

The challenges of responding to IFFs where political will is absent: a synthesis evidence review

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Summary

The Global Initiative Against Transnational Organized Crime (GI-TOC) is the largest dedicated independent civil society research and policy institute on organised crime, which publishes more than 80 research reports, policy briefs and risk bulletins per year, providing in-depth, granular political economy research on illicit economies, black and grey markets, flows, trends and actors across nine geopolitical regions. This research brief has been designed to pull out insights across this body of work in order to better understand (a) what enables IFFs, (b) if there is the political will to address illicit financial flows (IFFs) and (c) what interventions have been successful in addressing IFFs as part of a politically sensitive approach.

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Context

In the past few years, the conflict in Ukraine, the numerous leaks of compromising data on the role of banks and legal firms, and evidence of mass diversion of public resources during the COVID-19 pandemic have together thrown the issue of IFFs to the forefront of the global policy agenda. These events have highlighted the harms that can result when the proceeds of crime and corruption can be moved unimpeded through global financial and trade systems. Policymakers are looking to identify ways to respond better to IFFs, and in doing so this has brought to the fore the question of political will, and whether it is sufficient to meaningfully address the problem.

The conclusions in this brief are drawn from systematic analysis of four different sources of data: (i) more than fifty GI-TOC research reports; (ii) consultations with GI-TOC staff in regional observatories, in field networks and thematic experts; (iii) a review of the country profiles of the GI-TOC Organized Crime Index 2021, focusing in particular on the role of criminal and state actors and resilience building; and finally (iv) a comprehensive literature review.

Key findings

The overarching conclusion of this research is that the line between business, politics and crime has never been more blurred. As a consequence, the majority of illicit financial flows (IFFs) are not in fact illegal, but instead benefit from policies designed to create loopholes for a cadre of wealthy, politically connected elites to preserve and grow their wealth and move their assets, free of taxation, free of oversight and almost entirely beyond the sight and reach of regulatory bodies and law enforcement. States that have become compromised by illicit money have become spoilers in the multilateral system, hampering the ability to establish common frameworks and norms to govern IFFs and the systems that enable them. This closes the loop on protecting those who benefit most from the system.

The review found that the term IFFs is often used synonymously with money laundering and therefore conceptually restricted to the flow of money, for which the anti-money laundering (AML) regime is seen as the antidote. Conversely, research on the ground clearly shows that physical flows of (illicit) trade and trade-based money laundering are very significant sources of financial value transfer, and there is insufficient connection made between IFFs and trade, particularly in the framing of responses. It moreover finds that informality also contributes significantly to creating an enabling environment for IFFs. Drawing from the evidence review, this paper lays out what we have termed the 'IFF pyramid', the three dominant means by which IFFs are enabled, moved and held: financial flows, trade flows and informal flows.

Financial flows: A system of offshore jurisdictions with preferential tax regimes has been created and allowed to grow, with different countries competing to attract the wealthy to shift their vast and increasing global wealth into those jurisdictions. The various leaks – from the Panama to Pandora papers – have demonstrated irrevocably how the wealthy, the politically connected, the corrupt and the criminal have exploited the offshore system to launder dirty money. They show how a range of professional service providers, from bankers, lawyers, real estate agents and the purveyors

of luxury goods allow the plutocrats the means to bypass anti-money laundering regulations, weakening the rule of law. As demonstrated by the FinCEN leaks in 2020, enforcement systems are too weak and overwhelmed to respond; beneficial ownership and effective corporate registration processes which would enhance transparency (or conversely, reduce secrecy) have been left inadequate even in countries with no shortage of technical capacity to enact them. Countries such as the UK and their Crown dependencies, Switzerland and the United States have chosen not to make the reforms that would take them off the top of the Financial Secrecy Index, for example.³

Trade flows: Trade misinvoicing is done by either underpricing or overpricing the value of the physical commodities being shipped, with the discrepancy between the two as a means to illicitly transfer money across international borders, evade tax and/or customs duties, or launder the proceeds of crime through the use of trade transactions. Despite being about the physical movement of goods, the purpose of misinvoicing is to register the financial value of the discrepancy in a new jurisdiction – it is essentially a financial flow using trade transactions. The data also indicates that the scale of the problem is growing rapidly, with COVID-19 presenting even more new vulnerabilities to an already acute problem (GFI, 2021). There are more than 3,500 Free Trade Zones (FTZs) currently in 130 countries, compared to just 79 in 1975. This growth is driven largely by the massive proliferation of Special Economic Zones (SEZ) promoted by the Chinese who made SEZ concessions a requirement for Belt and Road Initiative funding for investment in many countries in the developed world.⁴ Run both by governments and by the private sector, FTZs facilitate trade by providing advantages to business with respect to

tariffs, financing, ownership, taxes, requirements for transparency and other regulatory measures that would typically be applicable.⁵ They are a policy choice that simultaneously encourages the profit accumulation preferences of wealthy corporate entities, while undermining enforcement of illicit behaviour.

Informal flows: The size of the informal economy and its continued growth are major facilitators of IFFs and reduce the capacity of both national and international actors to respond. The majority of transactions in the informal economy, from earnings to transactions to remittances, are transacted in cash or through unregistered financial value services, or the smuggling of value-holding commodities such as gold. These transactions go below the radar of formal financial system entities, avoid enforcement by having no identifiable trace owner, and create a significant hole in the ability of policymakers to understand the dynamics of the economy in its entirety. The overemphasis on countering IFFs through financial regulation and the FATF standards have motivated the growth of the informal sector, as practices of derisking leave a growing portion of people and sectors of the economy unbanked, whilst again reducing capacity for enforcement.

The challenging conclusion of this review is that political will is a tide moving in favour of enhancing the ability to move IFFs and to legitimise them, rather than to prevent and enforce against them. Many of the systems that enable IFFs have been policy choices: promoting the offshore financial system and failing to in ensuring transparent and accountable beneficial ownership systems; allowing the proliferation of free trade and special economic zones in the global trade architecture and failing to mitigate the growth of the informal economy.

3 In the 2020 Financial Secrecy Index, the Cayman Islands, a British Overseas Territory, is the top of the rankings list of most secret jurisdictions, followed by the United States and Switzerland. Financial Secrecy Index (2020). Tax Justice Network <https://fsi.taxjustice.net>

4 Comolli, V. and Rose, N (2021). *China's New Silk Road: Navigating the organized crime risk*. Global Initiative Against Transnational Organized Crime (GI-TOC). <https://globalinitiative.net/wp-content/uploads/2021/03/Chinas-New-Silk-Road-Navigating-the-Organized-Crime-Risk-GITOC.pdf>

5 OECD (2018). *Governance Frameworks to Counter Illicit Trade*. https://read.oecd-ilibrary.org/governance/governance-frameworks-to-counter-illicit-trade_9789264291652-en#page16

The conclusion of this research and evidence review is that in order to design effective strategies to counter IFFs, a number of steps are needed:

1. To take a wider view of the problem, moving beyond just financial flows (and thus the FATF) to also counter illicit trade and informality.
2. Recognising that traditional, technocratic responses – such as legal reform, capacity building of state institutions – look like action on paper, but a corrupt system where political will is weak means that these are easily undermined.
3. Multilateral system responses – whether UN norm setting processes, the implementation of conventions such as the UN Convention against Transnational Organized Crime, its sister Convention Against Corruption, or technical bodies like the FATF – are also weakened by corrupt states. There is a need for an overarching and holistic strategic response, means by which to credibly measure implementation, and to hold recalcitrant states to account – but under the current governance architecture it is unlikely to come.
4. The link between IFFs and violence is under-acknowledged. It is too often seen or described as a victimless or non-violent crime, a white-collar bureaucratic crime, rather than a serious social harm. Gang violence, minority violence and gender-based violence have all been linked to a sense of injustice, inequality and impunity in the system, based on a degradation in the rule of law and quality of governance.
5. In compromised states, civil society often plays an important role in oversight and holding authorities to account. However, the space for civil society is being closed; activists and vocal organisations targeted with violence, harassment, and legal action; with organisations blocked from multilateral processes.

Implications

Responding to IFFs is a collective action problem: unless all states agree to end the secrecy jurisdictions, then there will always be places for money to hide, though they may be harder to access. If the free trade and special economic zones are not all closed, then there will always be incentives for another state to negotiate a new one in an attempt to attract lucrative trade routes through their jurisdictions, allowing the black boxes in global trade to persist. Given the scale of political involvement in IFFs, technocratic solutions cannot succeed either, nor can any form of self-regulating model that is typically used to ensure that recommendations remain soft and implementation toothless. The consensus on recommendations is that a global governance mechanism is required to ensure that the systems that enable IFFs are transformed into something that enables a more development-centric distribution of value in the global economy.

However, making that shift is a challenge when political will is running so contrary to that objective. A more potentially tractable set of recommendations focuses on addressing the enabling environment around the states which persist in weakening the system, that works cross-sectorally with non-state actors, the private sector and aligned state actors with demonstrated integrity. The question then is how to accelerate those efforts and results. The report concludes by proposing three avenues:

1. The role of civil society has become more prominent, including playing a number of different roles as watchdog, advocate, activist, and source of resilience for those made vulnerable by the status quo. Those committed to fighting IFFs in a meaningful way will need to ensure that these sorts of efforts are funded and supported, and that their findings are amplified and championed in national, regional and international policy fora to raise policy concerns.

2. Informality, cash-based economies and shadow banking systems have all contributed significantly to allowing IFFs to move around the world with ease. Redressing this vulnerability is therefore an imperative in an effective response and, given the long-proven benefits of financial inclusion for core development objectives such as poverty reduction, there is little reason not to move this significantly up the policy priority hierarchy.
3. There has been a growing realisation under the FATF framework that banks alone cannot stand as watchdogs in the prevention of IFFs (FATF, 2018), and that there is a need to expand the net of actors who must be aware of the risks of IFFs, to include more of the professions that handle wealth – from lawyers, private educational and health institutions, and real estate agents, among others.⁶ Given the profits to be made by the facilitators of IFFs, rather than their criminal instigators, are lower in the system and their numbers far greater, changing their incentive structure, encouraging their integrity and reporting efforts, building them into networks of trust can be a more achievable target even in the current environment.⁷ That IFFs flow through a combination of financial, trade and informal channels was a key conclusion of the GI-TOC collective research, which significantly broadens the discussion of who the gatekeepers are of both licit and illicit economies, and experimentation and innovation is needed to see how to achieve this most effectively.

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⁶ The GI-TOC work on IFFs in the Balkans, for example, identified the extent to which money laundering was facilitated through the real estate sector, with large purchasing in cash (Reitano and Amerhauser, 2020); the report on money laundering through the education sector in the UK (Page, 2021) and in real estate, luxury goods and other sectors in North America (see for example German, 2019, who gives multiple examples). The World Economic Forum initiative on a 'Unifying Framework' for gatekeepers summarises this finding across the different corporate industries.

⁷ World Economic Forum (WEF) (2021). *The Role and Responsibilities of Gatekeepers in the Fight against Illicit Financial Flows: A Unifying Framework*. June 2021. https://www3.weforum.org/docs/WEF_Gatekeepers_A_Unifying_Framework_2021.pdf

The Serious Organised Crime & Anti-Corruption Evidence (SOC ACE) research programme aims to help 'unlock the black box of political will' for tackling serious organised crime, illicit finance and transnational corruption through research that informs politically feasible, technically sound interventions and strategies. Funded by the UK's Foreign, Commonwealth & Development Office (FCDO), SOC ACE is a new component in the Anti-Corruption Evidence (ACE) research programme, alongside Global Integrity ACE and SOAS ACE. SOC ACE is managed by the University of Birmingham, working in collaboration with a number of leading research organisations and through consultation and engagement with key stakeholders.

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