UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

Towards a Macrofinancial Framework:

IFFs and the macroeconomics of arbitrage

Shaping an environmentally sustainable and inclusive digital future

Anastasia Nesvetailova

Head, Macroeconomic and Development Policies Branch (DGDS)

IFFs have been growing

Crime-related IFFs

- Smuggling of Migrants
- Transfer of wealth
- Drug Trafficking
- Minerals Trafficking
- Corruption
- others

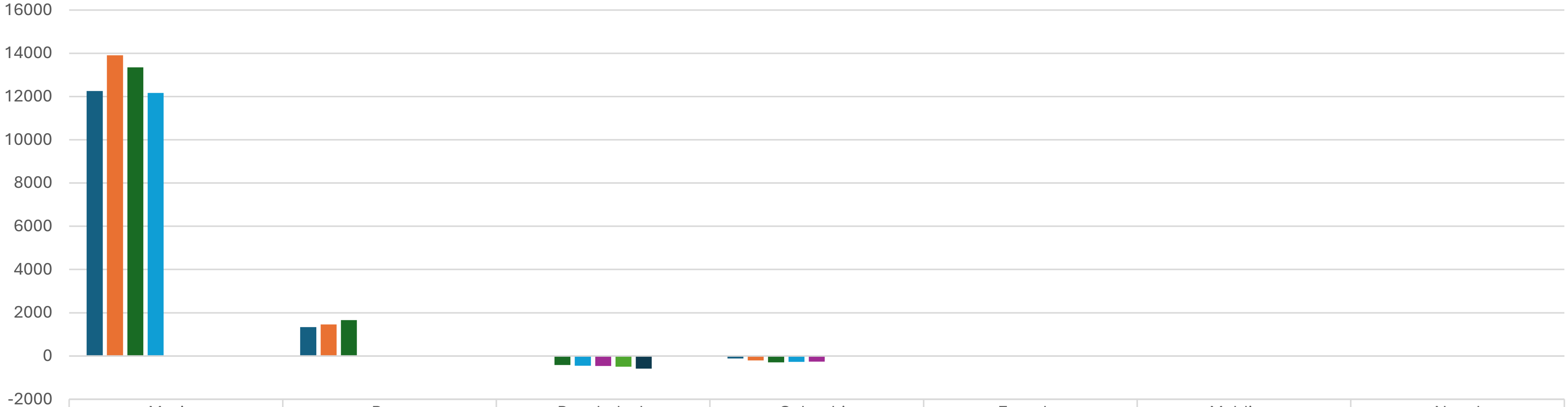
Commercial IFFs in International Business

- Profit Shift
- Regulation Arbitrage
- Financial Transaction
- Tax Avoidance
- Assets and intellectual property shifting
- Debt shifting

Towards a Global Economic Framework

Sources: UNCTAD (2023), 'Efforts to track illicit financial flows need scaling up', https://sdgpulse.unctad.org/illicit-financial-flows/

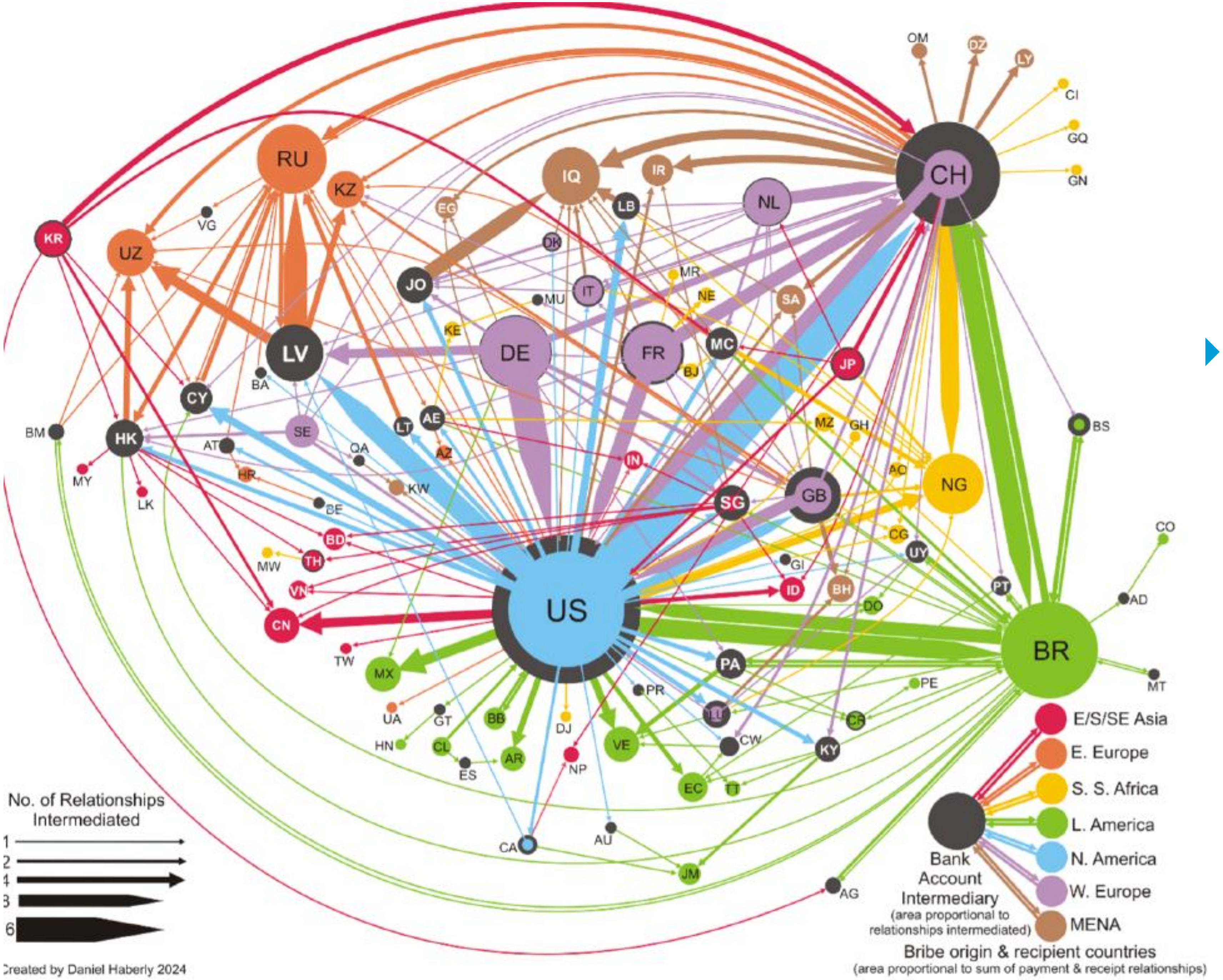
UNCTAD Illicit financial flows (IFFs) Estimation



	Mexico	Peru	Bangladesh	Colombia	Ecuador	Maldives	Nepal
2015	12261	1336		-116.70			
2016	13903	1454		-202.60	-19.00		
2017	13348.9	1657	-413.50	-293.10	-10.90		
2018	12170		-444.80	-268.40	-10.80		
2019			-459.50	-255.00			-3.80
2020			-497.40			-18.90	-4.80
2021			-588.50			-13.80	-5.20
2022							
2023							

2015 2016 2017 2018 2019 2020 2021 2022 2023

Sources: UNCTAD (2023), 'Efforts to track illicit financial flows need scaling up', https://sdgpulse.unctad.org/illicit-financial-flows/

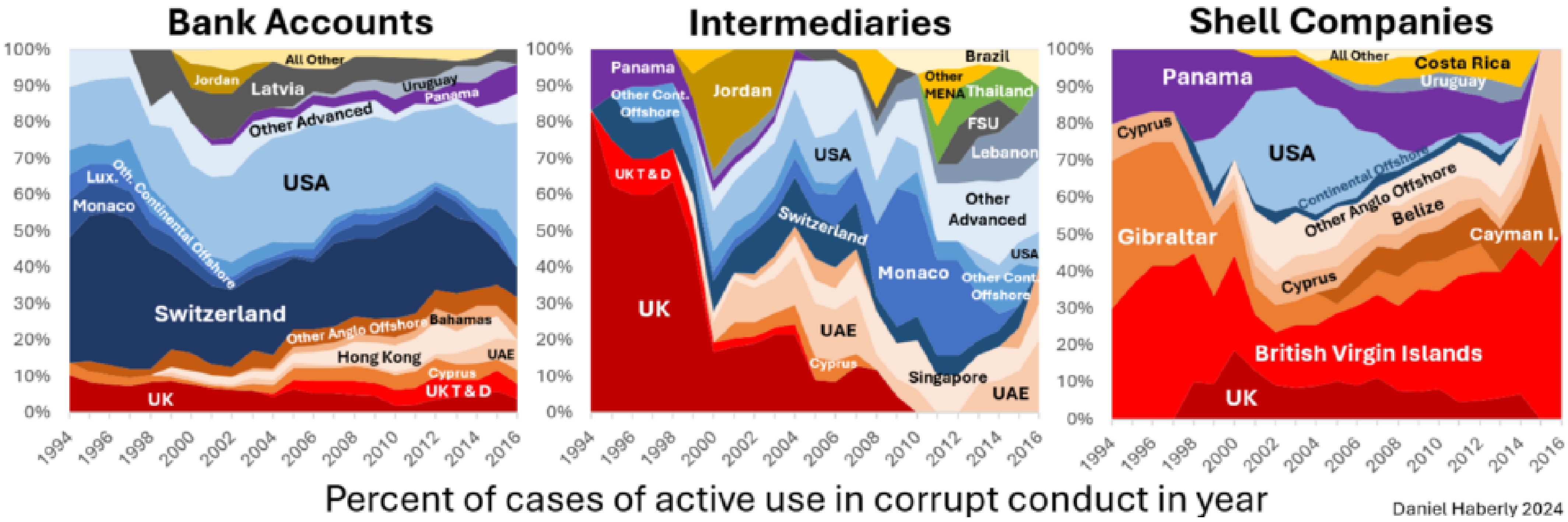


IFFs: Corruption through Corporations

- IFFs in Banking Accounts/Global Financial System, in different regions

Shipley, Thomas; Barrington, Robert; Haberly, Daniel (2023). Corruption, Shell Companies and Financial Secrecy: Providing an Evidence Base for Anti-Corruption Policy. University of Sussex. Report. https://hdl.handle.net/10779/uos.27931662.v1

IFFs in Macroeconomic System: Corruption



- Global Financial System facilitate IFFs through Banking Accounts, Intermediate Companies and Shell Companies.

Shipley, Thomas; Barrington, Robert; Haberly, Daniel (2023). Corruption, Shell Companies and Financial Secrecy: Providing an Evidence Base for Anti-Corruption Policy. University of Sussex. Report. https://hdl.handle.net/10779/uos.27931662.v1

IFF in International Business

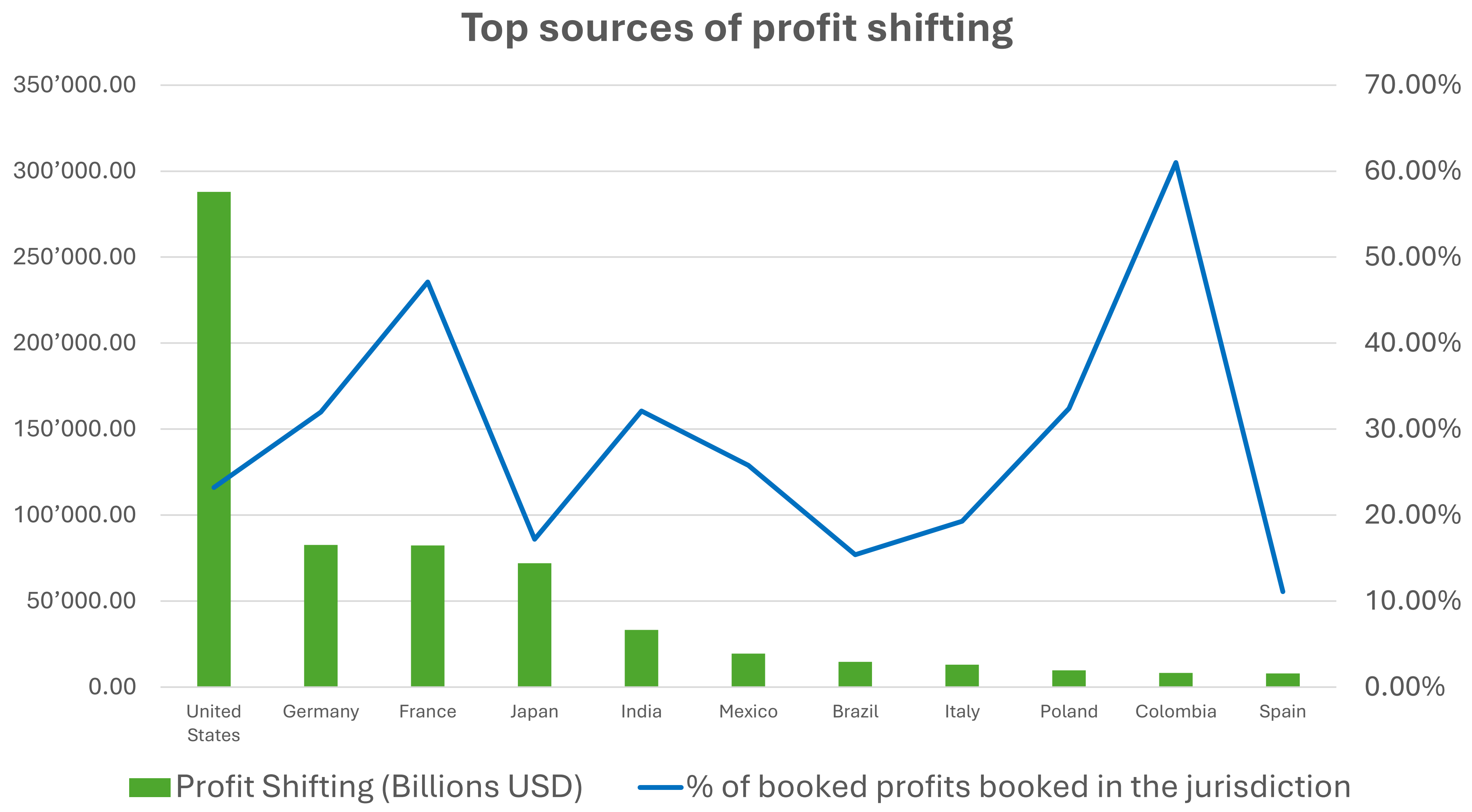
Multinational Enterprises' Profit Shifting

- Profit shifting is the practice of moving profits across borders to reduce business costs. This is often done through strategic business arrangements or transactions (corporate arbitrage).
- Between 2015 and 2019, around 40% of multinational profits were shifted to tax havens, resulting in a 10% cut in global corporate tax revenues. This regulatory arbitrage has disproportionately affected low-income countries, exacerbating their fiscal challenges.
- Domestic revenues are reduced by corporate arbitrage and illicit financial flows. Early studies indicate that in some cases, illicit finance accounts for as much as 50% of officially recorded trade.
- Data: *Garcia-Bernardo, J. and Janský, P. (2024) 'Profit shifting of multinational corporations worldwide', World development, 177(106527).*

Country	% of booked profits shifted from other countries
Barbados	99.1%
Gibraltar	99.0%
Isle of Man	98.8%
Bermuda	96.0%
Cayman Islands	95.6%
Jersey	92.9%
Puerto Rico	92.5%
British Virgin Islands	88.9%
Luxembourg	85.0%
Hong Kong	51.0%
Singapore	49.2%
Ireland	47.0%
Netherlands	47.0%
Malaysia	44.6%
Switzerland	44.3%
Norway	36.5%
Sweden	36.1%
Canada	31.3%
Australia	15.3%
China	2.7%
United Kingdom	2.3%

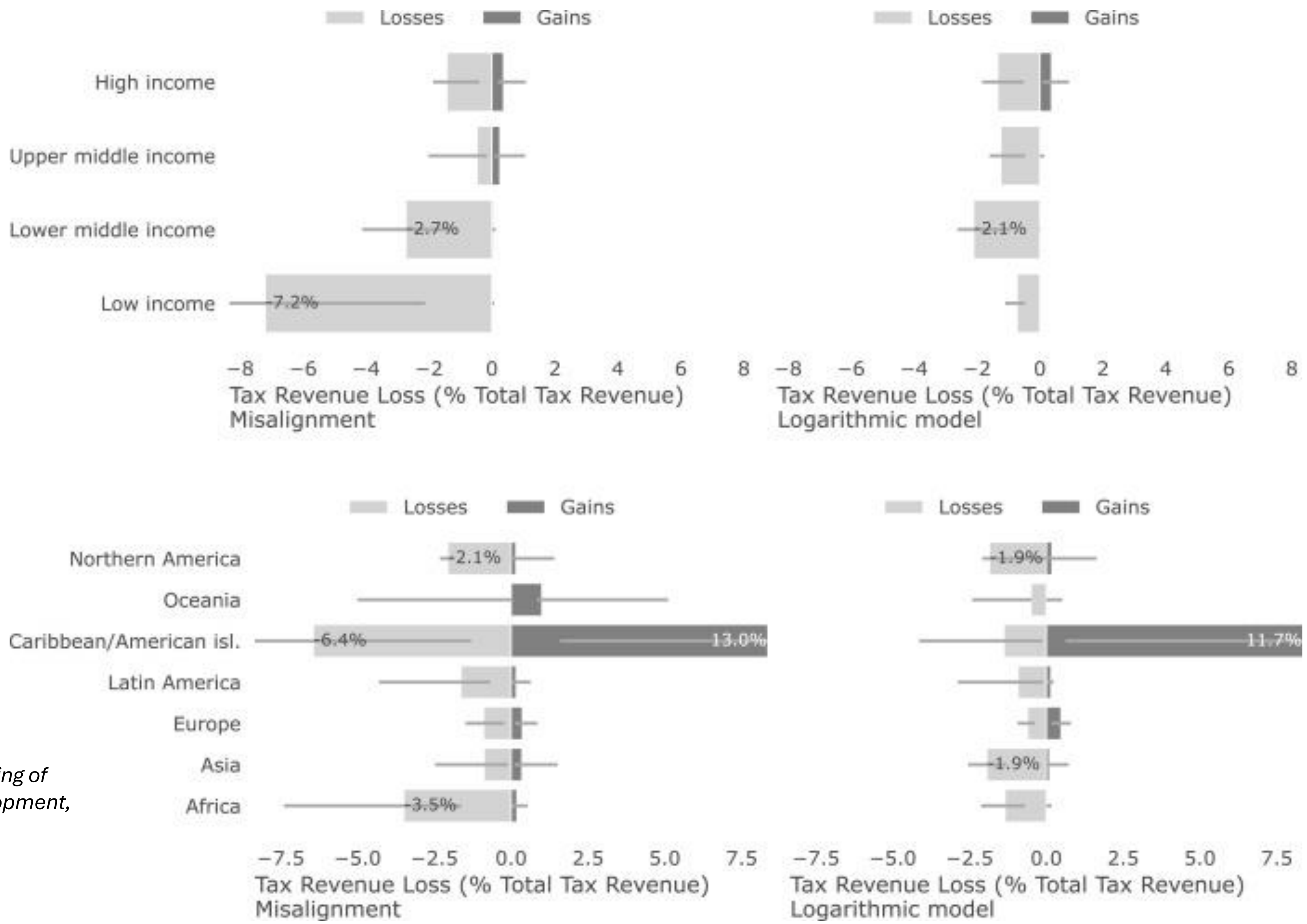
IFF in International Business

Multinational Enterprises' Profit Shifting, by source, 2020.



Profit Shifting and its impact on macroeconomy

Even though profit shifting takes place predominantly to high-income countries to low incomes countries, lower-income countries tend to lose more tax revenue relative to their total tax revenue



Garcia-Bernardo, J. and Janský, P. (2024) 'Profit shifting of multinational corporations worldwide', World development, 177(106527), p. 106527. Available at: https://doi.org/10.1016/j.worlddev.2023.106527.

The global corporate structure of a (non-financial) US MNE

Imagine a case:

- An emerging market country was successful in securing some $500 million worth of FDI from a global telecom giant.
- It is a success in terms of the inflow of capital, but what would this $500 million do when it lands in the host economy?
- Would it be used to lease land and equipment, hire staff, pay insurance and tax contributions, deal with local suppliers and consultants, invest in R&D?
- Or would the telecom giant simply use the money to buy an old factory in the host economy, with a view of selling the building sometime the future?

Two specific motivations:

1. There is growing awareness – in policy circles and in the academia – of the limitations of FDI statistics. Traditional FDI data, based on the flows of capital, tells us little about the **type** of economic activity associated with the incoming capital.

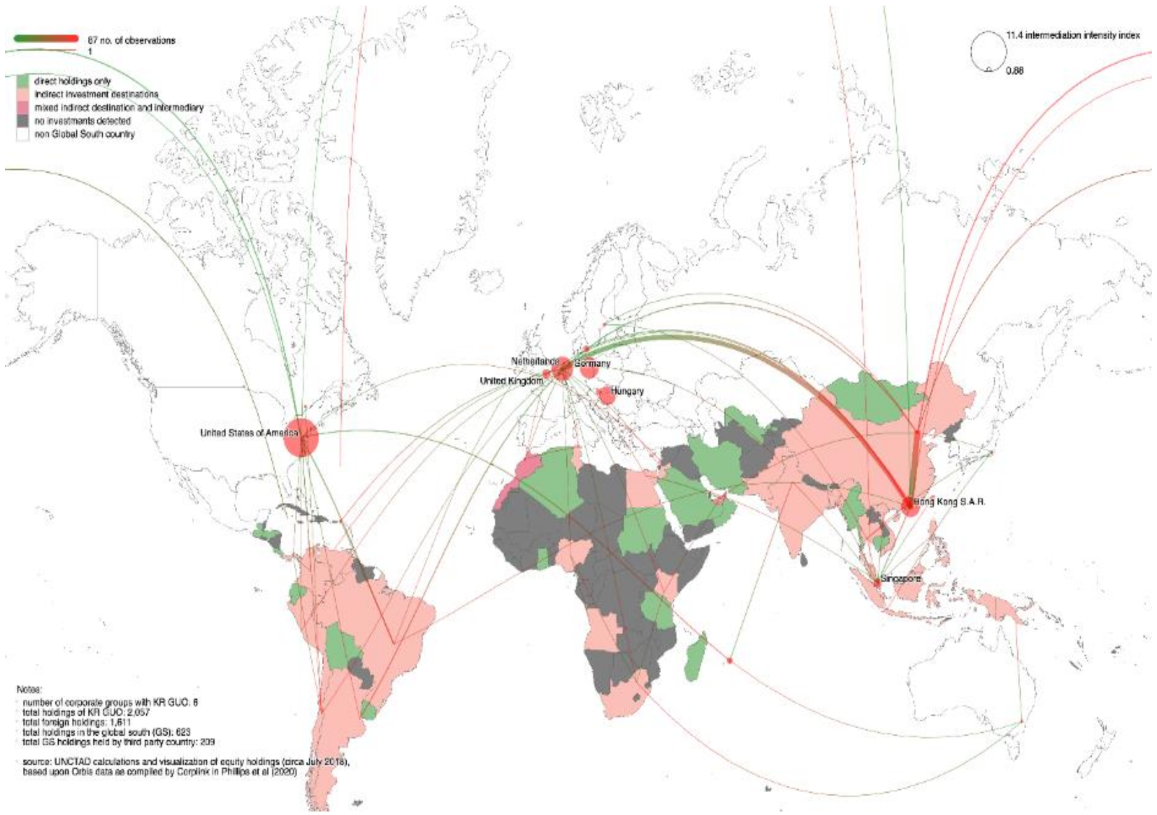
2. We focused on the role of strategic corporate maneuvering between different jurisdictional niches, with the aim of avoiding, or minimizing, regulation (and thus, maneuvering the placement of high value creating activities).

We call this phenomenon **corporate arbitrage**, and it is a key dimension of corporate power globally.

Partly, arbitrage is the outcome of the fragmented regulatory space; partly, it is the result of the transformation of corporate business activity itself.

TDR 2022 examined the equity structures, or what we call **equity chains**, of the top 100 non-financial MNEs across the world.

Equity structure of US and Rep. of Korea indirect Investment in the Global South



Finding 1:

- The study suggests that the most lucrative value-capture activities—legal infrastructure, financial, insurance, accounting, compliance services, R&D —were typically placed in conduit jurisdictions and the ‘competition states’ of Europe.

- So even if hosted by a developing country, a global MNE would strategically locate the activities yielding most income elsewhere.

Finding 2. Asymmetry in phantom FDI, or dormant entities

- 25% of the subsidiaries in the global South of the MNEs analyzed engaged in no apparent associated economic activity. They were dormant entities, or phantom structures.

- In advanced countries, by contrast, the proportion of such entities in the overall corporate structure comprises *less than 1 per cent*.

- Lower rates of phantom subsidiaries were found in jurisdictions with strong regulatory standards, including at regional levels.

Policy Lessons (1)

Success in attracting FDI inflows is not, in and of itself, conducive to making incoming foreign capital work for the host economy.

Corporate organization and arbitrage does have macroeconomic consequences.

Policy lessons (2)

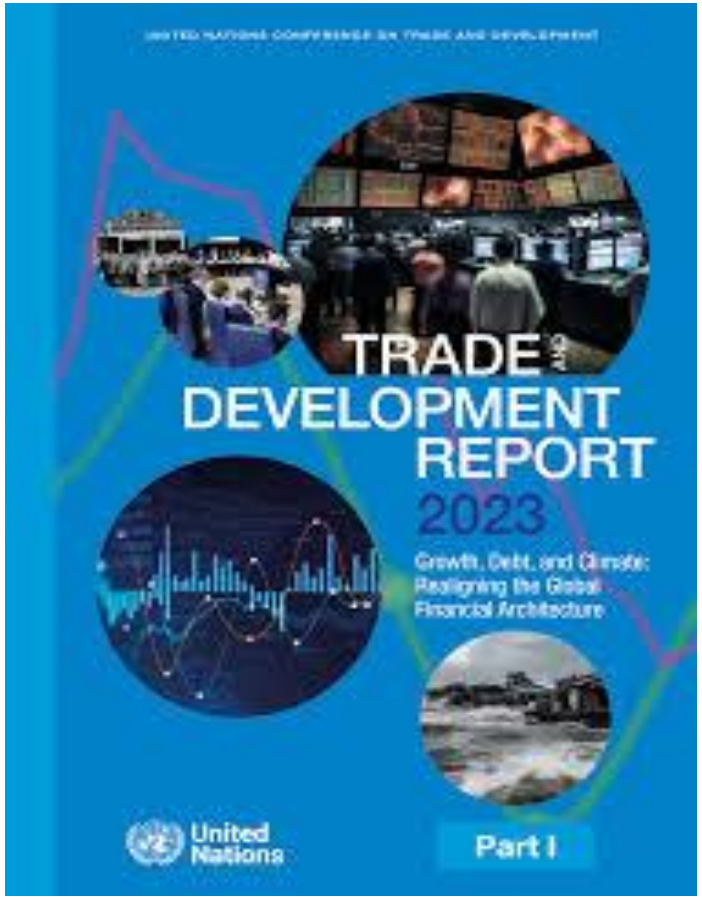
- Earning striping via corporate subsidiaries depletes the fiscal space of any host economy. Efforts to reform base erosion and profit shifting and introduce a global corporation-tax floor have begun to address part of this problem.

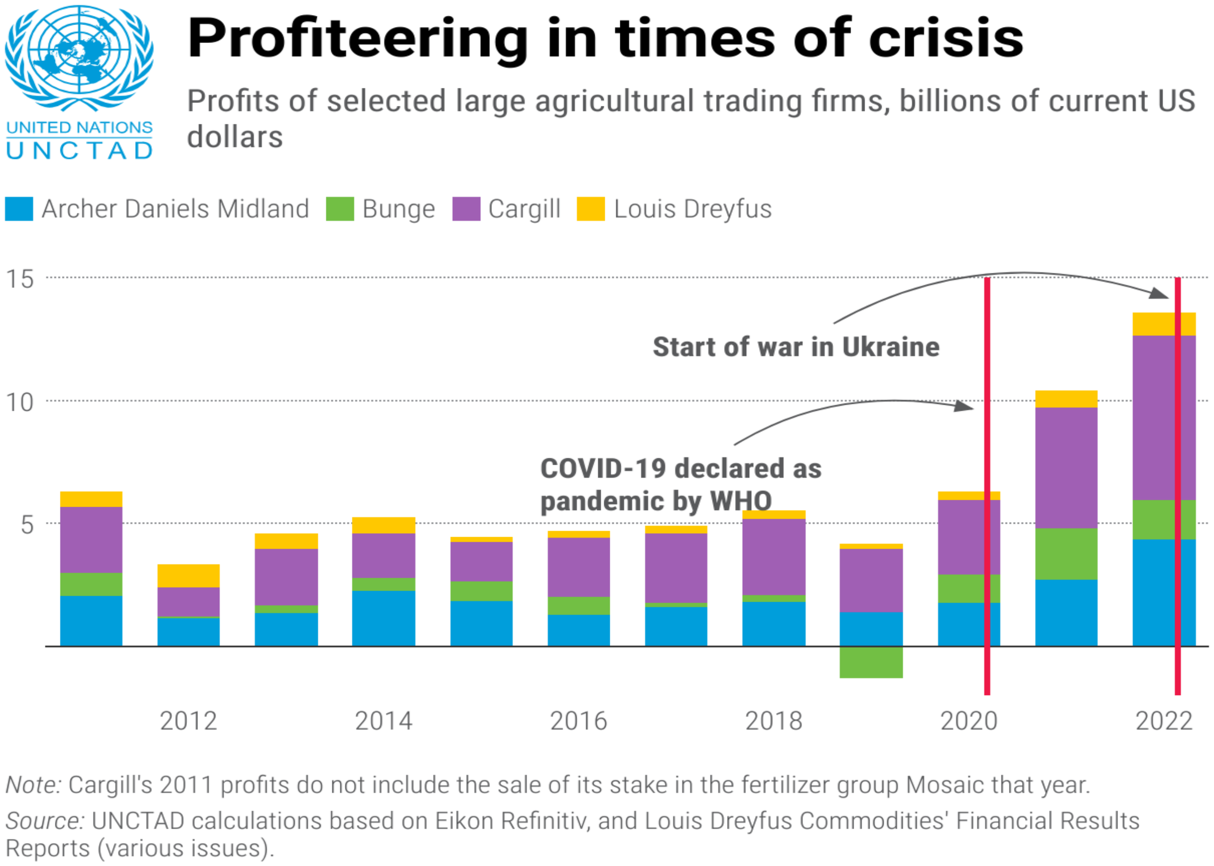
- But without a more integrated approach to multilateral corporate and financial regulation, any increase in corporation-tax revenues is likely to accrue primarily to richer countries where these MNEs register their revenues.

Policy lessons (3)

- Data transparency is crucial. Most data are owned by private corporations and public authorities at different levels may need to devise ways to get around this.
- The European Union was the first regional body to seriously consider making it mandatory for large companies to spell out the details of their subsidiaries in corporate registers. Australia was the second.
- If implemented and integrated with similar efforts in financial regulation, this could represent an important step towards systemic multilateral measures to render corporate behaviour accountable, including on IFF.

New research frontier: intra-company financial operations





Intra-company financial operations

- By using a series of subsidiaries located in appropriate jurisdictions, food monopolies have found a way to combine several advantages:

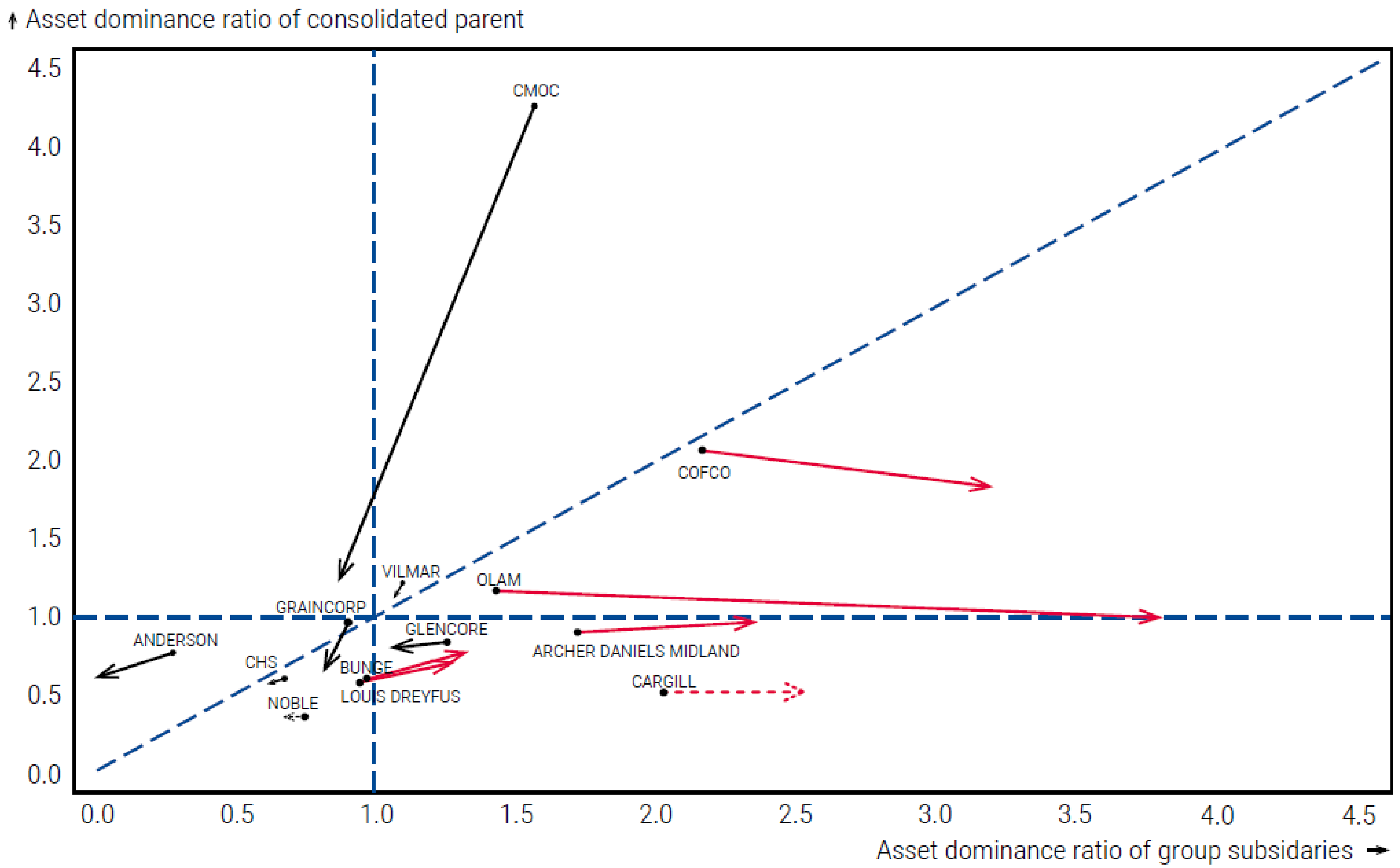
- a superior knowledge of the agricultural commodities markets (real-time supply and demand and prospective knowledge of their evolution);
- **an ability to store agricultural commodities to harness price surges when they occur, ABCD have invested heavily in infrastructure for storage and built significant grain reserves; but with no obligation to disclose their grain stocks;**
- secrecy of their operations and the benefit from derogations to the rules applicable to pure financial actors. ABCD have all legally structured their operations using hundreds of subsidiaries incorporated to take advantage of the various menus of regulations (or lack thereof) offered by the different jurisdictions, including secrecy jurisdictions, around the world (table III.1).

Table III.1 Global food trading companies: Number of subsidiaries

Global ultimate owner	Number of subsidiaries
Glencore	877
Archer Daniels Midland	825
Cargill	780
COFCO International	734
Wilmar International	619
CHS	353
Bunge	352
OFI Group (includes Olam)	207
Akira Holding (includes Louis Dreyfus Corporation)	187
Andersons	150
CMOC Group	100
GrainCorp	60
Noble Group	56
CGB Enterprises	46
Scoular	20

Source: UNCTAD calculations based on Orbis database.

Large food traders become unregulated financial institutions



Source: UNCTAD calculations based on Orbis database.

The change in asset dominance ratio between the consolidated parent and group subsidiaries in the food trading industry, 2014–2018 versus 2019–2022.

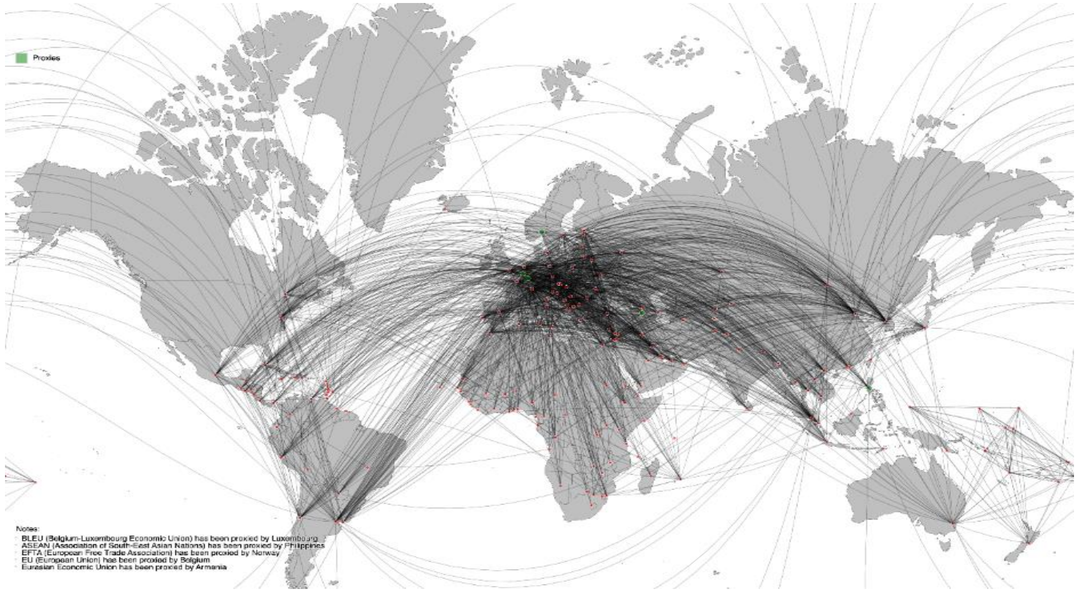
Rebuilding trust in the global economy and multilateral institutions

- Corporate power has expanded over state sovereignty around the world, but it is in the developing countries that the space for autonomous economic policy has diminished most sharply.
- Any serious discussion of how to address the world's divides should start with recognition that 'self-regulated' global corporations and financial institutions have contributed to distrust in the global market and institutions and to global economic fragmentation.
- MNEs and financial institutions are key conduits of financial stability and IFF risks.

The world of trade vs. the centre of capital

ALL ACTIVE REGIONAL TRADE AGREEMENTS (RTAS), 2022

ALL ACTIVE INTERNATIONAL INVESTMENT AGREEMENTS, 2022



Commodity Trading in Different Jurisdictions

Corporate Laws (Common Law VS. Civil Law), Corporate Taxation, Capital Gain Taxation, Property and Intellectual Property Protection, Money Laundry Rules for Capital In/Out Flow

- **Regulation Arbitrage between different jurisdictions**
- Commodity Trade under International Sanctions
- Trade intermediaries with subsidiaries in Offshore Financial Centers help producers circumvent international sanctions.
- **Optimizing Tax Strategies in Global Trading Activities through Multiple Jurisdictions**
- MNEs establish subsidiaries in low-tax jurisdictions to reduce tax obligations and maximize profit.
- Trading between MNEs subsidiaries in different jurisdictions shifts profits from high-tax areas to low-tax areas.
- Intellectual Property Rights can be transferred to offshore subsidiaries in low-tax jurisdictions.
- Aircraft and ships can be registered in offshore financial centers (like Ireland and Singapore) to minimize taxes (No Capital Gains Tax on Aircraft Leasing).
- **Direct and Indirect FDI through OFCs**
- Business and Financial Services provided in a few trading/financial centers help MNEs in their global trading activities, such as currency exchange, trading settlement through banking system, professional legal and accounting services, and consulting services.
- FDI are therefore going through theses services centers first, to get professional financial services or even money laundry and then flow to their final distinction

Financial Trading in Different Jurisdictions

Financial regulations, accounting standards, and supervisory practices differ between jurisdictions.

- **Financial Trading in Exchanges Across Different Jurisdictions**
- Traders exploit regulatory differences across exchanges to engage in arbitrage opportunities.
- **Hiding Trading Processes and Financial Disclosure**
- Financial institutions and products are often registered in jurisdictions with minimal mandatory financial disclosure requirements.
- This allows traders to conceal detailed trading processes, assets, and liabilities.
- **Providing Secret Financial Services for Clients**
- Financial institutions use offshore subsidiaries to offer services that help clients avoid tracking by states/ governments.