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"We want our money back": illicit financial outflows and political fragility as failures of global governance

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Executive summary

The overthrow of dictators in Arab countries has lifted the veil masking the massive and routine looting of their countries' assets by these dictators and their associates. Also exposed has been the collusion of Western banks and other firms in moving monies offshore, and in channelling monies to secrecy jurisdictions offshore and in shaping rules in ways that make theft and tax evasion easy, invisible and even legal. These global rules seriously frustrate equitable development and peacebuilding. Where states continue to lose the means to invest in public goods and thus to shore up popular legitimacy, the risks of fragility and instability rise. Hence, today's dictator- and corporation-friendly governance of global financial flows poses major obstacles to state resilience and sustainable peace. This article looks at this legalised transnational larceny and what can be done to end it.

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Introduction

"People's power" movements in North Africa and elsewhere have demanded not only the speedy removal of despots from power, but also the rapid return of the billions they and their collaborators have stashed abroad. From Albania to Zimbabwe, angry citizens want their nations' money back. These are valid claims. If honoured, they would not only bring back a great deal of badly needed cash, but also help repair the politics of fragile countries. Furthermore, a return of pillaged assets would boost public confidence that wrongful private enrichment can be curbed and illicit wealth restored to public ownership.

This ambition is achievable. Recent episodes have shown that, if pressed, Western authorities can act decisively to set aside secrecy rules and confiscate monies and properties wherever they may be. For example, in late February 2011 it took American and European authorities only a few days to locate and freeze tens of billions of dollars in Libyan assets held outside the country. In 2003–05 the US government coordinated a larger and more complex international initiative to curtail illicit North Korean businesses. This initiative took particular aim at international banks in order to freeze North Korean assets. A coercive global action, it brought banking and other authorities into line; and it achieved its purpose. Yet when faced with other cases of public treasuries looted or tax payments evaded, the same authorities claim that their hands are tied by international law and convention: financial secrecy rules must be respected.

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It is therefore no wonder that illicit surpluses continue to pour out of fragile countries, with few questions asked. These outflows exemplify today's weak and arbitrary global financial governance. Under an indulgent regime of international rules set up mainly to facilitate rather than curb outflows, those with offshore assets can conceal and spend them more or less as they wish. They deploy their wealth to keep their domestic clients and foreign collaborators happy through patronage payoffs and upscale investments. They also use these monies to coerce or intimidate opponents, often feeding armed criminality, thereby sacrificing yet more public legitimacy and social peace. Indeed, they evidently prefer a repressive status quo over equitable development.

The extent of the problem

How substantial are the outflows? Recent estimates (see table 1) suggest that outflows from African countries in particular, both north and south of the Sahara, have been massive. During the nine-year period between 2000 and 2008, Nigeria lost an amount sufficient to cover that country's cumulative public expenses almost twice over, while illicit outflows from Egypt, Côte d'Ivoire and Angola were equivalent to about half of those states' cumulative public outlays. Estimates of these flows are fragmentary and probably understated, however. This is because laws and a powerful financial industry allow their concealment.

Reasons for the outflows

What drives these outflows? Kleptocratic leaders, their dynastic entourages and high officials use their positions to seek and extract rents – i.e. excess incomes obtained by abuse of power over markets or policy. This predatory "power chasing wealth" accounts for some of this rent seeking. For the public at large, it personifies corruption. However, the phenomenon of "wealth chasing power" – moneyed elites pursuing state authorities' favours in contracts, permissions, privileges and protection – is usually more important, although it has a lower public profile. Its political damage is serious, for it results in "state capture" by wealthy interests. Kleptomania and capture can operate together, with cumulative effects. From Marcos to Mobuto to Mubarak to Mugabe, leaders create and cream off rents proactively in collusion with business people. But they also play the game passively, open to the solicitations of corporations and other wealthy actors.

Where the stakes are high, the financial gaming tables are poorly lit. Five lucrative business sectors – construction, armaments, hydrocarbons, public utilities and telecommunications – are especially murky and corruption prone. Thanks to forceful corporate lobbying, those markets are skewed, deal making is opaque and regulations are distorted. Foreign interests are especially active in all these domains, particularly in small, extraverted economies.

Table 1: Illicit financial outflows from selected African countries, 2000-08

	Cumulative outflows (conservative vs high-end estimates) in USD billions*	Cumulative outflows expressed as proportions of cumulative government spending**
Angola	18.3-24.1	39-52%
Democratic Republic of Congo	6.7-7.0	106-111%
Côte d'Ivoire	9.9-10.9	50-55%
Nigeria	130.0-152.9	171-201%
Zimbabwe	4.1-4.1	110%
Algeria	4.6-13.6	4-12%
Egypt	57.2-57.2	53%
Morocco	3.4-13.3	4-14%
Tunisia	8.7-9.3	23-25%

* Dev Kar and Carly Curcio, *Illicit Financial Flows from Developing Countries: 2000-2009*, Washington DC, Global Financial Integrity, January 2011, Table 7

** Own calculations, based on United Nations Statistics Division, "General government final consumption expenditure", *National Accounts Estimates of Main Aggregates*, http://data.un.org/

For some countries, the main driver of capital flight is not corruption or trafficking in illicit goods, but trade mispricing. This is an accounting gimmick made possible by transfer pricing, a practice legalised under international agreements allowing corporations to minimise their taxes. Because of those global financial rules, interests in rich economies gain many billions in hard currency every year – including billions from poor and fragile economies. According to the study cited in table 1,[1] mispricing of imports and exports in the period 2000-08 accounted for about two-fifths of illicit outflows from Egypt and Morocco, and nearly half of outflows from Côte d'Ivoire. Trade mispricing has surged across Africa; in 2009 Angola lost about $6 billion, roughly 18% of its gross domestic product, due to corporate collusion in this sophisticated form of tax evasion.

However, large portions of illicit outflows from Africa still run through normal banking circuits. These are derived from rents extracted in the form of kickbacks or simple looting by those with power in the conduct of legitimate businesses. The largest streams are those from mineral-based extractive industries, which remain Africa's chief magnets for outsiders, both mercantile and military.

Moreover, monies depart these economies *legally* as profits, the repayment of debt and the acquisition of savings vehicles, such as US Treasury bonds. Given the disputable, non-transparent gimmickry on which profits and taxes are calculated in some sectors, especially extractive industries, the degree to which such "legal" flows are in fact legitimate and honest is open to question.

Circumstances enabling these outflows

Beyond what drives them, what circumstances make these flows possible? Fragile places are affected by transactions in a variety of commodities and services: arms, drugs, timber, migrant labour, gemstones, hydrocarbons, precious metals or hazardous wastes, plus the freight services moving them across the globe. But whatever their material basis, their common denominator is financial. All rely on a system of laws and jurisdictions set up to conceal financial stocks and flows, their owners and beneficiaries. This system works mainly through lightly regulated offshore financial centres (OFCs) whose main selling point is secrecy. These places may appear as points on the map between which funds nominally travel, such as from Africa to the Caribbean, Delaware or The Netherlands. But this is largely fictional. The physical places are of only minor importance, for the essential operations of OFCs take place "nowhere". A few taps on a computer keyboard in New York are sufficient to "relocate" billions from jurisdiction A to jurisdiction B, then to C, to D and onward in complex strategies of concealment. These are politically constructed, juridically protected shell games.

Demand for OFC services is rising, together with pressures to reconfigure the regulation of global flows. These include light-touch supervision of banking and accounting practices, few-questions-asked licences for merchant shipping, and the certification of zones where normal labour rights, tax obligations and rules to protect the environment are suspended on behalf of footloose investors. These measures exemplify ways in which national sovereignty, even the power to make laws, has become a commodity. Laws are subject to a competitive global marketplace. In search of the softest possible regulatory climate, wealthy customers routinely select the most-favourable jurisdictions; this is termed 'forum shopping'. Forced to compete with other cash-starved places, authorities of poor states face powerful incentives to bend or shape rules to suit the highest bidders.

The rules of financial concealment, designed by globally powerful financial institutions and ratified by politicians, have expanded the enabling environment for looting, criminalising and enfeebling political life, economies, and public services across the globe.

Measures Taken Thus Far

Efforts to detect and discourage illicit flows have intensified in the past decade, reflected in widely ratified international conventions against official corruption and organised crime. Some of these, notably the United Nations Convention Against Corruption (2005), oblige governments to track down and return the fruits of high-level corrupt practices. With major media ready to seize on politically exposed persons (PEPs) and other unsavoury figures, and specialised lawyers and accountants spurred by the prospect of lucrative fees, a coalition of forces is taking shape to press for the recovery of ill-gotten assets.

1 Kar and Curcio, *Illicit Financial Flows from Developing Countries*.

Up to now, counter-measures have been sporadic and often ineffective. Banks show uneven and generally weak due diligence toward PEPs or suspicious transactions. Asset recovery efforts have not yielded very much. After decades of effort, the Philippines government has managed to claw back only a fraction of the many billions stashed abroad under the auspices of ex-President Marcos, whose dictatorship ended in 1986. However as laws and sanctions enter national statute books and jurisprudence develops, recovery measures may gain real teeth.

Asset recovery faces huge obstacles, many anchored in existing law and powerful coalitions of private and governmental interests. Hence, struggles to repatriate assets accumulated offshore by, for example, the Egyptian and Tunisian kleptocracies are likely to be intense and lengthy, as jurisprudence requires those seeking return of assets to prove that they were acquired illegally – a fact that bank secrecy usually conceals. Against calls for transparency, the financial industry is pushing back forcefully; hundreds of lobbyists and law firms have mounted the barricades in defence of secrecy rules. Currently, for example, the US Chamber of Commerce is spearheading efforts to weaken a major US anti-bribery law, the Foreign Corrupt Practices Act.

Given the massive power of corporate finance over Western democracies and their appointed financial regulators,[2] the prospects for curbing asset theft and illicit capital flight are not promising, but neither are they hopeless.

Further Measures Needed

As outlined in recent papers,[3] forceful measures are required to strengthen and widen intergovernmental cooperation. A key challenge is to expand the scope of financial governance progressively beyond the European Union and Organisation for Economic Cooperation and Development (where cooperation on taxes and customs services is taking place) to include G20 countries and further. The fundamental tasks are to lift secrecy and other rules that protect and promote:

- mispricing, chiefly through stronger monitoring of import and export invoices and payments;
- bribery and kickbacks, chiefly through obligatory transparency in public contracting (especially in construction, armaments, extractive industries, utilities and telecommunications); and
- tax evasion, chiefly in curbing secrecy jurisdictions, tightening bank compliance with due diligence rules, sharing information globally on households' assets held abroad, and rationalising tax systems to strengthen direct taxation and reduce indirect taxes.

To achieve this, tough political leadership and revived democratic politics are badly needed. This is not necessarily the kind of "good governance" that Western donors routinely talk about; what is needed is the autonomy of senior public authorities from financial and other corporate interests. These authorities need backing by vigorous public activism that takes place within robust political spaces. Today, citizen awareness and assertiveness on these issues have begun to emerge, such as in South America over the past decade. Research activism to expose illicit flows, such as by the Tax Justice Network, Global Witness and Global Financial Integrity, has begun to gain attention in governments and create allies among citizens affected by diminished public revenues and angered by the extreme inequality of assets and income that characterise their countries' richest and poorest citizens. With street protests about corporate tax evasion cropping up in Britain, the US and Canada, this research-and-publicity effort may find much more political traction in richer countries. It needs complementary efforts in poorer countries, including fragile ones. The "Arab Street" shows this potential, and with it, the prospect of citizen action transcending the ever-more-porous boundaries between the Global South and North.

2 A rising number of observers are calling attention to this alarming weakness in Western democracies. They include highly placed figures such as the International Monetary Fund's former chief economist, Simon Johnson, author of 'The Quiet Coup' (*The Atlantic*, May 2009), an insider's account of the financial industry's capture of US government policy.

3 UN Development Programme (UNDP), *Illicit Financial Flows from the Least Developed Countries: 1990–2008*, New York, UNDP Bureau for Development Policy, May 2011; Valpy FitzGerald, "Global capital markets, direct taxation and the redistribution of income", paper presented to the conference Economic Policies of the New Thinking in Economics, St Catherine's College, Cambridge, 14 April 2011.