

Understanding the Global Data on Illicit Financial Flows: A Legal Perspective.

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Executive Summary

Due to the increased attention given to Illicit Financial Flows (IFFs) globally, the data provided to support its magnitude is having repercussions across industries, sectors and stakeholders. The regulation, control and eradication of IFFs as a result has gained importance. However, there remains controversy on the data and questions exist on its reliability. This policy brief will explore the statistics given on IFFs globally, the diverse critiques that have been floated and the validity of the data from a legal perspective as well as making recommendations on how to approach the data.

1. Introduction

The phrase ‘Illicit financial flows’ is not a legal term nonetheless; it is being used by both the legal and non-legal fraternity to describe both criminal and legal activities. It is a phrase that although recently coined has gotten global recognition over the past decade. It describes money ‘illegally earned, transferred or used’¹. As a result, it covers: one, legally earned money that has been illegally transferred or used; or two, legally used money that has been illegally earned or transferred. It can cover both domestic or cross border transactions; private and public transactions; formal and informal transactions or a combination of any of them. However, it does not consider barter trade. It speaks of an incredibly large amount of money being unregulated at a global level with estimated figure of 1.9 trillion dollars. At the continental level, the data estimates show 100 billion flowing annually out of Africa; approximately USD 285 billion from Asia; 200 billion

¹UNECA

‘Iff_main_report_26feb_en.Pdf’ <https://www.uneca.org/sites/default/files/PublicationFiles/iff_main_report_26feb_en.pdf> accessed 14 July 2019.

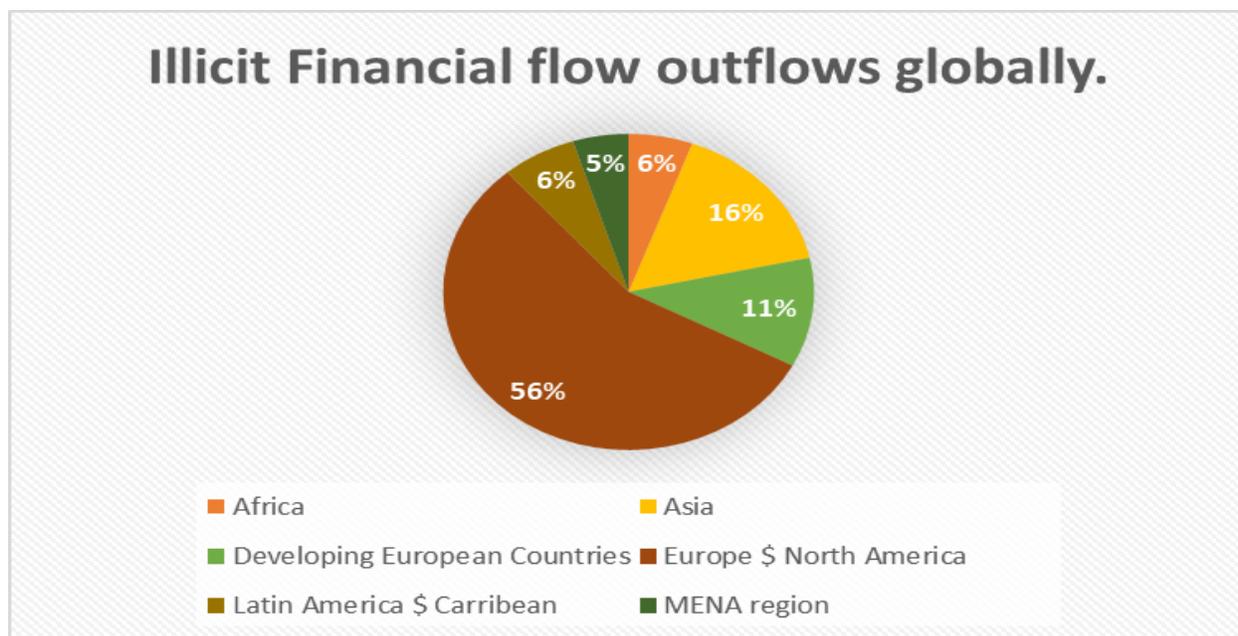
Global Financial Integrity ‘Illicit Financial Flows’ <<https://gfintegrity.org/issue/illicit-financial-flows/>> accessed 26 June 2019.

Peter Chowla and Tatiana Falcao, ‘Illicit Financial Flows: Concepts and Scope 20’.

‘The IMF and the Fight Against Illicit Financial Flows’ (IMF)

<<https://www.imf.org/en/About/Factsheets/Sheets/2018/10/07/imf-and-the-fight-against-illicit-financial-flows>> accessed 26 June 2019.

from developing European countries; 116 billion from Latin America and the Caribbean; 87 billion from the MENA region in 2011;² and an estimated 1 trillion loss from Europe and North America.



Source: Authors

If one were to look at the data on trade mispricing, the analysts' access to the information is limited. They may look at the data but it only shows the legal transactions as registered by the data collection agencies at the ports. If for example, a person places different items from those officially declared in a cargo container there is no way of verifying this data unless the border official catches the smuggler while physically checking the container. In addition, financial data cannot be triangulated because while goods and services may move between 2 or more countries, the payments often digital may move between banking institutions in a completely different set of states.

Two issues arise from a legal perspective: one, the veracity of the data and two, the underlying legal problems in stopping, tracking and returning these flows to their rightful destination. This policy brief highlights the diversity in the data. Despite the diversity of positions, this brief will move forward on the ground that these debates do not detract from the legal, economic and fiscal policy considerations that all states globally should consider when implementing reforms jointly and

²Marc Herkenrath, 'Illicit Financial Flows and Their Developmental Impacts: An Overview (2014) 5 International Development Policy | Revue internationale de politique de développement' <<http://journals.openedition.org/poldev/1863>> accessed 28 June 2019.

separately while relying on this data. This paper is divided into 4 parts: one, unpacking the definition and the data connecting to it; two, unpacking the data and pointing to both its strengths and weaknesses and three, making recommendations on the use of this data as well as how to improve it before finally, concluding.

2. The Legal Problems

2.1. Defining Illicit Financial Flows

Illicit money can be classified into three main forms:

- The proceeds of theft, bribery and other forms of corruption by government officials;
- The proceeds of criminal activities including drug trading, racketeering, counterfeiting, contraband, and terrorist financing;
- The proceeds of tax evasion and laundered commercial transactions³.

Although there is a debate on the definition, no matter which way one looks at it, the above three parameters are not in debate. Nevertheless, while creating these 3 classes within the definition the grouping by its very nature does not take into consideration the laws of different countries. For example, what is considered a bribe under the United Nations Convention against Corruption⁴ may be different in the domestic laws of individual countries. In the case of commercial corruption surrounding the world, football federation (FIFA) often referred to as the ‘bribery case with no bribery charge’ as there is no law on how money can be moved commercially by non-government institutions the collusion between the FIFA officials in commercial transactions could not raise a criminal charge of bribery.⁵ In other instances, although there are laws, there is limited, little or no enforcement e.g. Austria, Canada, Finland, Singapore, India, Mexico⁶ this means that data on these examples would be excluded from some IFF estimates.

³OSIWA `Illicit-Financial-Flow-in-Ghanas-Extractives.Pdf` <<http://www.osiwa.org/wp-content/uploads/2015/07/Illicit-Financial-Flow-in-Ghanas-extractives.pdf>> accessed 1 June 2019.

⁴UNODC `United Nations Convention against Corruption` <<https://www.unodc.org/unodc/en/corruption/uncac.html>> accessed 28 June 2019.

⁵FIFA: The Bribery Case with No Bribery Charge | Casetext` <<https://casetext.com/analysis/xyrwas9p8swf80k9-fifa-the-bribery-case-with-no-bribery-charge>> accessed 25 June 2019.

⁶Transparency International e.V, Foreign Bribery Rages Unchecked in over Half of Global Trade (www.transparency.org) <<https://www.transparency.org/news/feature/exporting-corruption-2018>> accessed 14 July 2019.

Voice of America `Anti-Corruption Watchdog: Most Countries Ignore Anti-Foreign Bribery Laws` <<https://www.voanews.com/archive/anti-corruption-watchdog-most-countries-ignore-anti-foreign-bribery-laws>> accessed 28 June 2019.

In 2001, Anti-bribery legislation to implement the 1997 OECD Anti-Bribery Convention became effective in Netherlands⁷. This means that the data from the Netherlands would not have included these amounts as an IFF. This concern of what is legal and illegal in different countries is an overarching problem which most of those working on the economic estimates have not yet addressed.

The IFF definition is set out as deliberately wide as it is intended to include both legal and illegal activities. For example, transfer mispricing is illegal only in countries where there is a law on transfer pricing. This law on transfer pricing allows a subsidiary company to move goods and services to another subsidiary or its parent company (a related company) at cost that as a result does not register a profit and therefore does not attract taxation. In addition, not all countries in the world have laws on transfer pricing and even when the law exists, it may not have the requisite regulations. The EY Worldwide Transfer Pricing Reference Guide 2018-2019⁸ only covers 124 jurisdictions or 102 countries⁹ out of 199 countries globally.

2.2. Evidence Law and IFF

Different countries globally have different thresholds for what information has evidentiary value in their judiciaries, their legislatures or their executives. One of the first analyses of IFF data came from GFI and included analysis of trade misinvoicing. The collection and transmission of this information can be traced from customs officials filing in national customs databases, after which the data is transmitted to the government data and statistics offices, and later on to global data repositories, international institutions and financial bodies. This country data is then cross-referenced with the corresponding countries by institutions who then estimated the IFF through misinvoicing using data transmitted electronically. Meso data like this as it is compiled often receives challenges on veracity and reliability.

⁷Netherlands - Corruption' <<https://www.globalsecurity.org/military/world/europe/nl-corruption.htm>> accessed 14 July 2019.

⁸'Worldwide Transfer Pricing Reference Guide' <<https://www.ey.com/gl/en/services/tax/international-tax/transfer-pricing-and-tax-effective-supply-chain-management/worldwide-transfer-pricing-reference-guide---country-list>> accessed 28 June 2019.

⁹'EY - 2018-2019 EY Worldwide Transfer Pricing Reference Guide' <<https://www.ey.com/gl/en/services/tax/international-tax/transfer-pricing-and-tax-effective-supply-chain-management/ey-2018-2019-worldwide-transfer-pricing-reference-guide-quick-reference-table>> accessed 14 July 2019.

'List of Countries of the World in Alphabetical Order' <<https://www.countries-ofthe-world.com/all-countries.html>> accessed 14 July 2019.

Within legislatures and executives, data of this nature is often presented by different stakeholders in guiding the legislation and policies being recommended for adoption in any sub-national, national, regional, continental or global parliaments and governments. However, the data is treated as persuasive at best and a guide for thinking and debate that results in law and policy making that is a reflection of the thinking of the majority. Conversely, depending on the stakeholder(s) that present the information it will be either taken on board or rejected and tends to be susceptible to lobbying processes.

Within judiciaries (national or international), rules of evidence guide the manner in which data is presented and relied upon. For example in the US federal rules of evidence rule 902¹⁰ the admissibility of documents from electronic sources states that an adverse party must have reasonable written notice and a fair opportunity to challenge it¹¹. A false foreign record attracts a criminal penalty in the country where the certification is signed.¹² In addition, only a qualified person can give certification of accuracy for electronically generated records.¹³ In addition, when admitting a document in a civil court as evidence, rule 36 of the US federal rules of civil procedure highlights that a party may request that an opponent admit the ‘genuineness of a document’ but authentication is not all that matters in admissibility of web based evidence, the information may be authentic but cannot be used to establish a prima facie case as was highlighted in *Doe v. Flaherty*.¹⁴ The data highlighting illicit financial flows even if admissible in a court of law is not strong enough evidence to establish a prima facie case even when authenticated.

3. Understanding the Data

As at 2019, the IFF data available includes analysis estimating trade mispricing: criminal activity and corruption. Nevertheless, there are no estimates presently available on one, linking money movements with their contracted goods and services; two, transactions purely in the digital economy; and finally, cash based informal economy transactions. In addition, the data can only guess at the size of the corruption and criminal activity since by their very nature IFFs related to

¹⁰Amendments to the Federal Rules of Practice and Procedure: Evidence 2017—Self-Authenticating Electronic Evidence, 2017.

¹¹‘Evidence-Rules-Procedure-Dec2017_0.Pdf’ <https://www.uscourts.gov/sites/default/files/evidence-rules-procedure-dec2017_0.pdf> accessed 16 June 2019.

¹²ibid.

¹³ibid.

¹⁴*Doe v. Flaherty*, 623 F.3d 577 (8th Cir. 2010).

criminal or illegal activities are designed to avoid regulation and oversight. The statisticians who work in specific fields focus on their particular field with the result there is limited cross discipline connections and analysis of data from the different statistical fields. For example, the analyst working on data on tax revenue losses from illicit outflows is different from one analysing data on import duties. Therefore, researchers who try to analyse the entirety of IFF face multiple hurdles. All of these result in an unreliable margin of error resulting in contradictory analysis.

3.1. Trade Mispricing Data

The first set of data to gain global recognition was the GFI data and the work of Boyce and Ndikumana which, developed IFF data based on estimates; but these were limited to trade mispricing and misinvoicing. For example, the Kenyan economy lost USD 9.64 billion in potential domestic investment from export under-invoicing and import over-invoicing during the years of 2002-2011 in this study, the government may have lost:

- USD 3.92 billion in tax revenue resulting from these illicit outflows and from the USD 3.94 billion in illicit inflows¹⁵.
- Tax and tariff revenues of USD 3.92 billion over the course of this study or an average of USD 435 million per year, based on official tax and tariff rates¹⁶.

The country of Mozambique lost USD 2.33 billion in illicit outflows of capital due to trade misinvoicing in the 2002- 2011, which, combined with cumulative illicit inflows of USD 2.93 billion, may have denied the government USD 1.68 billion in revenue¹⁷.

Import under-invoicing was the most rampant method of bringing in illicit capital in Mozambique, it totalled USD 2.22 billion from 2002-2010, an average of USD 247 million annually. This implies a loss in:

- Import duties of USD 37 million,
- VAT revenues at around USD 42 million,
- Corporate tax revenue equates to approximately USD 83 million on average. This combined with the losses incurred from import under-invoicing brings the average annual tax loss estimate to approximately USD 187 million per year¹⁸.

¹⁵Raymond Baker, 'Hiding in Plain Sight: Trade Misinvoicing and the Impact of Revenue Loss in Ghana, Kenya, Mozambique, Tanzania, and Uganda: 2002-2011' 72.

¹⁶ibid.

¹⁷ibid.

¹⁸ibid.

These two country examples highlight a figure much smaller than what is taking place on the ground. In Kenya, for example the revenue authority due to poor laws and regulations repeatedly lost transfer-pricing cases. In Mozambique, huge amounts of money have been channelled into corporations led by political elites. Both case studies while pointing towards the problem are underestimations of the real amount of IFF.

3.2. Data on Criminal Data

Data collected globally shows the amount of illicit financial flows from the global economy shows that counterfeiting and piracy amounts to USD 461 billion in 2013¹⁹

- On drug trafficking, the network is currently estimated to be worth between \$400 and \$600 billion, the illicit drug business is growing alongside licit trade hotspots with illicit trafficking of opiates to Europe yielding an estimated \$28 billion annually²⁰.
- Illegal logging is estimated to cause tax losses for governments annually valued at approximately USD 5 billion²¹
- Human trafficking is valued at USD 150 billion globally²²

However, the continental level data indicates the amount of illicit financial flows from Africa annually as varying by almost 300%. For example,

- Transnational criminal activities (counterfeiting) being USD 923 million to USD 1.13 billion has a difference of 900 million,
- Drug trafficking USD 426 billion to USD 652 billion a difference of 230 billion,
- Illegal logging USD 52 billion to USD 157 billion has a difference of 105 billion,
- Human trafficking USD150.2 billion,
- Illegal wildlife trade USD 5 billion to USD 23 billion has a difference of 18 billion

¹⁹'Global impacts of counterfeiting and piracy to reach US\$4.2 trillion by 2022' (ICC - International Chamber of Commerce, 6 February 2017) <<https://iccwbo.org/media-wall/news-speeches/global-impacts-counterfeiting-piracy-reach-us4-2-trillion-2022/>> accessed 28 June 2019.

²⁰'Barzoukas - 2017 - Drug Trafficking in the MENA.Pdf' <<https://www.iss.europa.eu/sites/default/files/EUISSFiles/Brief%2029%20MENA%20drugs.pdf>> accessed 28 June 2019.

²¹'Illegal Logging | Global Forest Atlas' <<https://globalforestatlas.yale.edu/forest-use-logging/logging/illegal-logging>> accessed 28 June 2019.

²²Tammy J Toney-Butler and Olivia Mittel, 'Human Trafficking', *StatPearls* (StatPearls Publishing 2019) <<http://www.ncbi.nlm.nih.gov/books/NBK430910/>> accessed 28 June 2019.

- Small arms and light weapons trafficking USD 1.7 billion to USD 3.5 billion, (In Libya, sale of arms, even though done publicly tracking the online sale of arms is challenging, particularly given the borderless nature of the trade²³) has a difference of 1.8 billion,
- Trafficking in cultural property USD 1.2 billion to USD 1.6 billion has a difference of 0.4 billion; totalling between USD 1.6 trillion to USD 2.2 trillion²⁴ with a difference of 0.6 trillion.

3.3. Data on Corruption

Additional disparities on corruption data shows that while on the one hand it was reported that USD 2 trillion is lost on corruption annually²⁵ another source stated that money lost on corruption is estimated between USD 1.5 trillion to USD 2 trillion²⁶. The EU alone losses €179 billion and €990 billion every year to corruption²⁷.

Recommendations and Conclusion

IFF should be recognised as a global problem requiring a global solution whose data seems to be underestimated rather than overestimated

1. Law on data collection and freedom of information should be improved to increase quality of data
2. All transaction data should be available to government and data collection agencies
3. Clearer and more specific laws on the financial benefits of corruption and other criminal activity as well as other IFF related legislation
4. Enforcement agencies must work more closely to pass across data on potential criminal activity to reduce data discrepancies

²³ENACTAfrica.org, 'Social Media and the Sale of Arms in Libya' (*ENACT Africa*, 12 April 2019) <<https://enactafrica.org/research/trend-reports/social-media-and-the-sale-of-arms-in-libya>> accessed 3 June 2019.

²⁴Attiya Waris, 'MEASURES UNDERTAKEN BY AFRICAN COUNTRIES TO COUNTER ILLICIT FINANCIAL FLOWS: UNPACKING THE AFRICAN REPORT OF THE HIGH-LEVEL PANEL ON ILLICIT FINANCIAL FLOWS' in Jeffrey Owens and others, *Inter-agency Cooperation and Good Tax Governance in Africa* (1st edn, Pretoria University Law Press 2017).

²⁵World Economic Forum 'We Waste \$2 Trillion a Year on Corruption. Here Are Four Better Ways to Spend That Money' <<https://www.weforum.org/agenda/2017/01/we-waste-2-trillion-a-year-on-corruption-here-are-four-better-ways-to-spend-that-money/>> accessed 28 June 2019.

²⁶Reuters 'IMF: Global Corruption Costs Trillions in Bribes, Lost Growth' (11 May 2016) <<https://www.reuters.com/article/us-imf-corruption-idUSKCN0Y22B7>> accessed 28 June 2019.

²⁷'Fact Check: "€ 904 Billion Goes to Corruption in the EU Every Year" – Euroscope Magazine' <<https://euroscopemag.eu/fact-check-e-904-billion-goes-to-corruption-in-the-eu-every-year/>> accessed 28 June 2019.

5. Bureaus of statistics should work more closely with revenue agencies, banks and other financial institutions, sub nationally, nationally, regionally, continentally and globally
6. Data should be publicly available to allow for checks and balances
7. Countries should have multi-disciplinary task forces to combat illicit financial flows and enhance the collection of valid and reliable data.

In conclusion, despite the clear concerns with the data it continues to require action to be tracked, controlled and stopped.

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