CURTAILING CAPITAL FLIGHT

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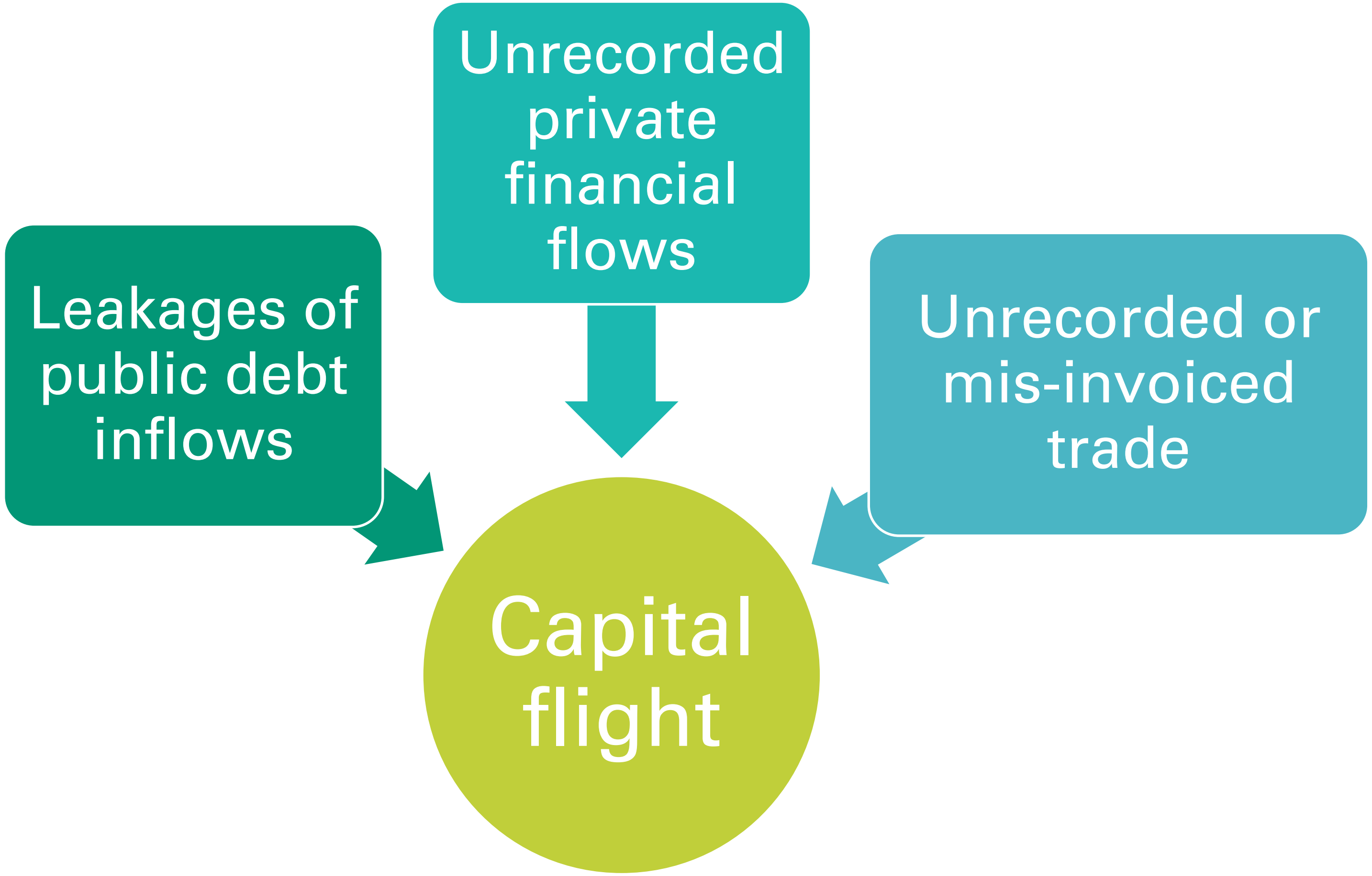
DEFINITIONS AND SCOPE

Definitions

Capital flight consists of unrecorded financial outflows from a country; i.e., discrepancies between inflows of foreign exchange and their uses as recorded in a country's Balance of Payments statistics

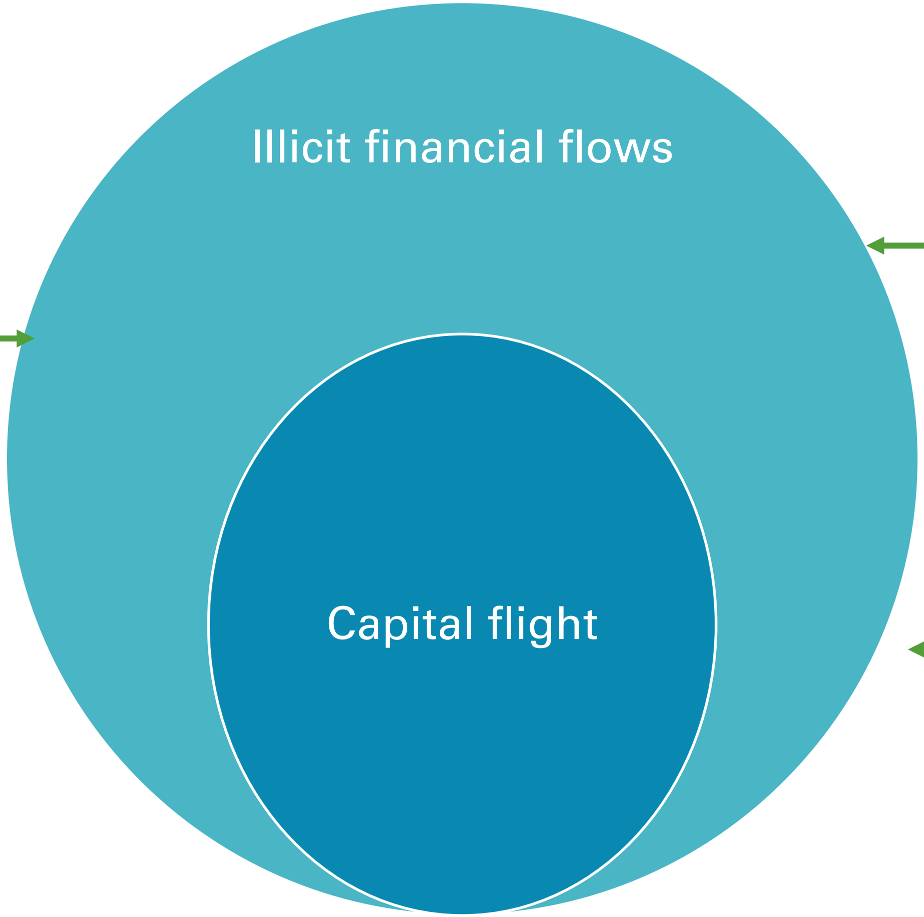
Flows and Stocks: The unrecorded/illicit outflows result in accumulation of 'private wealth' in offshore financial centers, real estate, and other assets abroad. ***Ultimate losses exceed the cumulative annual flows.***

Key mechanisms of capital flight



Capital Flight is only a subset of **Illicit Financial Flows**

Payments of smuggled imports = illicit, unrecorded, but not outflows



Recorded but illicit flows; e.g., Money laundering (proceeds of illegal activities)

Abusive transfer pricing: no invoicing discrepancies

Why combat capital flight?

- **For source countries:** Important for:
  - Achieving sustainable financing for development
  - Graduating from foreign aid
  - Overcoming the bondage associated with external indebtedness
  - Combatting the plunder of natural resources
- **For destination countries**:
  - Increase aid efficiency (value for taxpayer’s money)
  - Avoid the ‘financial curse’
  - Geopolitical strategic goals: Prevent financing of terrorism and illicit activities

Strategies and Tools for Curbing Capital Flight

What are we addressing?
Stock vs. **Flows**

- **Curbing** capital flight; i.e., reducing capital outflows

- **Repatriation** of the accumulated stock of wealth from capital flight = forcing and inducing asset repatriation

Legal vs. illegal capital/wealth accumulated offshore (abroad)

Acquisition / Transfer	Legally acquired	ILLEGALLY acquired
Legally transferred	Legal / clean capital	Laundered money
ILLEGALLY transferred	Smuggled capital	Corrupt & criminal money

Resource outflows: a typology

1. **Capital flight** (unrecorded capital outflows)
   i. Licitly acquired funds (e.g., for tax evasion or fear of theft)
   ii. Illicitly acquired funds (e.g., Mobutu stolen assets)
2. **Legal capital outflows** (recorded in BoP)
   i. Licitly acquired funds (normal outflows)
   ii. Illicitly acquired and **laundered** funds
3. **Other illicit financial outflows**
   i. Payments for smuggled imports (technical & pure smuggling)
   ii. Payments of contraband trade
4. **Profit-shifting** (by MNCs)
   i. Transfer pricing (e.g., intellectual property payments)
   ii. Financing arrangements (e.g., intra-company debt interest payments)
5. **Non-financial outflows** (e.g., smuggling of gemstones, ivory, ...)

Micro, Macro, Institutional and Political Economy Foundations of Strategies for Combatting Capital Flight

➢ Micro perspective

- ✓ Capital flight is not the outcome of portfolio choice
- ✓ So, while policies to increase returns to investment are desirable, they are not an effective deterrent of capital flight

➢ Macro perspective

- ✓ Macroeconomic stability and growth are desirable, but they are not a sufficient deterrent of capital flight

➢ Institutional perspective

- ✓ Governance (especially private and public sector corruption) is essential
- ✓ Increasing transparency in the global trade and financial systems is critical

➢ Political economy perspective

- ✓ Incentives and support for policies: **Political will** at the global and domestic level
- ✓ Power structure – domestic and foreign
- ✓ Voice and space for non-state actors

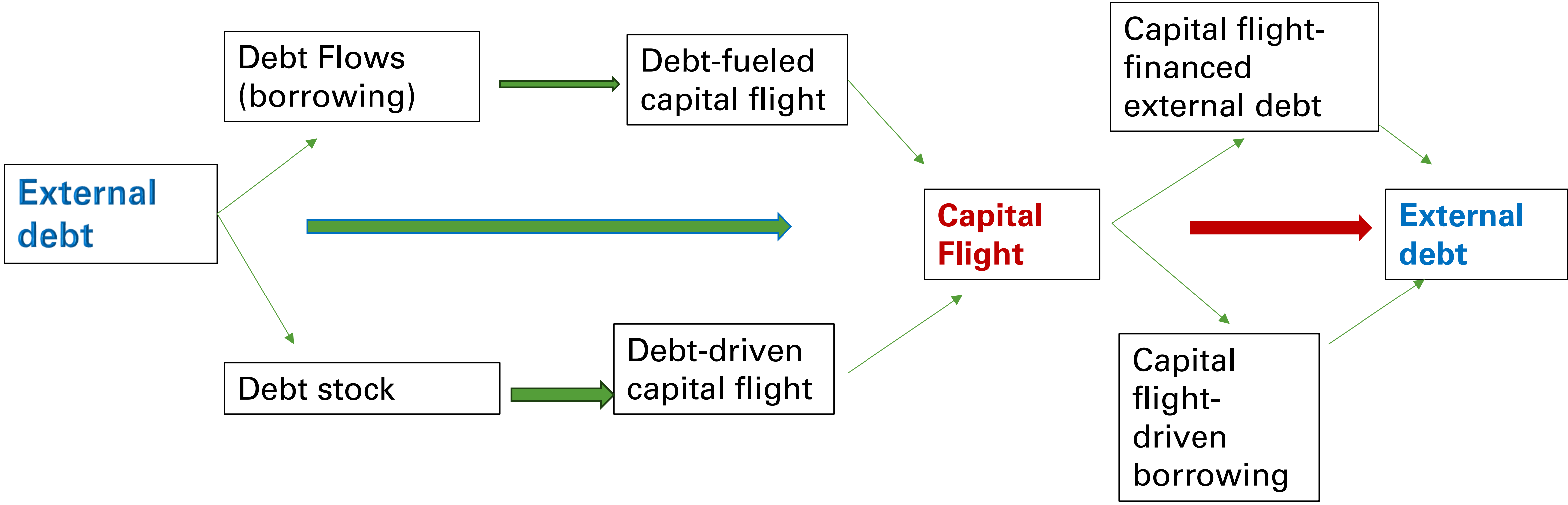
Deterring illegal export of honestly acquired capital

- Tailoring policy interventions to the **type of capital – legal vs. illegal**
- Strategies to encourage **home bias** in private investment decisions
- **Transparency** of international banking operations
- Capital account controls (*aka* **capital flow management**)

Addressing trade-related and tax-evasion motivated capital flight

- Focus on strategies for improving **reporting and monitoring cross border trade**
- Strategies to combat export underinvoicing
- Strategies to combat **import overinvoicing**
- Strategies to combat **transfer pricing**
- **Automatic exchange of information**

Breaking the debt-capital flight nexus – The Revolving Door



Breaking the corrosive debt-capital flight nexus

- ❖Transparent, Responsible and Accountable lending and borrowing
- ❖Combatting odious debts
  - ✓*Odious debts vs. odious governments*
  - ✓*Debt audits*
  - ✓*Selective repudiation*

Recovering and repatriating stolen assets

- Assets recovered: so far small! See next slide
- Provide incentives for capital repatriation. Can 'amnesties' work?
- Naming and shaming: lifting the veil on bank secrecy
- Building capacity for investigating stollen assets and managing recovered assets
- Strengthening political will on both sides

StAR: Stollen Asset Recovery Watch database

141
jurisdictions involved in international asset recovery cases

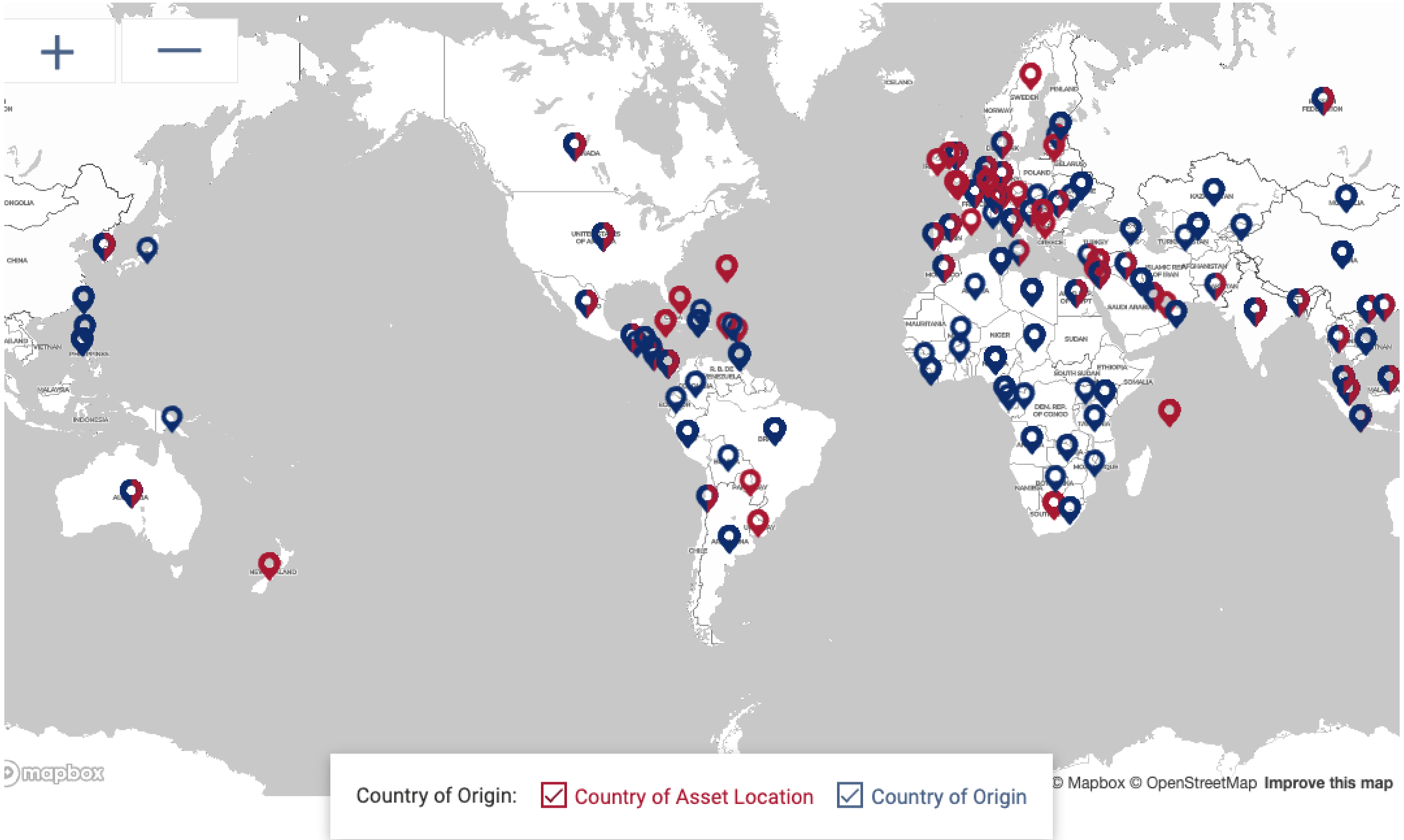
$10.0B
value of assets returned internationally (USD)

$16.5B
total value of assets (frozen/confiscated/returned) (USD)

563
international asset recovery cases documented

https://star.worldbank.org/asset-recovery-watch-database

StAR: Assets stemming from corruption: Countries origin and location



Africa is a clear "net exporter" of assets stemming from corruption

https://star.worldbank.org/asset-recovery-watch-database

The New Digital Economy and Illicit Financial Flows: two sides of the story

- **On the positive side:**
  - Digital technology can help in the prevention of IFFs
  - It can facilitate tracing and repatriating stollen wealth from abroad
- Examples of areas that can benefit from digital technology:
  - Customs: monitoring, tracing, and reporting on trade
  - Banking system: monitoring and reporting of financial asset holdings and transactions
  - Cross-border financial flows: increasing technical capacity of government agencies to regulate capital flows – IFUs, Central Bank, etc.
  - Establishing, managing and sharing information from a **Global Asset Registry** to tackle **"hidden wealth" (https://www.icrict.com/reports/it-is-time-for-a-global-asset-registry-to-tackle-hidden-wealth-2/)**

Digital technology and IFFs (cont'd)

- **But, on the flip side:**
  - Digital technology also facilitates IFFs by providing the sophisticated tools to evade regulation: **the bad guy is always ahead of the law** (e.g., the hackers, money launderers, scams)
  - Expansion of the 'digital economy' poses challenges to **taxation** systems:
    - **Tax base issues:** Identifying the activities to be taxed; some are "invisible"; taxing profits, sales, transactions?
    - **Tax jurisdiction issues**: Which state has the right to tax? Some multinational enterprises are **"stateless"**; Recommendation: Unitary taxation of MNEs (see ICRICT recommendation)
    - **Tax rate issues:** determining the appropriate tax rate for digital activities: some are new (therefore lack of benchmarks); others are globalized (posing challenges of comparative taxation to avoid both the race to the bottom and unfair international competition). Propose a minimum corporate income tax rate (enforce 15%, aim for higher rate, e.g., 25%)

Why need a global partnership on combating capital flight?

- There are **strong entrenched interests** against change
  - **Economic and political elites** in source countries
  - **Western governments** hosting offshore financial centers
  - **International corporations**
  - **Enablers:** Banks, Law firms, Accounting firms,
  - Free/perfect market **ideologists** (believers in optimality of financial markets)

- Need a **global partnership against capital flight**:
  - Strengthening multilateral cooperation
  - Resisting reversion to nationalism and isolationism

Contours of a **Global Compact** against capital flight

- **Strategies at the national level**
  - *Rules of **accountability** and **transparency***
  - *Role of non-state actors*
- **Strategies at the continental level**
  - *Leadership of continental and regional institutions*
  - *Establish and strengthen **enforcement capacity** of supra-national organizations*
- **Regional and international DFIs**
  - ***Mainstreaming** anti-IFFs in policies, strategies and operations*
  - *Establishing **tailored strategies**; e.g., AfDB Strategic Framework and Action Plan on the Prevention of Illicit Financial Flows in Africa (2017 - 2021)*
- **Strategies at the global level**
  - *Anti-ML, anti-IFFs strategies (e.g., SDGs 16.4)*
  - *Aid and technical assistance for **capacity building***
  - ***Funding for research** feeding into design of anti-IFFs strategies*

What is the key to progress in combatting capital flight?

- **Changing the conversation** from capital flight being an African problem (developing country problem) to capital flight being a global problem
  - Need to establish a global alliance against the plunder of African resources
- **Confronting the increasing imbalances between state (regulation) and corporations** (laissez-faire); and **between finance/capital and labor** (workers)
  - Combat against the **capture of the regulatory capacity of the state** by the corporate sector and its support network (enablers, corporate lobby, free-market fundamentalists in academia and in think tanks, …)

Key to success (cont'd)

- **Leveraging the gains from success in bilateral arrangements against banking secrecy and tax evasion** (e.g., US against Swiss banking secrecy; US IRS Form 8975 on country-by-country reporting) to build stronger and inclusive multilateral bodies that advance the interests of both developed and developing countries
  - **Resist reversions to nationalistic isolationism** (e.g., repeal of the Dodd-Frank Act; 'trade wars'; etc.)
- **Knowledge, capacity building and advocacy**
  - Still **inadequate investment in knowledge generation** on capital fight and illicit financial flows; it's not a 'subject of discussion in polite company'
  - In the meantime, the beneficiaries of the status quo consolidate their defense capacity; including through **disinformation campaigns; 'Research entrepreneurship' ('taxis for hire')**
  - Invest in **building the capacity of policy makers** to understand and appreciate the importance of capital flight, and to design and implement policies for combating the problem.
- **Political will** source and destination countries

Long road ahead

But Together We Can!