks legal force and is therefore difficult to enforce (ITIE-RDC, 2015). However, as it is not mandatory for companies to disclose beneficial ownership information, several extractive companies did not provide the information, or only partially responded to the questionnaire submitted by the multi-stakeholder group in charge of EITI (Minier, 2016). Some companies also made the choice of only disclosing the legal owner instead of the natural person(s) in ownership positions, arguing that, since Congolese law does not require the disclosure of natural persons, they were not obliged to comply with the request from the multi-stakeholder group in charge of EITI (ITIE-RDC, 2015).

Another way in which the effectiveness of beneficial ownership is undermined relates to the establishment of an ownership threshold, i.e., a threshold below which extractive companies would not be required to disclose their beneficial owners (EITI, 2017, pp. 20-1). In the DRC, a threshold of 25% was proposed while in Liberia the threshold is 5% (EITI, 2015b). Setting up a threshold means that natural persons under the agreed threshold will not be required to disclose their identity. This situation can undermine transparency efforts and provide an opportunity for opacity and concealing the identity of the ultimate owner. For example, in the DRC, the EITI pilot project highlighted that an important number of beneficial owners of extractive companies held less than 25% of the companies, and thus were not required to disclose their identities. There is a significant risk that beneficial owners will restructure their participation percentage to be below whatever threshold is chosen (Sayne et al., 2015). To ensure full transparency of beneficial ownership, it would be best if no threshold were applied.

Despite the potential pitfalls, disclosure of beneficial ownership is an important instrument to improve transparency and deter corruption. More and more countries are establishing publicly available registries of beneficial ownership of companies, including EU Member States through the effective use of the 4th anti-money laundering directive.⁹

Local content requirements: Current loopholes in a measure for curtailing IFFs

Over the last few years, many resource-rich countries have introduced legislation or specific provisions known as "local content policies" or "local content requirements" into their regulatory frameworks. The objectives of these policies are to create jobs, promote enterprise development, and increase the transfer of skills and technologies at the national and local level so that the country as a whole benefits from extractive activities.

Local content rules can take various forms: they can be quantitative (i.e. when targets or quotas are set to be achieved by companies) and/or qualitative, i.e. when they require technology transfer, training of staff and the like (Ramdoo, 2016).

Although local content policies were designed to shape and strengthen economic development, they have been misused and manipulated to generate corruption, elite capture and rent seeking in various instances (OECD, 2016). This led to the conclusion that local content requirements have "a dual nature", with some business entities viewing local content policies as a means of appropriating rents (OECD, 2016). The literature highlights cases where public officials "encouraged" or even required foreign companies to enter into partnerships with

⁹ See Council of Europe. (2019). "Project to assess compliance of EU Member-States with the 4th EU Anti-Money Laundering Directive (4 AMLD Project)." <https://www.coe.int/en/web/corruption/projects/4amld>

specifically designated local companies to operate in the country. These local companies were eventually revealed to be shell companies with disguised ownership or in which politically exposed persons and their proxies held interests (Martini, 2014).

Other schemes include foreign companies establishing a consortium with local companies ultimately owned by government officials to win a bidding process for licenses. Local content legislation can also be drafted to favour legal entities with close connections to public officials. In that regard, the Republic of the Congo's local content provisions are interesting. The Republic of the Congo presented to parliament a revised code on hydrocarbons in March 2015 with the objective of modernizing its oil and gas legal framework. In addition, extractive companies aiming to exploit oil and gas in the Republic of the Congo were required to partner with one or more "national private companies," i.e., a company incorporated and having its headquarters in the Congo and of which more than half of the shares are either held by Congolese nationals or by legal entities of which more than half of the shares are owned by Congolese nationals. A minimum share of 15% in the oil contract must be granted to these national private companies when a contract is awarded after the entry into force of the revised code. The share shall be up to 25% when an oil permit is renewed.

At first glance the requirements in the revised code in hydrocarbons adopted by the Congo seem to promote local content. Nevertheless, when one looks at the provisions in detail, it is striking to see how these rules could be perverted to perpetrate IFFs. Indeed, the code remains unclear in several places, opening a loophole that could allow the government to require extractive companies to work with local partners in which it has an interest. Article 143 of the code states that each extractive company must select national private companies to conclude an oil contract, but it does not specify how the national private companies should be selected, when the selection should take place or on the grounds on which it should be made. The answers to these questions could allow the government scope to intervene in the selection process and influence the extractive company's choice of partner.

Local content policies are not the only weak spots used by extractive companies and governments to circumvent legislation and initiatives designed to combat illicit practices. Other areas such as mandatory social contributions and subcontracting are increasingly favoured by some companies and governments to preserve their interests. For example, suspicions of corruption were raised after Statoil disclosed in 2015 that it paid Sonangol in Angola EUR 6 million for the Sonangol Research and Technology Centre, a research centre that apparently "exists only on paper" (Statoil, 2016). These payments were part of its mandatory social contributions included in its oil contract. Other extractive companies such as BP and Cobalt International Energy have also funded this mysterious research centre. In March 2017, the Securities and Exchange Commission (SEC) in Angola informed Cobalt International Energy that it had initiated an informal inquiry regarding the Sonangol Research and Technology Centre, but in January 2018 it ended its investigation and did not bring an enforcement action against the company.¹⁰

¹⁰ See Jaelyn Jaeger. "Cobalt: SEC ends second FCPA probe." *Compliance Week*, Jan 31, 2018. <https://www.complianceweek.com/cobalt-sec-ends-second-fcpa-probe/8819.article>

Lack of Policy and legislative reform; a loophole along the entire mining value chains

Transfer mispricing is one of the sources of IFFs from the extractive sector in Zambia, for example, which is said to have lost nearly 10 per cent of its GDP every year as a result of corporate tax avoidance schemes, including transfer mispricing, since the extent and efficacy of policy and legislative systems differ from state to state (UNCTAD, 2020). All case-study countries included in UNECA 2017 (the Congo, South Africa, Tanzania and Zambia) have some sort of legislation in place to curb transfer mispricing, but many have yet to formulate specific complementary regulatory guidance. The Democratic Republic of the Congo introduced a provision on transfer pricing in its Law No. 004/2003 of 13 March 2003 reforming tax procedures (UNECA, 2017), but no specific guidelines exist to date for determining the transfer pricing positions of multinational companies. Countries including South Africa, Tanzania and Zambia have created specific guidelines on transfer pricing. The penalties levied by South Africa and Zambia are much lower than similar mining countries like Chile and Australia, with average fines in the former countries between 40 and 50 per cent (including interest) of those in the latter for transfer mispricing deals designed to evade or minimize tax liabilities.

Excessive leveraging conducted by mining companies is a pivotal source of the erosion of the domestic tax base. The measures adopted to avoid this are ineffective and incorporate destructive seeds. Since interest gained from debt can be deducted from tax liabilities, mining companies have a strong tendency to borrow internally from their allied companies, rather than increase their capital through selling their shares. In comparable advanced countries, like Canada and Australia, debt-to-equity ratios are much lower (UNECA, 2017). Except for South Africa, no African countries have adopted the earnings stripping approach, which limits the interest as a portion of earnings that may be deducted from taxable income (UNECA, 2017).

Regarding the tensions between national and global systems

The scope and detail of the structure of global standards appropriate to IFFs puts severe constraints on countries' capacity to make policy decisions that are independent. Countries can, in principle, choose not to become a party to the conventions, standards, and initiatives (OECD, n.d). Nevertheless, the costs of doing so are high, since non-participation may lead to non-reciprocation and potential blacklisting by other states, loss of access to global financial markets or credits, as well as sanctions and countermeasures. Countries that do participate in the global framework to combat IFFs have significant constraints on their discretion. International standard-creating bodies oversee compliance, implementation, and effectiveness, using peer review mechanisms to assess whether the standards are properly applied. Maintaining the capacity required to comply with standards and to monitor implementation can be burdensome and expensive, especially for poor countries.

The international community has made progress over the last decade in improving the way in which it evaluates applications to join or subscribe to international standards. Both these approaches, either to become party to an international convention or not, take a more meaningful view of implementation, placing more weight on how a country has practically addressed the IFF threats it faces, and minimizing the emphasis on steps which may not be appropriate, or on formal obligations that are not practiced. This has led to the development of much-needed flexibility in

the assessments of different levels of assets and capacity (Barasa, 2018). The risk-based approach adopted by the Financial Action Task Force (FATF) on money laundering and countering the financing of terrorism is good example. This approach requires countries to assess their effectiveness and technical compliance through mutual evaluation. It helps countries assess risks of money laundering, terrorist financing and other risks they are exposed to and to apply proportionate measures to counter and mitigate them.

There is a wide policy space between mandatory, global standards and their implementation in the unique context of each country. There are no global standards that can specify how every country is to implement the requirements, and each country must adapt the requirements into a form that is in alignment with their legal, administrative systems and policy aims (OECD, 2014a). This creates a pressing need for policy coherence at the national level, and for coherence in the context of implementation as well as of policy.

Measures to combat IFFs

Strengthening legal and policy frameworks to promote transparency and mobilize domestic resources

Good governance is vital to raising adequate domestic resources and sealing gaps that allow IFFs. This involves the ability to develop and implement effective strategies, policies, laws and regulations that facilitate optimal revenue mobilization from the mineral sector. At the lowest level, this involves minimization of capital outflows and, at best, removing resource-mobilization impeding activities along the mineral value chain. Governance of domestic resource mobilization is also shaped by institutional and political economy factors, at both national and international levels. Incentives for IFFs stem from policy and compliance loopholes, permitting foreign and domestic interests to benefit from tax evasion and institutional weaknesses. In addition, corrupt revenue administration undermines the enforcement of policies designed to hinder IFFs.

To challenge and fight IFFs within the extractive industries sector, the international community has undertaken various actions and initiatives over the last two decades. International instruments to combat corruption were adopted by the OECD's Anti-Bribery Convention in 1997 (IMF, 2001), the UN Convention against Corruption in 2003 (UNCAC, 2004), the UK's Bribery Act 2010 (UK, 2010) and the French 2016 Law on Transparency and Bribery (Sullivan & Cromwell LLC, 2016).

More and more extractive companies are putting in place compliance programmes to prevent corruption, either through the development of their own programme or the implementation of anti-bribery standards such as ISO 37001:2016 (a standard adopted by the International Organization for Standardization in September 2016 that provides guidance for establishing, implementing, reviewing, and improving compliance programmes (ISO, 2016). Along with the fight against corruption, commitments have been made to revise international taxation regulations, notably through the OECD Base Erosion and Profit Shifting Action Plan, also known as the BEPS Action Plan (OECD, 2013).

Some of the measures covered in the BEPS Action Plan include automatic exchange of tax information, international exchange of country-by-country reports between tax

administrations, and modifications of tax treaties. Even though these measures do not specifically target the extractive industries sector, they do provide a response to the challenges encountered in this sector.

Instruments have also been designed to precisely combat IFFs within the extractive industries sector. EITI was launched in 2003 to "promote the open and accountable management of natural resources" and improve transparency (EITI, 2017). EITI is composed of representatives from governments, the private sector and civil society organizations. More than 51 countries that are rich in oil, gas and minerals are presently complying with the "EITI Standard".

The EITI Standard demands that "implementing countries", that is countries that have joined the Initiative, disclose a wide range of information, such as companies' payments, government's revenues, revenue allocations, and social and economic spending (EITI, 2017). Voluntary in nature, EITI only applies to countries that have joined the Initiative. Currently, several extractive countries such as Kenya and Angola are not part of EITI, which undermines transparency efforts undertaken throughout the sector. The adoption of EITI by all extractives countries in Africa would strengthen the capacity of individual countries and the continent to combat IFFs.

In addition to EITI, home countries of extractive companies have adopted legislation that requires their companies to disclose annually and publicly payments made to governments in which they have extractive activities, on a country by country basis and on a project by project basis. This is, for example, the case for the European Union with the Accounting Directive (2013/34/EU) and the Transparency Directive (2013/50/EU). Similar legislation was adopted in the United States in 2010, in Norway in December 2013 and in Canada in December 2014 (Gaita & Hubert, 2018).

Africa will have to mobilize more revenues in taxes than in aid to achieve its development priorities, and great potential exists for closing the revenue loopholes. The African Development Bank estimates that African governments can raise an additional \$300 billion in tax revenues yearly (ADBG, 2020).

Strengthening beneficial ownership requirements

Disclosure of beneficial ownership is an important instrument for curtailing IFFs, but weak requirements in this area pose a major problem and make it easier for criminals to misuse corporate vehicles and shell companies to hide ownership, to carry out transactions using illegal funds or to cover up illegal activities. All jurisdictions should require their financial institutions to determine the beneficial owner(s), and to ensure that this information is mandatorily available to relevant authorities and institutions. Without the need to gather, verify, keep, and make available information on the real beneficial owners of corporate entities and legal structures, other actors including banks, trust and company service providers and law enforcement authorities cannot comply with their requirements. The EITI's 2016 Standards recommend "... that implementing countries maintain a publicly available register of the beneficial owners of the corporate entity(ies) that bid for, operate or invest in extractive assets, including the identity(ies) of their beneficial owner(s), the level of ownership and details about how ownership or control is exerted" (EITI, 2017, p. 19).

According to Transparency International, secrecy jurisdictions (where beneficial owners are not disclosed), have a crucial role in facilitating IFFs (Martini, 2014). Therefore, governments must establish mandatory, public registers that disclose the beneficial ownership of trust funds and companies to allow IFFs to be more easily traced and make it even harder for individuals to benefit from the proceeds of corruption and crime. Introducing registers to catalogue who the actual beneficiaries are from activities within a jurisdiction will enable authorities to improve the transparency of transactions as well as to appropriately conduct investigations in the instance of suspicion of criminality. Given the complexity and the multijurisdictional structure of businesses, determining who the real beneficial owners are can prove a challenge.

The concerns raised about the grey area between transparency and privacy are to be treated with care, especially when considering developing country contexts, where the political class tends to be both the lawmakers and the lawbreakers. To this end, appreciating the trade-offs associated with increasing transparency while at the same time maintaining levels of privacy are important if there are meaningful reforms in the offing.

The World Bank states that having beneficial ownership transparency provides that the hidden power, their associates, and facilitators are not able to operate in secrecy and impede development. Improving the environment in which business can be done in a transparent and legal manner is central to developing countries being able to overcome the vicious cycle of poverty and dependency. Beneficial ownership registers are not the panacea for fighting IFFs, but they are an important step in the right direction.

Reform local content requirements breach to avoid perpetuating corruption

It is estimated that 90% of extractive countries in Africa are implementing local content requirements (UNECA, 2017). Angola, Ghana and Nigeria have adopted legislation entirely dedicated to local content issues and Uganda, the Republic of the Congo and Liberia have included local content provisions in their recent revision of their petroleum code. Local content policies often require foreign extractive companies to employ local staff from the mining areas with varying levels of knowledge at different stages of the extractive work. These policies can also include obligations to award a percentage of procurement of goods and services to local companies or enter into joint ventures with local partners to operate in the country. Local content requirements have the potential to promote economic development at national and local levels and to curtail IFFs. However, gaps in current legislation need to be addressed to avoid abuse and perpetuation of corruption.

General measures that have and can be adopted to prevent and curb corruption in local content requirements in the oil and gas sector include:

- (i) The adoption of anti-corruption clauses. Such clauses seek to spell out the behaviour expected from the contracting partners and send a strong signal regarding the government's or company's commitment to fight corruption. The oil and gas sector has created anti-corruption clauses in petroleum contracts between governments, international oil companies, joint ventures, and on agreements between international companies and local stakeholders.

- (ii) Creation of independent oversight bodies to assess and monitor local content implementation.
- (iii) Putting in place strict procurement rules that are transparent and that guarantee fairness throughout the process is central to preventing corruption within the local content process. These rules should take account of the fact that the number of companies bidding in local content tenders is usually small and then create measures to avoid overpricing, bid rigging and cartels. Within this framework, several countries have included provisions covering the procurement of local content. For example, Mozambique law requires that preferential treatment when buying local goods and services is given, especially when such goods and services are globally comparable in terms of standard, availability, and the amount required and given at prices including taxes (Transparency International, 2017).
- (iv) A requirement that contracts include information regarding the implementation of local content rules for transparent reporting on local content covering the number of local community members employed, goods and services that are procured by overseas and local companies, and beneficiaries of local policies. Such a requirement, together with publication of all contracts and licensing agreements awarded, will help in the assessment of whether local content rules are implemented in a way that supports the achievement of their objectives.
- (v) The creation of effective compliance systems by multinational corporations doing business in mineral-rich countries, including whistle-blower policies.

Additionally, in order to effectively stem corruption in the application of local content rules in the oil and gas sector, precise steps should be taken to address the corruption threats identified in the previous section, including the creation of rules stipulating conflicts of interest, revolving door arrangements, gifts and entertainment. Government workers and senior executives of state-owned companies should be required to declare their assets, access to information laws and the transparency of decision-making processes should be strengthened, and civil society participation in and oversight of oil agreements should be ensured.

Reforming taxation system and revenue transparency

Unless the underlying issue of taxing rights is addressed, African countries will remain susceptible to significant revenue losses. Therefore, African countries' interests must be defended in forums where their concerns can be aired and where alternative and substantiated views on global corporate taxation can be discussed.

There is an urgent need to improve the quality of human resources and institutions of taxation offices to ensure optimization of tax revenue, as well as to control and monitor the taxation sector. Revenue transparency should be promoted, especially in mining production, trading, and export and in ensuring the readiness of monitoring processes and validation for tax and revenue calculation (Kar & Spanjers, 2015).

African countries should focus on an intergovernmental position given the current momentum for global taxation reforms. The talks on the second wave of the OECD Secretariat proposals on the BEPS initiative, labelled pillar one and pillar two, began in early 2019 and are

planned to be held through multiple meetings until the end of 2020. Regarding the pillar two proposal, titled the Global Anti-Base Erosion Proposal, the focus is on tax challenges arising from the digitalization of the economy (OECD, 2019). As they stand, with their focus on tax and digitalization, these two proposals deal inadequately with the specific gaps that limit the taxation rights of African states. The gaps in the OECD proposals underline the urgent need for strong political leadership from Africa on international taxation reforms (OECD, 2019).

Furthermore, African countries should avoid signing tax treaties that impinge significantly on taxing rights. In addition, withholding taxes is a strong initial protection against profit-shifting for countries with weak administrative systems and capacity. Therefore, countries should not accept having withholding taxes significantly lowered by tax agreements. Correspondingly, tax agreements often completely absolve some types of income earned in the source state from taxation. Countries should assess the costs of removing these taxing rights against the expected benefits in increased foreign direct investment.

African countries should also aim at defining ways to curtail tax competition among themselves. Related efforts should include context-based analytical assessments of the welfare effects of falling headline tax rates and the proliferation of tax incentives across the continent. African countries should leverage the African Continental Free Trade Area (AfCFTA) as a platform to avoid a race to the bottom. More critically, African countries should build on the formidable negotiations forum that the continent has established in the context of AfCFTA. Currently the negotiations include senior officials of trade ministries and ministers of trade. Ideally mechanisms would be introduced to bridge the gap between these trade-focused groups, ministers of finance and the High-Level Panel on Illicit Financial Flows.

Improving tax compliance and strengthening data integration

Compliance should be ensured from the beginning, which is the licensing process. The relevant licensing authority should ensure that a mining license is only given to a company that has obtained a tax file number, while imposing penalties on license holders without a tax file number. Compliance also can be increased through improving internal controls and the strengthening of tax courts (Igbatayo, 2019). Moreover, strengthening data integration is an essential requirement to ensure compliance, as it determines the role of open and big data to prevent gaps in tax revenue.

Progressivity (the taxing of higher incomes at a progressively higher rate) is a sound principle for designing optimal tax instruments, but it remains a major challenge. African governments incorporate a wide range of systems for effective revenue mobilization from the extractives sector, including profit and production-based taxes. Nevertheless, efforts to ensure tax stability, efficient tax tools and implementation capacity remain weak. South Africa is the only African country that applies a profit-based structure for calculating royalty rates on different minerals (Igbatayo, 2019). Most of the case-study countries considered in the UNECA study on the impacts of IFFs on domestic resource mobilization apply ad valorem or sales-based royalty mechanisms, which factor in evolving market prices (UNECA, 2017). While resource rent taxes are generally recognized as having a neutral impact on investment decisions, none of the case-study countries apply an excess profit tax. Zambia has dithered with windfall tax changes, which were introduced in the 2008 Mineral and Mines Act and later withdrawn in the face of opposition from the extractive industry (Igbatayo, 2019).

Bridging information gaps regarding geology remains key to effective compliance and narrowing the tensions between national and international systems

Mineral-rich African countries are yet to leverage key information and knowledge of the sector in a forward-looking manner. All case-study countries in UNECA (2017) recognize the importance of geological information, but they have failed to implement investment and governance structures in ways that effectively mobilize revenue collection and stem IFFs. Mandatory submission of geoscience information by extractive companies to African governments is restricted by clauses requiring confidentiality, thus stopping African states from keeping custody of geo-scientific data. A further difficulty is created by the practice of incorporating geological information into legislation as records, rather than as data that could be aggregated and analysed for effective tracking and monitoring of IFFs. With the exception of South Africa, there is no requirement that pre-competitive data be submitted to the government to be digitalized. Data are often submitted in PDF format, which makes analysis difficult. Consequently, African countries lose billions of dollars in undervalued assets as well as underutilizing a critical tool for attracting foreign investment (Igbatayo, 2019). This lack of effective data management extends along the value chain. None of the UNECA case study countries' regulations include provisions for the tax administration to continuously review benchmarks for transfer pricing conditions or require the documentation submitted to reflect the changing norms endorsed by mining companies. This implies that regulations are likely to lag behind mispricing practices, with the threat of serious leakages through lack of information. There is also a need to ensure that financial institutions and all other designated non-financial institutions and professions conduct proper client assessment procedures when starting a business relationship and throughout the relationship.

Vital to build investigative capacities to tackle economic crime in the African countries

Combating IFFs and corruption in all its forms must be given greater priority across Africa. According to a European Commission estimate, mining and extractive companies are responsible for 65% of Africa's tax fraud, through tax avoidance and evasion and transfer pricing (Aranda, 2020). The capacity of law enforcement departments in African countries to investigate and prosecute economic criminality is very limited, and it is essential that this capacity is strengthened, where necessary with the assistance of international development partners such as the European Commission.

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