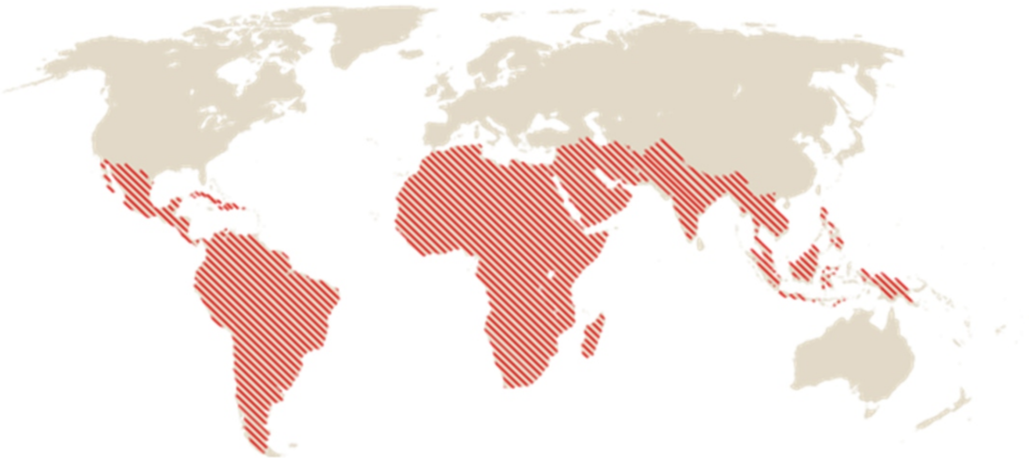

THE SPECTRE OF ILLICIT FINANCIAL FLOWS: UNDERMINING JUSTICE

A primer on illicit financial flows,
opacity in the global financial system and
challenges for developing countries

CBGA

FINANCIAL TRANSPARENCY COALITION

Photo Image Credit: African Outlook Online

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Contents

Glossary

AAAA	Addis Ababa Action Agenda
AML	Anti-Money Laundering
CIT	Corporate Income Tax
ECLAC	Economic Commission for Latin America and the Caribbean
EPA	Economic Partnership Agreement
EPZ	Export Processing Zones
EU	European Union
FDI	Foreign Direct Investment
FTZ	Free Trade Zone
GDP	Gross Domestic Product
HNWI	High Net-Worth Individuals
IFF	Illicit Financial Flows
MDG	Millennium Development Goal
MNC	Multi- National Companies
ODA	Official Development Assistance
OECD	Organisation for Economic Cooperation and Development
OFC	Offshore Financial Centre
PEP	Politically Exposed Person
SEZ	SpecialEconomic Zone
SDG	Sustainable Development Goal
SIC	Small Island Country
UBO	Ultimate Beneficial Owner
UNODC	United Nations Office of Drugs and Crime

What are Illicit Financial Flows?

Illicit finance generated through tricky structures and channels harm the development and growth of a country. The problem of illicit financial flows poses as the greatest development challenge in present times. Illicit financial flows are the illegal movement of funds or capital from one country to another. These funds may be earned, transferred and/ or used from the proceeds of crime and corruption, or activities like money laundering, trade based manipulation, tax evasion and avoidance practices used by multinational corporations (MNCs) or the elite.

1. How Do Countries Lose Money Globally?

Cross- border loss of revenue in countries is commonly associated with capital flight. However, massive cross-border revenue losses in countries occur as also illicit financial flows (IFFs). Historically, laundering of illegal capital from proceeds of crime, terrorist financing, corruption and tax evasion have received a greater focus when defining an IFF. Hence, IFFs have synonymously been referred to as grey money and black or dirty money in different regions depending on the context. While grey money mostly implies money generated from tax evasion related activities, black or dirty money denote money generated from crime, fraud or corruption. Both terms convey a sense of 'illegality' either in the origin of the revenue or the act itself. In this context, capital flight arising from illegal sources or moved through illegal channels is a component of IFFs. Capital flight is essentially an unreported and undocumented outflow or transfer of asset to another jurisdiction in order to minimise the "loss of principal, loss of return or loss of control"[1]. There could be a variety of reasons for capital flight from a country to occur depending upon political reasons like regime change, decline in economic stability or stricter capital regulation. There is documented evidence of some developing regions suffering unusual capital loss even with political stability. For example, despite better political stability after democratic elections were held in 1994, a study by Mohammad and Finn (2004) found higher capital flight from South Africa in this period. Further, IFFs have allowed the debate to be contextualised in the role played by the fault lines in the current international financial system. While, all capital flight is essentially illegal not all of it classifies as IFFs.

Global financial opacity systematically provides multiple safe channels for IFFs to remain outside the scrutiny of national laws and public eyes, regardless of the nature of IFFs.

[1] Epstein, G. (2007). Capital flight and capital controls in developing countries. Cheltenham: Edward Elgar.

Being deeply intertwined with global financial flows, it is in the ability of an illicit financial outflow to manifest itself into licit financial circles. This may occur in the form of development aid[2] or foreign direct investment (FDI), both licit in nature. For example, offshore financial centres (OFCs; commonly known as tax havens) are used to round trip illicit funds that have escaped from national authorities to the country of origin as FDI. Normally FDIs entering a country are not taxed and therefore, are an effective method of dodging taxes. There have been studies arguing that nearly a third of global FDI occurs via OFCs (Haberly & Wojcik, 2015).

Being able to remain out of any institutional scrutiny is a central characteristic of IFFs. The shift in the international understanding from capital flight to illicit financial flows highlights the active role of secrecy jurisdictions in facilitating IFFs through anonymous structures and complicated arrangements[3].

1.1 Illicit over Illegal: The Difference

The focus on the term 'illicit' in IFFs reflects the impact on human rights on the basis of that revenue loss or how the funds have been used and the activities contributing towards the cross-border flow. For example, money transfers across jurisdictions for the purpose of diversifying portfolio shares or money transfers like remittances that are informal in nature do not fall under the purview of 'illicit' flows. Informal does not necessarily mean illegal or illicit. However, IFFs stemming from unscrupulous and abusive tax dodging and minimization strategies used by MNCs could be either depending upon national laws of that jurisdiction. These practices may not necessarily be characterised as illegal or even potentially illegal in the national legal framework but have adverse socio-economic implications. These financial outflows that slip through legal loopholes defeat the legislative intent of the law but do not violate the letter of the law itself. National regulatory bodies may determine and scrutinize the legality of similar behaviour on a case by case basis; however, the resulting high costs discourage state authorities from being able to pursue them. Since, tax departments and state watchdogs are overburdened and severely under-resourced and under-funded both in low income countries and emerging economies, there is little chance of monitoring dubious activities or recovering stolen public funds and assets. This should not detract from the possible illegality of the practice.

1.2 Gatekeepers, Components, Methods & Practices

Amoral intentions on the part of gatekeepers are both the cause and consequence of

[2] Mainly tied aid implemented through contracts, companies to developing countries.

[3] Herkenrath, M. (2014). Illicit Financial Flows and their Developmental Impacts: An Overview. Revue internationale de politique de développement, (5.3).

illicit financial flows. Gatekeepers or enablers are a heterogeneous network of professionals that flout and use loopholes in both national and international laws to generate and drive the cross-border outflow of illicit finance. Any “entity” or high net-worth individual (HNWI) looking to effectively hide this trail of money uses the counsel and assistance of a hub of experts and professionals like bankers, lawyers, notaries, chartered accountants, wealth managers, bookkeepers, auditors and brokers.

- **Informal or underground banking channels:** Most developing, low income countries, conflict ridden or fragile states do not have proper banking systems and institutions in place and are heavily cash-strapped. As public trust in banking structures or the state itself is not very high, there is huge reliance on personal relationships, bonds and networks to transfer funds. Alternative private channels of banking exist in emerging economies like China too and are actively used for money laundering. These channels are widely used by criminals, corrupt and the general public to move large sums of funds both within and across borders. These laundering channels can range from primitive methods to utterly complex tools. *Hawala* or *Hundi* networks in South Asia or the *Fei Ch'ien* system in China too, navigate transfer of money through trustworthy intermediaries, similar to the peso exchange network present in Colombia.

- **Corporate vehicles and service providers:** A secrecy jurisdiction (or commonly known as tax haven) provides multiple legal and financial services, arrangements and layers of anonymity in all forms to hide illicit finance. These structures and channels exist within countries for illicit outflows to occur. Secrecy caters to ensure both onshore and offshore financing by concealing the identity of the true owner of that legal entity (company, trust, foundation, limited liability partnership, co-operative society, association). High net-worth individuals (HNWIs), politically exposed persons (PEPs), dictators, oligarchs, art dealers, smugglers, the corrupt and terrorists alike have been known to use 'shell companies'[4] to mask their money, assets and operations from prying authorities. Through revelations like the Lux leaks, financial institutions have also been found guilty of not following due diligence procedures and conducting proper background checks to solicit in tax avoidance deals at the behest of MNCs and lobbyists.

- **Offshore wealth:** The use of tax havens have corporatised concealing of private wealth from regulatory authorities, a person's own family or business associates or competitors. Offshore wealth has been understood as the assets held by an investor

[4] Shell companies are entities with no real economic operations, physical presence or employees but are used as tools for money laundering. They are also referred to as on-paper companies, front companies.

in a country without having legal residence in the country. Estimates of undeclared global private wealth accumulated in tax havens ranges from 8-18 percent, amounting in trillions[5]. Additionally, the existence of trust laws has allowed a person to divert inheritance laws. Narrowing down the geographical origins of wealth continues to remain a challenge due to the dearth of data. The motivation behind declaring only a portion of wealth in some cases is the assumed security over assets offshore or fund management services provided in offshore financial centres.

- **Crime related:** Organised crime operates as a shadow economy through local power structures, underground money laundering and trans-border trade networks. These networks comprise of small brokers, public actors, politicians, informal money transfer channels that work in coherence with each other as a close-knit business. A 2011 report[6] by the United Nations Office of Drugs and Crime (UNODC) found that drug trafficking constitutes the largest share of illicit funds originating from criminal activities, almost 0.9 percent of the global GDP in 2005.

- **Corruption:** Practices like rent-seeking are normative in Petrolist or mineral-rich developing economies. Rent-seeking refers to increasing one's share of wealth without contributing to an economic activity that generates value. These may include bribery in both the public and private sector. The High Level Panel report on IFFs (2015) argues that the main purpose of corrupt activities is beyond only generating more IFFs. Money laundering helps corrupt politicians be in power without any accountability. The Azerbaijani Laundromat scandal is a perfect tale of high level corruption where money was laundered between 2012-2014 through shell companies registered in the United Kingdom involving EU politicians, Azeri kleptocrats and lobbyists under the guise of conducting independent and democratic elections in Azerbaijan. Anti-money laundering (AML) policies are primarily focused towards addressing IFFs that emerge from drug and human trafficking, terrorism, illicit weapon trade, theft of public funds etc.

- **Trade related:** Almost 80 percent of the world trade occurs between MNCs and their subsidiaries or related companies in the global value chains[7]. A 2016 study by the UN Conference on Trade and Development (UNCTAD) argued that trade misinvoicing of goods results in "some countries losing 67 percent of the value of

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[5] Alstadsæter A., Niels Johannesen and Gabriel Zucman (2017). Who Owns the Wealth in Tax Havens? Macro Evidence and Implications for Global Inequality. Working Paper 23805. National Bureau of Economic Research. Available at: http://www.nber.org/papers/w23805

[6] United Nations Office of Drugs and Crime (2011). Estimating illicit financial flows resulting from drug trafficking and other transnational organized crimes

[7] UNCTAD (2013). World Investment Report:Global Value Chains: Investment And Trade For Development

their exports"[8]. A discrepancy reported as over or under-pricing of goods and services in trade receipts of exports and imports is called trade misinvoicing. Other practices like double invoicing allows companies to produce two different invoices of goods at different sides of the border in the same supply chain. Many developing countries have trade-related tariffs, quotas, rules concerning foreign ownership. IFFs can be motivated by evading such rules by falsifying import-export invoices on the basis of their price, quantity or quality.

- **Tax evasion:** Capital regulation allows countries to keep control on any illegitimate activities. Illicit capital flows motivated from activities like tax evasion[9] could occur from forged tax returns, manipulation of rents by corrupt bureaucrats or public officials (rent scraping) where a share of the profit may go into filling their pockets. Without institutionalised watchdogs, tax evasion contributes to a large share of the shadow economy and lowers compliance encouraging wilful dodging of taxes. False reporting on income or profits is also common in this scenario. The more corrupt a society is there are more opportunities available to evade taxes.
- **Tax minimisation and avoidance strategies:** While tax evasion is clearly illegal, tax avoidance occurs through the gaps in the legal laws, lapses in regulation and through opaque structures and arrangements.
    - Tax incentive abuse: Tax incentives are policy instruments given in various forms of tax breaks, holidays, deductions, rebates, royalties or as special economic zones (SEZs) to boost trade, investment and jobs. Slashed corporate income tax (CIT) rates, a form of tax rebate to businesses, not only harm local enterprises but categorically give rise to artificial tax competition. Unchecked exemptions provide avenues to businesses where they set up fake companies in SEZs to shift profits or may dodge paying import duties and other similar tariffs or benefit from lower taxes. As a result, countries end up limiting their sovereign abilities to tax and enter an intense race to the bottom with countries employing similar tactics. Governments relying solely upon their discretion, offer covert deals, discussed behind closed doors, as exemptions or breaks on taxes to investors and big businesses. These deals are in particular susceptible to corruption and often a direct result of intense corporate lobbying.
    - Abusive transfer pricing: Transfer price is the cost of a transaction between two related parties. Cross-border intra-trade between MNCs and related parties

[8] Ndikumana, L. (2016). Trade Misinvoicing in Primary Commodities in Developing Countries: The cases of Chile, Coté d'Ivoire, Nigeria, South Africa and Zambia. Geneva: UNCTAD

[9] Tax evasion and corruption can easily influence and enforce each other.

are calculated at an arm's length principle[10]. Ideally, market forces would determine the cost of a transaction between two independent entities. However, subsidiary or associated companies at trade may manipulate this price to dodge their tax liabilities from state authorities. For example, each country categorises commodities differently and may extend tariff exemptions on certain products. A loophole, MNCs exploit through intra-firm trade to misprice commodities exempted from taxes in the destination country[11]. It has been found that related party prices are much lower than the market price calculated at arm's length. Countries with weak tax structures and monitoring mechanisms in place are the most affected by such practices.

- Thin capitalisation: A tax minimisation and profit shifting strategy, where a parent company rearranges the internal structure of subsidiary, based in a low tax jurisdiction, by financing it using debt in order to reduce their taxable profit and reduce compliance. The subsidiary in such a case is known to be a thinly capitalised entity. Known as intra-corporate loans, under this practice, the subsidiary based out of higher tax jurisdiction can borrow from the subsidiary based out of the lower taxed jurisdiction (or tax haven) and thus claim maximum tax deductions on interest payments on the loan in the higher taxed jurisdiction. Intra-corporate loans can however, also be with an unrelated party which is not the case with a thinly capitalised subsidiary.
- Tax or corporate inversion: A corporation may move their legal ownership to a tax haven while retaining their economic operations in the high tax country. This practice of corporate inversion allows companies to artificially move their profits accordingly and reduces the tax collection in the jurisdiction with business presence.
- Tax Treaty Abuse: Tax or investment treaties are international agreements between governments that detail a division of taxing rights to avoid double taxation of corporate incomes (dividends, capital gains or interest gains) earned in the 'source' country[12]. They have come under scrutiny by international institutions for their misuse by MNCs. MNCs plan their investments through countries with whom their 'domicile' country[13] has

[10] Arm's length principle is a price which is applied in a transaction between persons other than associated enterprises in an uncontrolled environment.

[11] Bernard et al (2006;2008)

[12] Source country is the place of operations where the actual economic value is created.

[13] Country where the MNC is headquartered at or with permanent establishment, also known as residence countries.

bilateral investment and taxation agreements with. A legal person may seek treaty benefits not attributed to them directly from a third country on income generated in another country. Consequently, even as economic value is created in developing countries, they end up losing control of their ability to tax. Ultimately, MNCs evaluate and identify the terms of these treaties and domestic legislations which offer better incentives for their investments and route them to the source country through tax havens in order to avoid paying tax[14]. Owing to the tax treaty between India-Mauritius, from April 2000 to March 2011, inflows from Mauritius alone constituted almost 41.50 percent of the entire foreign direct investment to India[15]. MNCs are known to influence the effectiveness of the treaty in their favour by intense lobbying and using political ties.

[14] Action Aid (2015). Levelling Up: Ensuring a Fairer Share of Corporate Tax for Developing Countries.

[15] Ministry of Finance (2012), 'The White Paper on Black Money', Central Board of Direct Taxes. Pp 1-96

2. How Do International Institutions View Illicit Financial Flows?

Global institutions have continued to struggle to come up with a comprehensive definition and set of actions to tackle illicit financial flows. Transitioning from the Millennium Development Goals (MDGs) in 2015, the United Nations (UN) came out with 17 global goals with a range of 169 distributed targets as SDGs 2030 primarily encompassing global issues and financing needs of countries in achieving these goals. After months of negotiations, the year 2015 also saw countries unequivocally support the Addis Ababa Action Agenda (AAAA) at the Third International Conference on Financing for Development (FfD). While, the AAAA commits to *"substantially reduce illicit financial flows by 2030, with a view to eventually eliminating them, including by combating tax evasion and corruption through strengthened national regulation and increased international cooperation. (...) and reduce opportunities for tax avoidance",*[16] it does not constitute a clear definition.

The target 16.4 in Sustainable Development Goals (SDGs) limits the definition of the term illicit financial flows generated from organised crime related activities and focuses on "reducing illicit financial and arm flows and retrieving stolen assets". IFFs are currently categorised as a tier 3 indicator and therefore, there does not have a set definition, design or methodology for national governments to work on. Further, IFFs also have cross-sectional inter-linkages with targets looking to reduce corruption and bribery in all forms (16.5) and strengthening domestic resource mobilisation in developing countries (17.1). Without a dedicated agency that works on this target, there continues to be a real gap in the conceptual, contextual and terminological understanding of IFFs. It is clear, how illicit financial flows are conceived is deeply influenced through geo-politics.

Organisation for Economic Co-operation and Development (2014)

> *"(...) essentially they [IFFs] are generated by methods, practices and crimes aiming to transfer financial capital out of a country in contravention of national or international laws."*

[16] Addis Ababa Action Agenda (2015). Available here: http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf (paragraph 23)

High-level Mbeki Panel report on 'Illicit Financial Flows from Africa' (2015)

> *"Money that is illegally earned transferred or utilized. These funds typically originate from three sources: commercial tax evasion, trade misinvoicing and abusive transfer pricing; criminal activities, including the drug trade, human trafficking, illegal arms dealing, and smuggling of contraband; and bribery and theft by corrupt government officials."*

The report adds,

> *"(…) the term "illicit" is a fair description of activities that, while not strictly illegal in all cases, go against established rules and norms, including avoiding legal obligations to pay tax. Our purpose in doing so was to establish the nature of such outflows, given the harm that they cause to African economies."*

European Parliament (2015)

> *"(...) all unrecorded private financial outflows involving capital that is illegally earned, transferred or utilized", and then goes on to say that " (...) typically originate from tax evasion and avoidance activities, such as abusive transfer pricing, against the principle that taxes should be paid where profits have been generated."*

Human Rights Council (2016)

> *"(...) a large number of phenomena classified as illicit financial flows, including illegal tax evasion; tax avoidance by transnational corporations; bribery, corruption and concomitant asset recovery; and other criminal activities."*

Economic Commission for Latin America and Caribbean (ECLAC) (2016)

> *"Son movimientos de un país a otro de dinero que ha sido ganado, transferido o utilizado de manera ilegal. En general se originan en:*
>
> *– actividades comerciales,*
>
> *– en actividades delictivas y en la corrupción."*
>
> *(Translated: Illicit financial flows are the movements of money from one country to another gained, transferred or used illegally. In general they originate from:*
>
> *- Commercial activities,*
>
> *- Criminal activities and in corruption.)*

Financing for Development: Progress and Prospects', Report of the Inter-Action Task Force on Financing for Development (2017)

> *IFFs are often defined as constituting money that is illegally earned, transferred or used and that crosses borders. (...) there are generally three categories of IFFs, although these are not mutually exclusive or comprehensive: IFFs originating from transnational criminal activity; corruption-related IFFs; and tax-related IFFs.*

UN Second Committee Resolution on Illicit Financial Flows (2017)

> *"(…) the impact of illicit financial flows, in particular [to] those caused by tax evasion and corruption, on the economic, social and political stability and development of societies."*

World Bank (2017)

> *"(…) refers to the cross-border movement of capital associated with illegal activity or more explicitly, money that is illegally earned, transferred or used that crosses borders. This falls into three main areas:*
>
> *The acts themselves are illegal (e.g. corruption, tax evasion); or*
>
> *The funds are the results of illegal acts (e.g. smuggling and tracking in minerals, wildlife, drugs, and people); or*
>
> *The funds are used for illegal purposes (e.g., financing of organized crime)[17]."*

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[17] World Bank (2017). Illicit Financial Flows. Available at: http://www.worldbank.org/en/topic/financialsector/brief/illicit-financial-flows-iffs

3. How Do Illicit Financial Flows Undermine Justice in Developing Countries?

The steady decline of public investment in social services after financial liberalisation has been a vibrant debate in the economic development of developing countries. Developing countries face a global infrastructure deficit of $3-$5 trillion annually[18], infrastructure that is crucial to achieve the 2030 goals. To fulfil these goals for lower income and lower-middle income countries alone, the UN Sustainable Development Network estimates a revenue figure of at least $1.4 trillion annually. Bilateral aid to the poorest countries declined in 2016, despite calls to fulfil Official Development Assistance (ODA) commitments by developed countries in both the SDG and AAAA framework. As financing gaps widen, there is a rising cost attached to eradicating poverty and resolving intersecting inequality. IFFs understandably contribute to exacerbating this financial gap and prevent the immediate and progressive realisation of rights through mobilisation of domestic resources. As foreign aid flows to developing countries decline, there is a resounding recognition on financing development through domestic mobilisation of resources. Chowla and Falcao (2016) argue that IFFs do not include the national activities generating illicit funds that do not cross border and are thus, a subset to the gargantuan problem of illicit finance itself. There may not be consensus over how IFFs are defined but their harmful impact on especially developing countries is not contested.

Since IFFs are essentially hidden, it is challenging to calculate and estimate the potential direct and indirect spill-over effects with accuracy. Broadly, the definition of IFFs can be categorised into the moral and legal aspect. Additionally, estimating the size of IFFs would require a wide range of activities to be included as issues. For developing countries, these activities are regionally and nationally influenced. Even with IFF estimates it is hard to illustrate its impact on human rights tied in a single thread. While there have been estimates around large scale illicit outflows, there have also been disaggregated estimates on the basis of source, activity, the method employed to facilitate IFFs and the conduit used for transferring funds illegally from one jurisdiction to another. There have also been studies estimating overall i.e. global, regional, national figures for IFFs. Economist Gabriel Zucman (2013; 2015) uses ownership to determine the asset share owned by foreign nationals in tax havens, expanding this data by including central bank reserves and bilateral investments between countries. According to this method, the offshore wealth was estimated at $7.6 trillion in 2015. Without taking tax avoidance, cash-based money laundering and misinvoicing on services into

[18] Inter-Agency Action Task Force (2017). Financing for Development: Progress and Prospects

account, Global Financial Integrity offers a conservative range of $620-970 billion as the total illicit outflows figures in the year 2014 from developing countries. The actual figures are well over this.

One-third of the global revenue losses related to tax avoidance occur from developing countries (Cobham & Janský, 2017), close to $100 billion annually[19]. Exemptions on taxes are provided mainly to drive FDI in the country with the promise of increased local job growth. Governments also open Special Economic Zones (SEZs) and Free Trade Zones (FTZs) to corporates offering them lucrative tax holidays. Not only does this lead to misuse but there is also little evidence to support that incentives are able to drive FDI. If ones notes, the current definition on IFFs given by premier global institutions does not account for revenue loss through abusive and wasteful tax breaks used by MNCs to avoid taxes.

A least developed country like Bangladesh offers 15 years of tax holidays to coal-based power generation companies and nearly 5-7 years of tax holidays to companies established in 'export processing zones', a form of SEZs. In Bangladesh, for example, SEZs also allow varied exemptions on stamp duty levied for land registration, value added tax for services consumed in the zone and custom duty imposed on exports. An unintended consequence of tax incentives are the 'leakages' of goods destined for exports that have not paid tariffs. Taking advantage of such ambiguities, companies manipulate trade receipts to avoid paying import tariffs. ECLAC in their Economic Survey of 2015 concluded that trade misinvoicing in fact represented 1.8 percent of their regional GDP.

In comparison to a southern[20] country, a rich developed country has more leeway over negotiating bilateral agreements on trade and investment. As mentioned earlier, these agreements particularly factor the allocation of taxing rights. Bangladesh loses up to $85 million annually due to unfair and exploitative treaties that prevent it from taxing accrued dividend incomes[21].

[19] United Nations Conference on Trade and Development (2015). The World Investment Report 2015: Reforming International Investment Governance

[20] Global South represents countries in the developing regions of Latin America, Africa and Asia that share a colonial and imperial past. Southern countries refer to countries belonging to the Global South.

[21] Action Aid (2016). Mistreated: Tax Treaties.

Case Study: Kenya's experience with the Economic Partnership Agreement with the EU

The cut flower industry in Kenya is the second most important national industry that produces exports worth nearly €360 million[22] annually. Kenya was forced to enter in an Economic Partnership Agreement (EPA) with the EU in late 2014 after EU introduced tariffs on Kenyan flower imports affecting the livelihoods of more than 500,000 people where a majority of the workers are women. Since they were levied, in the subsequent three months, the Kenya Flower Council estimates that its exporters racked up costs of about €3 million (£2.3 million)[23]. EPA's are trade agreements that also detail taxing rights between the jurisdictions involved. To protect its local businesses, Kenya opened 80 percent of its market to EU imports. The Economic Commission of Africa in a report argues that such deals will expose local industries to international competition on an unequal playing field and "lead to uneven trade gains for Africa"[24]. Unjust and restrictive tax treaties and free trade agreements that developing countries are arm-twisted into signing not only leads to severe loss in domestic revenue but also undermines worker's and women's rights.

In another example, an Australian mining firm dodged taxes in Malawi for six years using loopholes and structures that deprived the country of $43 million in revenue[25]. Tax-related IFFs directly or indirectly undermine a country's ability to raise and effectively mobilise domestic revenue. The grey-zone of abusive practices may or may not be classified as illegal as they are often not investigated, resulting in a legal silence around these practices, and thus, as they are not statutorily outlawed.

Following trade liberalisation in developing countries, there is a greater possibility among developing countries to levy indirect taxes on consumption to keep up with falling revenue collections. Indirect taxes on consumption (like service taxes, value added taxes etc.) essentially impact the poor and the vulnerable disproportionately. Such taxes inadvertently push the burden of taxes on the poor, women and other marginalised sections of the society who primarily depend on government sponsored services. Further, owing to a sizable informal sector, developing countries have poor labour standards. Jobs generated in SEZs pay subsistence wages and have been accused of causing grave environmental violations.

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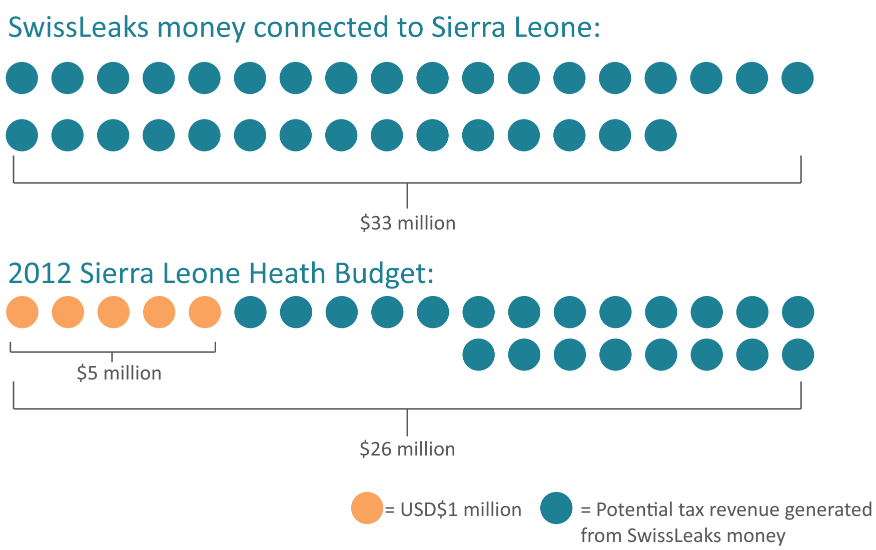
[22] Fair Trade (2014). EU Import Duties on Kenyan Flowers threaten Future of Fairtrade Producers. [Online] https://www.fairtrade.org.uk/Media-Centre/News/September-2014/EU-Import-duties-on-Kenyan-flowers-threaten-future-of-Fairtrade-producers

[23] Moulds, J. (2015). EU trade agreements threaten to crush Kenya's blooming flower trade. Guardian. [Online] https://www.theguardian.com/sustainable-business/2015/jan/16/kenya-flower-trade-eu-pressure

[24] UN Economic Commission for Africa (2015). Industrialising through Trade: Economic Report on Africa.

[25] Action Aid (2015). An Extractive Affair.

IFFs restrict public investment in social sectors like education, health, sanitation, welfare schemes. The percentage of people living on less than $1.25 per day up to 2015 was the highest in Sub-Saharan Africa, closely followed by South Asia and South-East Asia. After Swiss leaks, it was revealed that India lost between $492 million-$1.2 billion in revenue through just one branch of the named Swiss bank. The leaks showcased a giant tax evasion scheme orchestrated by the British bank HSBC through its subsidiary based out of Switzerland. The lost revenue made up to 6 percent of the social sector budget for the financial year 2016-17. This sum equalled to nearly 44 percent of spending allocated to women's rights[26].

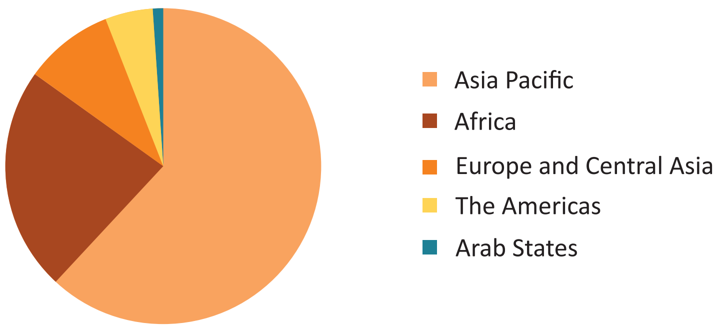


Source: Financial Transparency Coalition and Christian Aid (2015). Swiss Leaks Reviewed.

Patriarchal structures leave women and other ostracised genders vulnerable to exploitation and violence. Women and the marginalised contribute greatly as disguised labourers, working in hazardous conditions with abominable wages. According to a 2017 report by the International Labour Organisation and Walk Free Foundation, women and girls constitute to nearly 71 percent out of the 21 million victims of global human trafficking. There is no doubt those global profits accrued from illegal activities of human exploitation, arms trade, conflict and organised crime are well-integrated into the licit economic circles. Refugees escaping conflict are easy targets for traffickers as has been evident from the current crisis of the Libyan slave trade and the genocide of Rohingyas in Myanmar.

[26] Center for Economic and Social Rights et al (2016). Submission to the Committee on the Elimination of Discrimination against Women 65th Session, November 2016. Swiss Responsibility for the Extraterritorial Impacts of Tax Abuse on Women's Rights. Available at: http://www.cesr.org/sites/default/files/switzerland_cedaw_submission_2nov2016.pdf

Global Distribution of Forced Labour



Source: Global Estimates of Modern Slavery: Forced Labour and Forced Marriage by International Labour Organisation and Walk Free Foundation (2017)

IFFs pose a genuine threat to geo-political security and may fuel conflict. Small arms and light weapons trafficking alone generate an industry of $1.7-3.5 billion annually[27]. Europol, the law enforcement agency of the EU, was able to link nearly 3,500 suspected criminals including terrorists after the Panama leaks for sheltering their illicit money[28]. Like a vicious cyclical loop, any generation of IFFs only leads to its further generation. IFFs harp on existing structural inequalities to permeate and intensify the economic divide in a society. Not only are illicit outflows damaging to the very foundation and ethos of justice, they also adversely affect the rule of law of a country.

3.1 The Role of State and Institutions in the Global South

The quality of institutions and structures in a country can be traced to it's colonial past[29]. Colonies exploited for their extractive wealth in fact are net creditors of IFFs to the world. It is no coincidence that these colonies have also inherited poor quality institutions and surface low on socio-economic development indicators with high inequality levels. For example, a Petrolist (or petrol producing) developing state is less likely to adhere to democratic standards if the oil prices are up[30]. The progressive realisation of human rights and capabilities through domestic mobilisation of resources in Southern countries provides an opportunity to reverse the colonial legacy of institutions. While taxation remains a sovereign issue, tax base erosion of Southern countries by IFFs hinders this

[27] May C. (2017). Transnational Crime and Terrorist Financing. Global Financial Integrity

[28] Pegg, D. (2016). Panama Papers: Europol links 3,500 names to suspected criminals. The Guardian. [online]Accessed on 31 Aug. 2017 at: https://www.theguardian.com/news/2016/dec/01/panama-papers-europol-links-3500-names-to-suspected-criminals

[29] Acemoglu, Johnson and Robinson (2001); Easterly and Levine (2002)

[30] Friedman, T. (2009). The First Law of Petropolitics. Foreign Policy. [online] Accessed on 4 Nov. 2017 at: http://foreignpolicy.com/2009/10/16/the-first-law-of-petropolitics/

redistribution process. It is more likely that corporate taxes form a greater share in a developing country's direct tax base. The extent of illicit financial outflows is also significant to the status of the prevailing tax system and political freedoms accorded to the citizens of that country. As state and institutions have progressed, so have the activities contributing to illicit finance. The moral role of states and institutions in fulfilling development justice to restore public faith is not without robust regulation that promotes transparency and upholds the autonomy of oversight institutions.

3.2 The Hegemony of Secretive Jurisdictions: Where Does the Money End Up?

Tax havens have existed from before World War I. The term haven refers to a place of refuge and a tax haven would be such a place providing solace from taxes. In other languages a mistranslation of the English term 'haven' as 'heaven' has led them to be called 'fiscal paradises' (French, Spanish, Portuguese), while most languages have translated the term literally from English showing its origins in the post-colonial era in the British offshore dominions. It is however, unfair to use the term tax haven or much worse a 'fiscal paradise' to illustrate the pervasive impact of these jurisdictions on human rights. Tax havens have also been referred to low tax jurisdictions which is significantly better at capturing a central function of preferential tax regimes i.e. they have low taxes. While this term is certainly an improvement, it does not encapsulate those jurisdictions that offer furtive services and anonymity to tax dodgers, the wealthy, criminals and the corrupt. The etymological understanding of tax haven has evolved to secrecy jurisdictions. It best describes the covert nature of the offshore industry including hubs of onshore secrecy. Most Latin American countries have now adopted using terms like 'preferential fiscal regimes' or 'low tax jurisdictions', which rightly highlight the two aspects of tax haven.

If one notes, the legacy of such jurisdictions came out of the disturbing legacy of colonialism and imperialism. A large part of the offshore economy operates on investments made anonymously in London, New York, the US State of Delaware, Amsterdam (a legacy of Dutch East India Company), Frankfurt and others, which also happen to be influential international financial centres. A 2015 investigation into property investments across London, since 2008, were revealed to be worth of at least £100 billion bought through unknown overseas based structures[31]. By 2015, more than $12 trillion[32] was siphoned out of emerging economies and developing countries as

[31] Crerar, P. and Prynn, J. (2015). Revealed: How foreign buyers have bought £100bn of London property in six years. Evening Standard. [online] Available at: https://www.standard.co.uk/news/london/revealed-how-foreign-buyers-have-bought-100bn-of-london-property-in-six-years-a3095936.html

offshore finance. A recent study published by Garcia-Bernado et al (2017) disputes the traditional idea of small islands countries (SICs) being largely identified as tax havens. The study argues that SIC jurisdictions are in fact used as conduit routes for illicit capital outflows only to finally end up in financial centres based in rich and developed countries. This is particularly the case for three UK overseas territories of Caribbean states, such as Cayman Islands, Bermuda and British Virgin Islands, only for these flows to be negotiated so they end up in major financial centres such as London and New York and Hong Kong as exposed by the links to offshore law firms in Paradise Papers and Panama Papers. To put this in perspective, the capital lost from developing countries is likely to end up and be retained in rich and developed countries. This is precisely why the geographical locations of such jurisdictions matter. While this holds true, offshore developments have shown a worrying shift to wealth being parked in Asian international financial centres like Hong Kong, Singapore and Taiwan[33]. Hong Kong surpassed Singapore as a preferred destination for cross-border wealth management in 2015. Newer international free trade zones like Horgos[34] on the China-Kazakhstan border, launched as a part of the Silk Road Initiative, are increasingly being used for its perverse tax breaks. To add more, Asia is also notably the fastest growing region contributing to the global illicit market. Investigations like the Paradise Papers, Panama Papers and Swiss leaks have shown how the offshore industry consciously works against the redistributive needs of countries.

[32] Stewart H. (2016). Offshore finance: more than $12tn siphoned out of emerging countries. [online] the Guardian. Accessed on 15 Nov. 2017 at:

https://www.theguardian.com/business/2016/may/08/offshore-finance-emerging-countries-russia-david-cameron-summit

[33] Hong Kong is ranked 2nd and Singapore the 4th on the Financial Secrecy Index (2015). More info here: http://www.financialsecrecyindex.com/introduction/fsi-2015-results

[34] Wong, S. and Gordeyeva, M. (2017). Silk Road hub or tax haven? China's new border trade zone may be less than it seems. Reuters. [online] Accessed on 10 Jan. 2018 available at:
https://www.reuters.com/article/us-china-silkroad-horgos/silk-road-hub-or-tax-haven-chinas-new-border-trade-zone-may-be-less-than-it-seems-idUSKBN18V15Z

4. Restoring Justice: Putting an End to Illicit Financial Flows

The global financial crisis of 2007-08 exposed the reckless unregulated and deeply deceptive behaviour of banks, financial intermediaries and institutions. Regardless of the widespread public outcry, global offshore wealth has actually increased by 54 percent since 2007 (Zucman, 2015). Appropriate transparency and legislative measures backed with resource mobilisation plans can restore public faith and integrity back in state institutions.

The lack of terminological clarity on IFFs deters healthy policy making. Even civil society groups have divided positions on IFFs and fail to agree as to what is an IFF. Representing the moral character of IFFs in figures is a genuine challenge faced by governments, regulatory bodies and advocacy groups. Moreover, addressing only loopholes leading to criminal financing is inadequate because the network of global financial secrecy caters to all types of illicit financial outflows. There is an urgent need for developing countries and international institutions to take cognizance of the problem of IFFs and come up with a mutually agreed upon work plan in order to tackle them. International cooperation on tackling illicit financial flows and ensuring tax justice is at the core of upholding social, economic and political rights. It is incumbent upon national governments to protect their fiscal space and reprioritise public spending.

Tax and judicial investigations are also made difficult by the lack of information on ultimate beneficial owners[35], accounting, and other financial information to enable authorities to investigate IFFs. A public registry of ultimate beneficial owners of all legal entities including asset ownership and public country by country reporting of financial information by MNCs are imperative measures in the fight against financial secrecy and tax dodging practices.

- The criteria set for identifying a beneficial owner should be at 5 percent[36] or lower, as a higher threshold is susceptible to abuse. Multiple faux representatives can be appointed to tamper with the extent of economic control a BO has over an entity and thus, circumvent reporting commitments of identifying a BO. Developing countries like Afghanistan, Ghana, Kenya, Nigeria, Indonesia and Ukraine have committed to come up with public beneficial ownership registries. Increasing the capacity of developing country authorities to both investigate and gain access to information on foreign-owned and operated entities would significantly assist tackling IFFs of such kind.

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[35] An ultimate beneficial owner(s) is the human owner of an entity who exercises direct or indirect economic control over that entity.

[36] Publicly traded companies are required to disclose beneficial ownership information to the US Securities and Exchange Commission at 5 percent.

- Public financial reporting of profits (or losses), payments, revenue accrued, taxes paid on income and profits, number of employees etc. on a country-by-country basis by all MNCs. Further, the public account of financial information should also report dividends, license fees, rent, entry tariffs, royalties, exemptions on taxes received by MNCs to improve transparency.

Any tax handout to corporates must be disclosed publicly and must be bound in time, purpose and scope by law. Reforms in national tax policymaking should aim at reducing inequality through progressive taxes like inheritance taxes and wealth taxes accompanied with gender-responsive budgeting. Nationally greater coordination is required between financial intelligence units, anti-corruption wings and tax departments to build strong anti-IFF policies. Advocacy through case study backed evidence may prove helpful in the absence of robust research on IFF estimates.

Tax cooperation is also crucial to prevent arm-twisting of developing countries into signing agreements that work against them. One such endeavour in this direction was the Mbeki Panel Report in 2015 combined with regional advocacy that listed a three-way process to curbing IFFs plaguing Africa as a continent. ECLAC has launched similar initiatives to build national ownership and awareness on these issues. Integrating the development justice agenda with a movement on South-South tax cooperation can pave the way for solutions mainly affecting developing countries. This space could support asset recovery efforts, enable exchange of transfer of expertise and best practices, end race to the bottom practices, legal assistance in international arbitrations, better impact driven literature and adoption of progressive social policies.

As rich, developed OECD[37] and G20 countries are at the centre of influencing and forming the current rules on international finance, civil society groups and many G77 countries have extended their support to a global tax body under the aegis of United Nations, as an equal and democratic platform to debate and inform policies on taxation that affect all countries and not just a few.

[37]Organisation for Economic Co-operation and Development (OECD)

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