

# Illicit Financial Flows: The Missing Link in Development

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## “Illicit Financial Flows: The Missing Link in Development.”

Upwards of \$500 billion a year exits developing and transitional economies and is deposited into western accounts. Almost all of it is a permanent outward transfer, with little ever returning to countries of origin.

While the numbers are staggering, they suggest a truth that is even more sobering: for every dollar of foreign aid going into poor countries some ten dollars of illicit capital streams out into western coffers. At this rate, even if the most commonly discussed development goals are realized—more aid, more trade and debt forgiveness—there is little chance that poor nations will develop to the point that they no longer need financial assistance.

The idea that illicit financial outflows have a devastating effect on poverty levels and economic growth has begun to seep into discussions of frameworks for development analysis. These frameworks now include or should include:

- a) a discussion of the massive amount of illicit capital flowing out of developing nations,
- b) an understanding that this hemorrhaging undermines any attempt at long term development
- c) a realization that efforts must be taken to stem the tide of capital flight.

The conference panelists were a unique and world-class assemblage of economists, , lawyers, anti-corruption advocates, philosophers and international financial institution representatives. The stature of the conferees, including the participation of high-level World Bank officials, indicates that the conversation about how to “do development” is ripe for a lucid, momentous shift.

Addressing this issue in a purposeful way will demand an acceptance of the notion that illicit transfers are a problem of immense proportions, **undermining other development efforts**. To arrive at this understanding, economic researchers must be prepared to deal with uncertainty. Ample data exists indicating the order of magnitude of the problem, but hard numbers on these opaque and hidden flows will be elusive. Yet it is by grasping the enormity of the problem that this issue can secure its place on the political-economy agenda.

## **OPENING PRESENTATIONS**

**Raymond Baker**

**Director, Global Financial Integrity, Center for International Policy**

### **The Ugliest Chapter in Global Economic Affairs Since Slavery**

Mr. Baker discussed the international structure that supports the flow of illicit money, and the impact it has on economic growth and poverty. To begin, Baker presented statistics demonstrating that the income of the top 20% of the world's population is 70% to 90% of the global total, leaving only 10% to 30% of global income for the bottom 80% of the world's population. Illicit flows drive the movement of money from the bottom to the top.

Baker addressed three forms of illicit money: the proceeds of bribery and theft by government officials, the proceeds of criminal activities, and the proceeds of tax-evading and laundered commercial transactions. By definition, illicit money is labeled as such if it breaks laws in origin, movement, or use. Baker argues that since the 1960s the international community has built a global financial structure that facilitates the movement of illicit money for two reasons. First, the period of decolonization encouraged political leaders and businesspeople to take their money out of newly independent countries. Second, the expansion of multinational corporations increased the use of tax evading techniques.

Baker then discussed the interrelated parts of the illicit financial structure that are used by all three forms of illicit money: tax havens, offshore secrecy jurisdictions, disguised corporations, flee clauses, anonymous trust accounts, fake foundations, false documentation, falsified pricing, money-laundering techniques, and holes left in laws of western countries to facilitate receipt of illicit money. This structure was originally developed by the West, but many other groups have stepped in to move their money around the world, including drug dealers, racketeers, and terrorists. Although anti-money laundering legislation exists, Baker claims that there are major loopholes in the laws of all western countries. He used the United States as one example; while we bar money from the proceeds of drugs, bribery, and terrorism from coming into the country, it remains legal to transfer money into the U.S. from racketeering, credit fraud, counterfeiting, slave trading, sexual exploitation of women and children, and tax-evading money.

Baker estimates, as detailed in his book *Capitalism's Achilles Heel*, that \$1 trillion to \$1.6 trillion of illicit money moves across borders annually, but these figures are considered conservative by other analysts. Baker believes that, "illicit money that moves across borders and the structure that facilitates its movement is the biggest loophole in the global economic system."

Turning to poverty and inequality, Baker estimates that half, \$500 to \$800 billion per year, comes out of developing and transitional economies. The damaging effects

include massive capital flight, draining of hard-currency reserves, increasing inflation, reducing tax collection, increasing income gaps, canceling of investment, damaging competition, and undermining trade. “The poor deserve better from us,” Baker commented. According to Baker, the bribery and theft component is the smallest at 3%, (but enables the other maladies), the criminal component is about 30% to 35% of the total, while the commercially tax-evading component comprises 60% to 65% of the total.

Baker discussed four assumptions many people make about economics that illicit financial flows challenge. First, that illicit money is a temporary phenomenon. According to Baker, **most of the money flowing illegally out of the developing world is permanently transferred to the West.** While little comes back in the form of foreign direct investment (FDI), Baker points out that profits on FDIs are intended to go abroad again. The second assumption is that it is not possible to distinguish between legal and illegal capital flight. Baker disputed this by observing that legal transfers are documented and accessible while illegal transfers disappear from all records in countries out of which the money comes. Third, the view that the “errors and omissions” account in national statistics shows capital flight going out of a country. Baker argues that this actually shows very little of it because it ignores trade mispricing, which is the biggest component. Finally, that economic statistics depict an accurate assessment of a country’s economy. In contrast, Baker claimed that trade mispricing misstates the value of imports, exports and capital transfers causing an inaccurate calculation of GDP. Furthermore, **Baker pointed out that the estimate of global inequality is vastly understated because it is difficult to obtain accurate information about the trillions of dollars stashed in tax havens.**

In a further analysis of the impact of the money flowing out of developing countries, Baker discussed three points. First, illicit financial flows curtail the effectiveness of foreign aid. The total amount of aid is \$50 to \$80 billion per year, compared to the \$500 to \$800 billion of illicit money flowing out. Second, Baker considered the effect for individual countries. In numerous examples, including Russia, China, Nigeria, Congo and Venezuela, Baker examined how capital flight increases mortality rates and poverty. Finally, Baker connected capital flight with other “global ills.” According to Baker, the illicit financial structure makes the drug problem insolvable, allows rogue governments to purchase weapons, and finances terrorist organizations. Baker stated, “In my reading of history and in my judgment, this reality is the ugliest chapter in global economic affairs since slavery.”

Baker encouraged the audience to “think what would happen if \$500 billion a year... stayed in developing and transitional economies rather than coming illegally out.” Regardless of the reasons why this topic has been ignored for so long, Baker believes that illicit flows must be addressed in the analysis and pursuit of economic development. To begin, he advocates obtaining a complete picture of the whole of the financial equation for economic development.

In conclusion, Baker called for three things. First, he charged the World Bank and other financial institutions to do their own research to obtain their own estimates of the severity of illicit outflows. Second, he asked for flexibility in the numbers, as it is difficult to obtain exact statistics on hidden money. Finally, he called for bolstering political will

with the numbers. "It is time," Baker exclaimed, "to put the whole of the financial equation for economic development squarely on the table. This may well be the most important contribution we can currently make toward achieving poverty alleviation, growth, security, and perhaps even contributing to peace for the vast majority of people in our shared world."

## **Daniel Kaufmann** **Director, Global Programs, World Bank**

Dr. Kaufmann began by discussing the different forms that the fight against illicit funds has taken over the years. Before the 1990s the field was basically ignored, but there has been increased attention since the mid-1990s. In Kaufmann's view, the World Bank is mandated to address development, which former Bank President James Wolfenson interpreted to include illicit funds. By 2000 there was a concrete agenda for tackling corruption, which focused on codes of conduct, legal solutions, and decreasing the number of bribes. Furthermore, there were more organizations with operational and concrete views on the issue.

Kaufmann then discussed necessary changes. After September 11<sup>th</sup>, 2001, and the Enron scandal, people realized that the focus on combating corruption needed to shift to anti-money laundering campaigns and financial corruption. But there is a debate on the best approach.

There are two general options: an upstream approach (anti-money laundering) or a downstream approach (recovery of stolen assets). The World Bank currently utilizes a downstream approach with the Stolen Asset Recovery (STAR) initiative, which works with the UN Office of Drugs and Crime to return stolen money stashed in overseas banks. This initiative is aimed at combating the estimated \$20 to \$40 billion per year that is laundered by public officials. According to Kaufmann, it is the responsibility of rich countries to recover stolen money. "We tend to always lecture developing countries on the problem of corruption, but another side of the coin is the global responsibility of the rich countries," Kaufmann stated.

However, Kaufmann also pointed to a number of obstacles, including limited institutional capacity and resources, lack of responses to requests for assistance, lengthy legal processes, lack of responsibility to the public by officials in developing countries, vested economic and political interests, use of recovered funds, and difficulties with international cooperation. To address these obstacles, he supports integrating the topic of illicit funds into broader anti-corruption efforts, because these are not separate tracks. However, even if governments can agree on the connection, there are often disagreements over operational approaches.

In conclusion, Kaufmann supports integrating illicit flows with the topic of governance in several ways. First, the data needs to be improved and expanded, followed by the formation of evidence-based policy. Second, in order to effectively gather data, there needs to be a clear set of priorities defining what is most important. In Kaufmann's

view, the first order issue should be dealing with kleptocrats, while second order issues should include tax havens and other financial mechanisms. Third, incentive-driven policies should be implemented rather than purely legalistic approaches. Data should be used as an incentive as well as a tool for analysis. Finally, Dr. Kaufmann called for international cooperation to tackle entrenched corruption networks.

## **Lord Daniel Brennan Counsel, Matrix Chambers**

Lord Brennan reviewed the recent history of the global economy. In the 19<sup>th</sup> century there was a global laissez-faire attitude, which evolved to brute capitalism in the 20<sup>th</sup> century. In the 21<sup>st</sup> century there is a push for responsible capitalism. The globalization of goods, money, and business requires the globalization of standards. Brennan advised that global financial institutions, including the World Bank and International Monetary Fund, need to be challenged to adapt to a new world. According to Brennan, in order to do this there are three questions that need to be addressed: what do we know now, what do we need to know, and what do we need to do?

First, Lord Brennan discussed what we know now. Publicly, there are many examples of government corruption, including Kenya failing to account for \$50 million in 2005 as well as allegations about illegal payments by U.K. aerospace giant BAE to Saudi government officials. In addition to numerous public cases, there is the reality of living in poverty. People in developing countries want to escape the poverty they experience everyday. African women carry the burden of Africa, Latin American workers are refused dignity in their jobs, and children grow up in despair. He believes the poor want hope, especially for their children. Finally, the poor desire a fair judicial system and good governance. This is a tough problem. While there are current investigations into African heads of state and cases in other countries, Brennan wants this issue to be globally recognized.

Second, Brennan asked what more do we need to know? He pointed out that problems do not stop at national borders. Therefore, we need to work for our world and establish global citizenship. Brennan noted that the World Bank should implement these ideas by knowing much more fully what is going into the developing world and what is going out. By establishing the facts, Brennan believes people will step up and realize that capital flight must be addressed. Each aspect of the illicit financial structure should be identified and made public.

Last, Lord Brennan discussed what we need to do. Legislation, anti-corruption commissions, money-laundering legislation, and chasing illicit money all need to be pursued. The basic model, Brennan said, should comprise prevention, deterrence, and capture. International agencies should be created to recover, register, and redeem corrupt money. In particular, he stated that recovery should be pursued not by bureaucrats, but by individuals involved in the financial system, including law enforcement and whistleblowers. Although bureaucrats should back up action through enforcement legislation, money should be chased everywhere by people who know

what they are doing. Credibility and transparency must be established for the process by publicly registering how the money is recovered and returned. Finally, he believes the money belongs to the poor and should be given back through public goods.

Lord Brennan was “not talking about idealism, we are talking about pragmatic realism. There is a problem, investigate it, do your best to resolve it. That’s what every decent World citizen would want us all to do.” **While the World Bank is the vehicle, he believes the United States is the place to start because it is a country of values that nearly always translate into action.**



## PANEL 1

### What is Known About Illicit Financial Flows

#### John Christensen Founder, Tax Justice Network

Mr. Christensen asked two main questions: how does corruption happen, and how can it be measured? Christensen estimated that for every dollar in aid into Africa, for example, about five dollars goes out, although there are various estimates as to the exact number. Regardless of the amount, illicit financial flows are enabled through various mechanisms. Two examples given by Christensen were cases in Malaysia and Jersey. Malaysia has a history of massive fraud and embezzlement; over \$100 million disappeared through unregulated financial investments in offshore tax havens. Jersey, a British Crown dependency, is home to insider trading, market rigging, lack of disclosure, illicit arms, illicit donations, bribery, and fraud. According to Christensen, these tax havens operate because of lax legal standards.

Christensen stated, “if we are serious about tackling dirty money flows... this **enabling environment** must be a first-rank priority.” Secretive arrangements exist throughout the financial structure, which Christensen pointed to as a major barrier to legitimate investments. Unfortunately, there are recent alarming trends towards even more secrecy, including an increase in redomiciliation structures and protected cells. According to the Tax Justice Network, approximately \$11.5 trillion is held offshore and largely untaxed. When all transactions are examined, Christensen said that **Africa is a net creditor to the rest of the World.**

Christensen relayed the words of the Ghanaians with whom he met, “The best way to fight African poverty is to help us maintain our own resources.” To do this, Mr. Christensen emphasized that we need to know more about the mechanisms of off-shore structures and the blindness that enables illicit financial flows.

#### Eva Joly Special Adviser, Norwegian Agency for Development Cooperation

Ms. Joly was the French Magistrate who ruled on the Elf Aquitaine scandal in recent years. The ELF case demonstrated to Joly that companies are not necessarily working for the best possible good. It demonstrated how Angola was being used to finance a lavish lifestyle for many Elf executives. Joly commented that transfer pricing was a common technique to move money from Angola to France. The money was accepted by banks in Liechtenstein and Switzerland willing to open accounts for African leaders and accept large cash deposits, even if they are politically exposed persons (PEPs). Decolonization of Africa is rhetorical, according to Joly. Money flowing out of developing countries relies on offshore companies located in developed areas. In spite of various legal rules, banks still accept money without asking questions and enable developing markets to be drained through capital flight.

While good governance and a strong judiciary are important for developing countries, these structures will take time to build. Joly argued “we can fight poverty today by closing down those places where launderers hide the money, by making [transactions] transparent, and getting back to reality.” Each government must start in its own jurisdiction. **If the U.S. took the lead, an international financial revolution is possible.** The challenge, Joly said, is to take the necessary steps and get through the seducing rhetoric and attack tax havens. Tax havens, according to Joly, “exist only because we want them.” Ms. Joly contends that companies are adapting and the global community must fight to expose efficient hiding places. Otherwise, developing countries will continue to mirror Zambia’s financial situation, where only a tiny fraction of the value of copper sales were received by the country.

## **Raymond Baker**

### **Director, Global Financial Integrity, Center for International Policy**

Mr. Baker explained that a primary conclusion of his book, *Capitalism’s Achilles Heel: Dirty Money and How to Renew the Free-Market System*, is that **\$500 to \$800 billion of illicit money flows out of developing countries per year.** He noted that to obtain that figure he examined each of the three types of corrupt financial flows - bribery and theft, criminal, and commercial - and calculated the magnitude of money involved through the use of surveys and data analysis.

Baker said bribery and theft account for about \$20 to \$40 billion dollars of the total cross-border illicit flows. This data was obtained through interviews with hundreds of individuals in the financial sector, compiling data, recording stories, and verifying facts against financial records. This number is relatively low compared to other estimates of the total amount of bribery and theft, but Baker pointed out that a large portion of illegal money stays within the country. According to Baker, the practice of transferring the funds overseas has continued for so long because Western financial institutions have been slow to prohibit receipt of the funds. Although this component is the smallest of the three, Baker asserts that it is catalytic to the other two.

Second, Baker talked about data on criminal financial flows. A number of different groups publish statistics on the amount of criminal money flowing around the world. Although drug proceeds are the largest component, Baker explained that it is not the majority of the criminal money.

Finally, Baker addressed the commercial component, the largest of the three. The commercial component consists of falsified pricing and faked transactions, in whole or in part. Out of all of the methods, Baker testified that falsified pricing moves the most money across borders because “it is the only way of shifting illicit money across borders without anyone else in the country knowing about it.” Generally, mispricing is invisible to the outside observer. While this makes it difficult to measure, Baker asserted that there are methods to collect data, including checking after the fact, asking people what they are doing, or performing statistical analysis on trade data. Baker’s estimates of the

commercial component are from a carefully designed survey of cross-border arms-length trade, which estimates that about 50% of transactions are mispriced by an average of 10% in Latin America and Africa, while similar results are evident in other areas of the world. Although Baker does not have specific data on money transferred within multinational corporations, from his experience this amount exceeds that of mispricing between arms-length traders. In total, Baker estimates that \$300 billion per year flows because of transfer pricing. However, these statistics are just the beginning. Baker acknowledges that more data needs to be collected.

**Simon J. Pak**  
**Associate Professor of Finance, Pennsylvania State University**

Professor Pak discussed the commercial side of laundering money, transfer pricing in particular. More than ten years ago Pak became an expert witness in a case where a company was importing goods about three times over the market price. This is proof that fraudulent transfer pricing is happening, he noted. He explained that the case demonstrated that the same razors were imported from the Cayman Islands at \$18.26 each and from Panama at \$29.35 each.

Looking at Africa, exports are priced extremely low – coffee from Nigeria was 10% of the market price and diamonds from Ghana were exported at 7% of the market price. On the other hand, there are high priced exports from the US to Africa – golf clubs at 161% and combustion engines at 1,508% of market price. Nigeria had the largest number of under-priced exports from 1970 to 1996, he said. Pak stated, “This kind of mispricing is done primarily for capital flight or tax evasion.”

Pak’s research is based on statistics. A range of prices is identified as a normal range, which includes the middle 50% of transactions. Transactions above this range are considered overpriced and transactions below are considered under-priced. The probability that numerous transactions by one party are legitimately either over or under the normal range is extremely small.

The total flow of money out of Nigeria to the United States via trade mispricing between 1996 and 2005 was \$1.87 billion. Looking at all African countries, Pak calculated that the amount of money flowing out had doubled over these ten years.

Pak stressed that this research is just the beginning of a long process. While it provides a basis for evaluating trade between the United States and other countries, he emphasized the need to have data for trade to and from many different countries. With this data, he explained, it would be possible to come up with a quantified method to curtail transfer pricing. For example, the World Bank could provide assistance for customs reorganization. A normal price range would be calculated for each commodity entering or leaving the country. Any transaction invoiced above or below the normal price range would be investigated. Professor Pak believes that significantly curbing transfer pricing is achievable and should be pursued.

## PANEL 2

### **Including Illicit Financial Flows in the Development Equation**

#### **Herman Wijffels Executive Director, World Bank**

Mr. Wijffels said his experience at the World Bank taught him many things, particularly that colonialism continues today. In what he calls “grand corruption,” Wijffels explained that many developed countries are still taking advantage of underdeveloped countries. This time, instead of armies, they are using banks, money, and corruption to do it.

He proposed three responses to this problem. First, we must **create awareness**. He cited the conference as a good start. Second, we must understand that **the world is one coherent, interdependent system**. We cannot afford to be segmented. We must abandon the notion of Darwinism, because that promotes an ideology that says it is the right of the fittest to exploit the weakest. We are in it together and we must accept this. Third, we must help to **build real global institutions** to help fix the problem. Despite his World Bank allegiance, Wijffels believes we only have multilateral institutions that are dominated by individual nation-states, rather than global entities.

**Wijffels' underlying message is that fighting corruption and illicit financial flows is essential to fighting poverty.** Illicit financial flows are a global problem and thus need to be included in the development equation. Mr. Wijffels believes the new World Bank president, Robert Zoellick, “has the responsibility not only to continue the responsibilities of the Bank, but also to take our efforts to the next level... [which] explicitly includes the issue of financial flows in the development equation.”

#### **Anthea Lawson Researcher, Global Witness**

Ms. Lawson started her presentation with evidence of capital flight and corruption: aid money being spent on multi-million dollar homes in Malibu, oil money spent at Louis Vuitton, vacations in Spain, and embezzlement through commercial banks that put the developed world to shame. Her evidence for capital flight and illicit financial flows was overwhelming.

**Lawson emphasized the role of mainstream commercial banks in developed countries in propagating financial corruption.** Lawson pointed out that while we have many checks in place to fight terrorism and try to catch terrorists, there is little or no regulation on commercial banking, even though both move money illegally. This allows the industry to use loopholes and secrecy to reap money from struggling countries. Included in these transactions are the natural resources that many poor countries possess but cannot seem to use effectively. Such is the case with diamonds, oil, illegal logging, and natural gas.

Commercial banks shelter and aid illicit financial flows, she said. Oil companies fare no better. Lawson called for increased transparency for commercial banks and oil companies as well as a crackdown on oil-backed loans, which further facilitate the problem. Though legal, oil-backed loans are highly unethical and create even more debt for impoverished countries. Banks that participate in these loans are complicit in corruption, Lawson noted.

Lawson argued that both oil companies and commercial banks must be more regulated and provide more transparency to the public. She cited the United Kingdom's role in allowing commercial banks free reign, encouraging further corruption and capital flight. Lawson called for the international community "to tackle the role of commercial banks in fueling corruption... [including] a high level independent panel to examine all the ways in which banks facilitate capital flight and make robust recommendations, including banking secrecy." Ms. Lawson promoted regulating commercial banks internally as something national governments can do to fight global financial corruption.

## **Sanjay Reddy** **Assistant Professor of Economics, Columbia University**

Professor Reddy examined development policy choices and the role of illicit financial flows in both the planning and executing stages of development. He stressed the need to correctly measure the magnitude of illicit financial flows and to determine which are the most damaging. From this, he expressed the need to invest in gathering accurate data because it is of the utmost importance in developing good strategies to combat corruption. Reddy said, "if it is costly to collect data, it is surely more costly to act without having the data."

Reddy discussed the flow of money from South to North, implying that development money did not stay and serve its intended purpose in poorer countries. He also stressed the importance of macroeconomic issues: holding large reserves (particularly of foreign currency), managing national reserves (such as China and the United States), and the export of capital from all countries. Reddy underlined the need to strike a balance of responsibility between surplus and indebted countries, rather than place the burden in one realm or the other. Rather than coming from a sense of guilt, his studies have indicated that all beneficial development has come from some mutual interest between a developed country and a developing one.

The United States' power, both nationally and globally, is threatened by the account deficit. He theorized that there is more American money abroad than we know about and that this lack of knowledge is dangerous.

Reddy also touched upon the growing inequality gap between the "haves" and the "have-nots," not just between persons but also between nations. This inequality is directly linked to illicit financial flows. Most money ends up back in developed countries and Reddy wants to know why. He cited two major sources of corruption: lobbying (which he sees as unproductive and wasteful) and suboptimal decision-making by consumers.

Professor Reddy argued that the actual cost of corruption is much more than perceived. Thus, to combat corruption we must focus on gathering good data, implementing efficient strategies, and improving incentives.

## **Nancy Zucker Boswell** **Managing Director, Transparency International USA**

Ms. Boswell is intimately familiar with corruption through her work at Transparency International (TI) and TI's Corruption Index, an annual report ranking countries on a corruption scale. She stated that while developing countries need to take ownership of the fight against corruption, developed nations must take responsibility for their involvement in aiding and abetting corruption that undermines development. She contended that development assistance is not always beneficial. Aid deliveries are often a supply and demand industry rather than addressing the most pressing need. Boswell discussed four initiatives that were originally presented by Ngozi Okonjo-Iweala, the former Finance and Foreign Minister of Nigeria, which focused on the political aspect of corruption, preventing foreign bribery, facilitating asset recovery and setting an example at home.

According to Boswell, one vicious aspect of the corruption cycle is the politics involved and, as a result, cracking down on it is difficult. Transparency in government activities is essential to correcting the problem but is lacking in one in four countries, according to TI. "Clearly greater effort is going to be needed to secure broad adherence that is necessary to deal with the magnitude of the problem," Boswell said.

The second issue, bribery, contributes an estimated \$1 trillion to corruption annually. She advocated tackling this problem from the supply-side and denying asylum for corrupt officials in exile. TI has approached this issue by advocating legislation and private sector adherence to codes of conduct. Although there has been progress in implementing legislation, particularly in OECD countries, many countries lack the necessary enforcement, Boswell said.

The third initiative, assisting developing countries with asset recovery, has received more attention internationally, particularly by the World Bank. There has been a growing recognition of, and a growing demand for, asset recovery among developing countries. Boswell declared that the return of funds will discourage future embezzlement.

Finally, Boswell emphasized the need for wealthy countries to set a good example for poor ones. Developed countries must establish a moral authority for their involvement in developing countries, she said. There have been many examples of corruption in the developed world that have undermined their moral authority, including the BAE case. On the positive side, Boswell is optimistic about the potential role of international commercial banks in developing countries. Ms. Boswell acknowledges the need to work on broadening adherence to heightened international standards.

## KEYNOTE ADDRESS

**Moisés Naím**  
**Editor, *Foreign Policy***

Dr. Naím stated that money laundering is part of a larger, world-changing trend and that we must work to understand the problem. To do this, we must create a demand for the information. Naím claimed the problem of corruption cannot be solved until the problem is recognized and studied. "Illicit trade is changing the world far more than terrorism," Naím commented.

Naím spelled out three illusions that we suffer from with regard to illicit trade. First, the belief that money laundering and illicit trade are old hats and there is nothing new in this realm. In fact, much has changed, he said, and the role that illicit financial flows play has evolved. Second, Naím argued that we are under the illusion that illicit trade is just about crime, when in fact it is not. Finally, Naím pointed out that the conventional wisdom is that illicit trade is underground, deviant, and the exception rather than the rule. None of this is true, according to Naím. In many countries, money laundering and corruption are out in the open and an accepted activity, and in some the majority of GDP is made illegally. In fact, Naím commented that Wall Street and London are both active players despite anticorruption laws.

Naím also discussed three "blurrings." First, criminals are some of the largest and most successful financiers in the world. Many if not most criminals engage in at least some legal activity; they adopt the practices of the private sector and diversify. Thus, money flows between the legal and illegal sectors freely. Second, Naím claimed that politics and criminality are intimately tied. Lobbying is simply a legal form of corruption, and politics is heavily steeped in criminal activity. Third, Naím argued that contrary to public perception, criminals are philanthropists. Criminals often donate money to appear legitimate and clean. This also gives them access to sectors they may not have been exposed to before and can actually make illicit trade easier in some cases. According to Naím, **the various forms of illicit activity, namely tax evasion, political corruption, and financial criminal activity, are actually intertwined in very complicated ways.**

Naím stressed the importance of picking the battles we choose to fight. Emerging economies, such as China, are enormously important. Only 8% of China's GDP is manufacturing and exporting, which indicates that much of the GDP is obtained illegally. The difficulty is that the poor people in China often need their illegal jobs to stay afloat, and an assault on corruption in China would do more harm than good.

Another issue Naím considered was the idea that cracking down on corruption in one sector would drive the dollars into other parts of the illegal sector, not the private sector. Though globalization has produced many good things, it has also facilitated many bad things too. Thus, Dr. Naím warned we must be careful in how we fight corruption, but it is essential that we fight.

**PANEL 3**  
**The Push and Pull of Globalization**

**Charles Davidson**  
**Publisher & CEO, *The American Interest***  
**Advisory Board Chair, *Global Financial Integrity***

To define the title of the panel, “The Push and Pull of Globalization,” Davidson discussed how ‘push’ means money going into developing countries and ‘pull’ means money coming out of developing countries. Because we have a fairly good idea of the push, he challenged his panel to consider the political and economic consequences of the pull.

**Eric Le Boucher**  
**International Editor and Economic Columnist, *Le Monde***

Mr. Le Boucher began by discussing why we still have resistance to global financial integrity. To fight inflation, governments have chosen to promote competition through deregulation, liberalization, and privatization. This has led to less inflation, more development, and less equality. Le Boucher argued that the consequence has been less justice and less law. Furthermore, he claimed that this has been compounded by technology. Finally, Le Boucher believes that globalization, specifically the explosion of multinational corporations and outsourcing, has created the situation we are in today.

In Le Boucher’s opinion, the common view among business people, politicians, and financial investors is that fighting dirty money would be going back to regulation and protectionism. He believes we need to convince people that capital flight is occurring and action needs to be taken. In France, half of the people view the rich moving to areas of fewer taxes as smart, while only half view them as bad citizens. Although there have been initiatives in Europe try to coordinate taxes and regulations, Le Boucher points to England as the actor who says “no.” He believes it is the job of NGOs and journalists to convince people and governments.

Illicit flows accompany licit flows, Le Boucher remarked. The deficit in Europe, the US, and Japan have caused this abnormal flow of funds. In order to address this issue, Le Boucher believes that developed countries need to promote savings, reduce deficits, and invest in development. He supports changing the current brutal capitalism of today, which is composed of more growth and less equality, into a more responsible global system. “We need to convince the elite... to find a way to keep growth and have more justice in it.” Although there has been progress on transparency and governance, Mr. Le Boucher believes that the elite still need to be convinced of the value of justice.



**Jack Blum**  
**Counsel, Baker Hostetler**

Mr. Blum pointed to the signing of the Treaty of Versailles, which has given to even very small jurisdictions the same rights afforded large countries, as the beginning of our “orgy of sovereignty.” As an example, Blum pointed to the Republic of Nauru, which gets its main source of income from selling bank charters to Russian criminals. Blum alleges that the globalization of many aspects of society has led to confusions of law, language and accounting, which has encouraged a system where a lot of people do not pay taxes. According to Blum, there is hypocrisy in the theory of not standing in the way of money coming into the country no matter what the source.

While the UN has asset recovery programs, Blum points out the investigators have found real problems in actually locating and obtaining the money. “Sovereignty above all! This does not provide the tools that people need to solve problems.” It is viewed as the rule of law, but this prevents people from doing their jobs. Blum views the lending systems of the World Bank and the International Monetary Fund as operations of the Cold War, rather than systems able to address the problems of today. Also, the Bank does not go after those who fail to repay their debts, and the details of the loans are not public information. The worst case is the Middle East, where officials steal everything, from natural resources to government money. Blum argued that it is the importance of oil that prevents corruption investigations.

Blum maintained that the information exists, but it is not being publicly collected. He believes the issue is too painful to address and many officials don’t want to be embarrassed. “The time has come to own up to a lot of this and realize that the solutions are going to have to mean that we look beyond sovereignty.” Mr. Blum emphasized that there needs to be discussion on how to prosecute international commercial corruption, who prosecutes, how they obtain information, and what is the punishment.

**Jonathan Winer**  
**Partner, Alston & Bird LLC**

Mr. Winer began by discussing his investigation into the assets of a prominent politician. Records pointed to offshore holdings in the Cayman Islands. However, when he contacted the appropriate individuals they refused to disclose any information. This is the result of U.S. laws, he noted. Furthermore, Winer pointed out that there are shell companies not just in offshore locations, but in the U.S. and the U.K. as well.

Although there is money moving around the world from various criminal activities, Winer believes “that the proceeds of corruption and tax evasion actually substantially dwarf all of the criminal stuff put together in its importance and its corrupting influence”. Starting with definitions, Winer argued that trading a commodity is legal if a company can provide proof that taxes have been paid and there is proper documentation. Often no one is able to locate this information. Next, Winer suggested eliminating legal arbitrage and implementing universal standards. He believes that global standards will promote

transparency and encourage the private sector to take the next step, which is enforcement. Due to corruption, many governments will be unable to enforce such standards, but Winer said the private sector can step into that role.

Finally, Winer believes governments should ask the WTO to come up with a labeling system. If an item is labeled with proper documentation then it receives priority, making it in businesses' economic interest to provide the proper paperwork.

Winer believes the problem is a failure of political will. Although there is the Financial Action Taskforce (FATF) there are no red flags for a variety of corrupt practices, including corrupt oil payments, illegal logging, and many others. With the appropriate red flags in place, Winer argued we could have compliance officers paying attention to these issues in the next few months. Furthermore, he believes security laws should be used to require disclosure. One example he used as a step in the right direction was the Sarbanes-Oxley law, which makes senior corporate executives responsible for whether they told the truth about their internal controls and their efforts against corruption. Mr. Winer agreed that there is much more that needs to be done.

## **George Ayittey** **Professor of Economics, American University**

Professor Ayittey claimed that globalization has not caused illicit financial flows; rather, it has always existed. Speaking specifically about Africa, Ayittey discussed how the financial system is a mess, and how both domestic and foreign investment are needed.

Resources in Africa are not being used to address African poverty issues. There is a large resource bowl, but it leaks. Ayittey argued that continuing to fill the bowl will continue to have a limited effect unless the hole, capital flight, is plugged.

According to Ayittey, there is a total leakage of \$246 billion out of Africa per year. "Of the hidden leakages, number one is corruption," Ayittey said, which the African Union estimates causes an outflow of about \$148 billion. African leaders amass wealth in many countries around the world. Second to corruption, Ayittey believes that military spending on imports sends about \$15 billion abroad for weapons that are not used to protect the people. Third, civil war destroys approximately \$15 billion in infrastructure. Finally, food imports cost about \$20 billion per year.

To begin addressing the financial distress of Africa, Ayittey argued that the environment for investment must be improved and that there must be far more independent media. According to Ayittey, investment can be encouraged by the international community through supporting the enforcement of property rights, the rule of law (with an independent judiciary), and the development of basic, functioning infrastructure.

Ayittey cited the example of Nigeria. From 1970 to 2004 over \$450 billion flowed into the country, but over \$400 billion was stolen by military rulers. Ayittey claims these rulers must be exposed through free, independent media. Using the odious debt principal, Professor Ayittey believes countries should not be required to repay loans that were taken without the consent of the people.

## PANEL 4 Governance is a Two-Way Street

### Leonardo Burlamaqui Program Officer, Ford Foundation

Mr. Burlamaqui posed three topics to the audience. First, he brought attention to the political aspect of the illicit financial flows problem when he asked how a country would implement solutions presented in the earlier panels. The important role of the political dimension, the political economy, according to Burlamaqui, must be carefully examined to move from conceptual discussion about the global financial situation toward action.

Second, Burlamaqui observed that this will require increased financial regulation, or financial governance. Burlamaqui stated that current global institutions lack the ability to tackle global illicit financial flows. He called for the construction of an international organization capable of tackling the global financial system, which would require significant development in both the technical and political dimensions, as could be demonstrated from previous presentations.

Third, Mr. Burlamaqui asked the audience to reflect on the accountability of such an organization. He observed that accountability has not yet been discussed, but that it is an important aspect of creating the necessary global structure.

### Charles Abugre Head of Policy, British Christian Aid

Mr. Abugre argued that governance is about managing power. The key, he said, is to ensure that those who manage power do so in such a way that promotes integrity. A violation of integrity is corruption, whether or not it is for the private or public good.

Abugre believes that corruption, no matter the end result, is unacceptable because it undermines the integrity of institutions. The long-term **consequences of corruption are undermining democracy and good governance**, according to Abugre.

Unfortunately for developing countries, the period of de-colonialization failed to develop a line between state powers and the management of resources, which encouraged the growth of kleptocracy.

“Corruption... is at the heart of undermining democracy and good governance,” commented Abugre. In order to move forward, he recommended solidifying the integrity of public services and retaining resources for development. In his view it is important to **retain domestic resources**, rather than do anything it takes to attract foreign aid or foreign direct investment. Abugre also argued for building democracy, particularly encouraging free media, and said investment should support civic and civil organizing. Finally, Abugre encouraged the international community to **develop a regulatory framework and international accounting standards**, including declarations by

businesses of who they are, where they are registered, who their subsidiaries are, and where they are paying taxes. Mr. Abugre believes that this framework will provide the financial system with accountability and integrity.

**Thomas Pogge**  
**Professor of Political Science, Columbia University**

Professor Pogge stressed the fact that **international financial investors not only enable but seduce political figures into corrupt activities**. Pogge analyzed the thinking behind their activity. The first justification for this activity is that investors are in a competitive situation and would be at a disadvantage if they did not attract all the investment they could. Second, they are ethically responsible for their shareholders' money. Third, their participation is not making the outcome worse because a competitor would do the same thing. According to Pogge, this logic must be attacked by regulating banks in such a way that they cannot be pitted against one another.

However, Pogge conceded that the U.S. system of pure procedural justice will resist any such regulation because of the influence of banks through lobbying. In response, Pogge suggested designing regulation in such a way as to preserve the relative competition, even if it may harm business in absolute terms. Not only is this logic applied to business within countries, but between countries themselves. The previous arguments will be used by governments, but because of the tradition of sovereignty, the solution must be different.

Pogge began by addressing this issue with a discussion of sovereignty. Our current international system says that those who hold power speak for the country, but a moral perspective would say the people speak for the country. This creates a difficult situation when, in the name of the country, a kleptocrat borrows money and then dies, leaving the debt to the people. The result is a viscous cycle, legitimizing that power as long as that person or people hold it, regardless of the means. Professor Pogge stated, "there is a huge headwind against poverty eradication in poor countries that comes from structural features deeply imbedded in our global system."

**Kannan Srinivasan**  
**Monash Asia Institute, Australia**

Being a journalist for most of his life, Mr. Srinivasan has seen both the internal and external views of India. The international view of India as a development model is contrasted by the reality of India where more than half the population is living in poverty. In trying to connect these two views of India, Srinivasan pointed to two occurrences.

First, Srinivasan talked about important policies that have resulted in the regressive distribution of wealth. Many industries have been privatized, which transferred wealth to individuals rather than public entities. Furthermore, theft has been legalized through a variety of methods. The recent trend in debt forgiveness is one part of this. Second,

Srinivasan discussed the corruption that has permeated the Indian financial system. He has seen an increase in corrupt deals, particularly in naval procurement from Germany, Russia, and Ukraine that use systematic mispricing of individual parts. According to Srinivasan, Bank of America has been a major participant in both the transfer of money and the pervasive corruption. “It is a peculiar anomaly,” Srinivasan observes, “that with all of this talk of monitoring tax jurisdictions and tax havens there is not serious concern on the part of the international agencies, the World Bank and the IMF in particular, about seriously monitoring and regulating the private banks.”

Srinivasan argued that the result is the movement of money out of India. In particular, rich Indian nationals move money out of the country into private banks offshore. Although the money stashed offshore is often reinvested under a different name, it is not invested in important sectors, such as infrastructure and social programs.

Srinivasan expressed his concern that despite the rhetoric of regulating tax havens there is no serious concern by international financial institutions about the monitoring of private banks in developed countries. According to Srinivasan two points need to be examined. First, whether, when asked, a tax haven or a developed country would cooperate. Second, whether a developing country is going to ask in the first place, which is unlikely considering political corruption is rampant. Mr. Srinivasan believes we do not need to wait until the poor can speak for themselves; instead, we must demand information and accountability as world citizens.

## **CONCLUDING STATEMENT**

**Bjorn Brede Hansen**  
**Royal Ministry of Foreign Affairs – Norway**

Mr. Hansen read a letter from the Norwegian Minister of International Development, Erik Solheim, in regards to the issue of illicit financial flows. The complete letter is on the following page.



ROYAL MINISTRY  
OF FOREIGN AFFAIRS

*Minister of International Development*

Raymond Baker and Tom Cardamone  
Global Financial Integrity  
Center for International Policy  
1717 Massachusetts Ave. N.W., Suite 801  
Washington, D.C. 20036

Your ref:  
Letter dated May 7, 2007

Our ref:  
07/04278

Date:  
26 June 2007

**Possible World Bank study on illicit financial outflows from developing countries**

Dear Sirs,

Having carefully read your 7 May letter, I am pleased to inform you that Norway is eager and willing to ask the World Bank to undertake a much-needed study on illicit financial outflows from developing countries. In principle, we are also prepared to finance such a study, pending agreement with the Bank on the Terms of Reference and budget for such an undertaking.


As my staff in the Multilateral Bank and Finance Section has already informed you, Norway is considering to take the lead in establishing an international task force on combating tax haven abuses and capital flight. A World Bank study would fit hand-in-glove with the work of such a task force, a primary task of which would be to help push this important development finance issue upwards on the international agenda. The way we see it, such a study could become an important input to the "Monterrey+6" Financing for Development Conference in Doha in the fall of 2008.

A Norwegian-lead task force, if established, would be a most fitting supplement to our engagement in the STAR program, the ambition of which is to facilitate the recovery of assets illicitly stacked away in tax havens. For us, these two engagements would be seen as highly complementary.

My staff will make contact with World Bank counterparts on these matters, so as to hopefully agree on the key terms for a study. Alongside NORAD's Eva Joly, they will also take part in the 28 June GFI/CSIS Washington conference on "Illicit Financial Flows – The Missing Link in Development", which I consider a most praiseworthy initiative of yours.

Moreover, if and when the above mentioned task force is established I sincerely hope that we can count on the participation and support of the Center for International Policy and the Global Financial Integrity program, alongside the World Bank, the Tax Justice Network and others. I believe we can do some good and important work together and I'll do everything I can to be helpful along the way.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Erik Solheim". The signature is fluid and cursive, with the first name "Erik" being more prominent than the last name "Solheim".

Erik Solheim