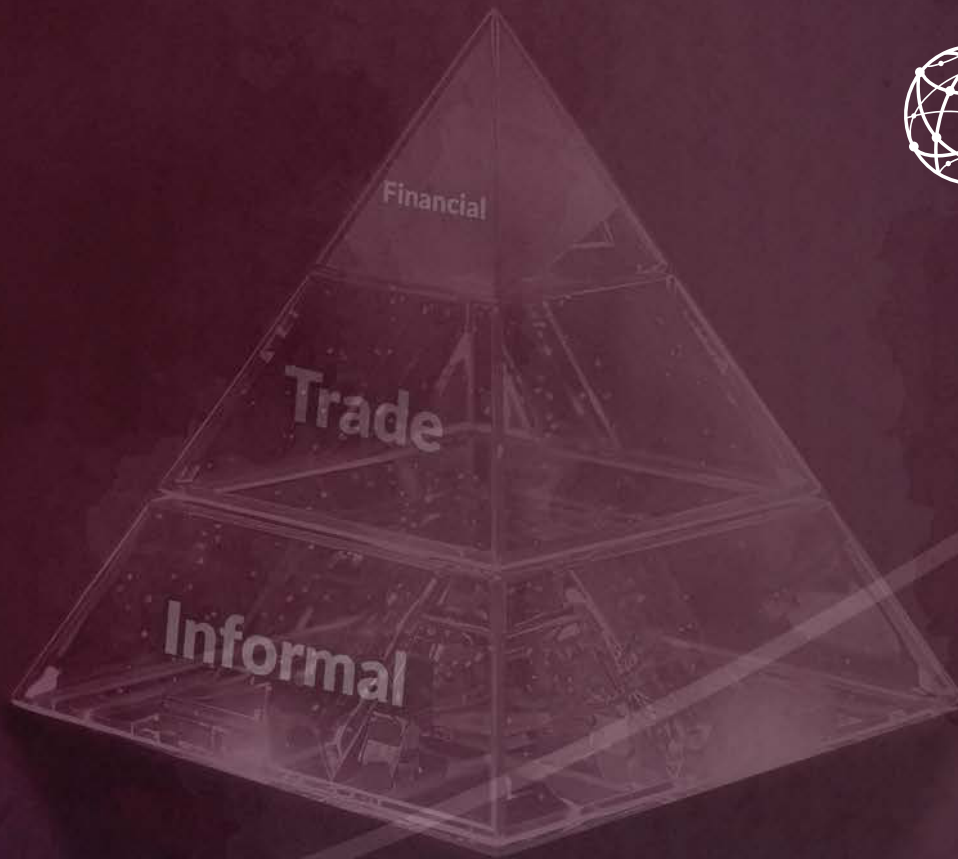




**GLOBAL
INITIATIVE**
AGAINST TRANSNATIONAL
ORGANIZED CRIME



THE PLUTOCRATS' PYRAMID

UNDERSTANDING THE
CHALLENGES OF COUNTERING
ILLICIT FINANCIAL FLOWS

Tuesday Reitano

MAY 2022

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ACRONYMS AND ABBREVIATIONS

AML/CFT	Anti-money laundering and countering the financing of terrorism
BRI	Belt and Road Initiative
FATF	Financial Action Task Force
FTZs	Free trade zones
GFI	Global Financial Integrity
GI-TOC	Global Initiative Against Transnational Organized Crime
IFFs	Illicit financial flows
OECD	Organisation for Economic Co-operation and Development
SEZs	Special economic zones
TBML	Trade-based money laundering
UNCAC	United Nations Convention against Corruption
UNTOC	United Nations Convention against Transnational Organized Crime



EXECUTIVE SUMMARY

Finding responses to illicit financial flows (IFFs) and preventing the extraction, movement and secretion of wealth from the licit global economy has become a growing policy preoccupation. The scale of IFFs and their continued growth has been linked to damaging consequences for governance, and the building of peaceful, inclusive societies that achieve development for their citizens.

This paper draws on the body of research by the Global Initiative Against Transnational Organized Crime (GI-TOC) to demonstrate how and why responses to IFFs are falling short.

This wide-ranging review concludes that:

- The response to IFFs is too focused on the international financial system, and has failed to recognize and integrate the need to also strengthen oversight and integrity in trade flows, which is one of the dominant means by which illicit value is transferred.
- Informal economic activity, and the size and growth of the informal sector in many economies, is undermining the efficacy of regulatory and oversight instruments.
- Political will to tackle the problem appears lacking – instead, in a number of key states, policymaking has been captured to serve the interests of those for whom the offshore financial system and other legal and regulatory loopholes are of significant benefit. Moreover, state actors are both a significant part of the problem, both as a source of IFFs and as a conduit to enabling their continuation.

The implications of such extensive state involvement are profound, ranging from an overly technical approach to the challenge; the capture and distortion of multilateral processes; the failure to link policy to insecurity and violence; and a closing space for civil society manifested in legal, reputational and physical threat.

In the absence of political will, and given the way that the traditional avenues for policy and programmatic response have been compromised, the paper concludes by proposing a few ways to strengthen the response, including by building a stronger and more active role for civil society as activists, whistle-blowers and sources of oversight and response; promoting financial inclusion and reducing informality; and focusing on the role of non-state actors as potential gatekeepers to guard against IFFs.

INTRODUCTION

IFFs have become a serious threat to good governance at national and international levels, to security and to development in countries on both hemispheres – developed, middle-income and developing. IFFs exacerbate the conditions into which serious and organized crime grows and thrives. Not only are they the framework by which illicit money can be moved and hidden, but they also erode good governance and trust in institutions, exacerbate wealth inequality and a sense of inequity in society, divert funding for development investments, create a culture of impunity and fundamentally break down the rule of law.



In the past few years, the conflict in Ukraine, the numerous leaks of compromising data on the role of banks, 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 GI-TOC is the largest dedicated independent civil society research and policy institute on organized 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, while our field networks channel through the observatories a constant insight into the dynamics driving the illicit economy in the world's most vulnerable places. This large body of research, produced by a broad and diverse range of experts, provides huge potential for lessons learning across a range of thematic and geographic areas through evidence synthesis and analysis.¹

The objective with this paper is to test the potential for such synthesis, focusing here on IFFs. The research has been designed to pull out insights across a body of studies in order to better understand (a) what enables IFFs; (b) if there is the political will to address IFFs and (c) what interventions have been successful in addressing IFFs as part of a politically sensitive approach. The research methodology has been to work systematically across the GI-TOC body of research, much of which is centred on national or local realities, in order to synthesize the evidence and draw a set of higher-level findings and policy relevant implications. Four levels of systematic analysis were undertaken to derive the conclusions in the paper.

Firstly, more than 50 GI-TOC research reports were comprehensively reviewed in the course of this study. This included a combination of geographies and flow-specific pieces of research. In particular, the GI-TOC has specialized in research on the intersection between IFFs and extractives, particularly gold, which provided a set of insights rarely seen in broader IFF debates. More general political economy reports allowed for a wider contextual analysis of how organized crime and IFFs work together, and the actors and structural factors that enable those flows. In relation to each of the GI-TOC's IFFs or political economy reports, a standard set of questions were asked, including:

- how well the concept of IFFs is understood among relevant stakeholders;
- what the major sources of IFFs are;
- what enables them;
- what evidence is there of political will to address IFFs, and how effective are they; and finally,
- what action was taken by international actors, or non-state actors.

The literature review was analyzed in order to derive the common themes that occurred across the different geographies, markets and political economy environments.

Secondly, a series of conversations with the GI-TOC experts in the five regions where we have observatories were convened, where the key findings from the literature review were discussed in a semi-structured way. The purpose of these conversations was to qualify or verify the written research reports and to add additional information and insight that has not yet been published in the public domain. The GI-TOC observatory teams are well situated to provide their knowledge across the countries in their region, which allows for a broader scope of conclusions than an individual, in-depth study might provide.

The third layer of analysis was to review the GI-TOC Organized Crime Index 2021 for all 193 countries profiled in the Index.² As the main interest in this research paper is IFFs and political will, the review was looking in

particular for the role of state embedded actors in furthering IFFs and to assess the nature of the national response and its efficacy. Therefore, while the full profile was reviewed, particular attention was given to the 'criminal actor' category of the criminality pillar, and the 'resilience' pillar of the Index.³

Finally, the entire research was situated in and benefitting from the global policy evidence. We conducted a literature review of over 100 global policy reports from academia and the grey/policy literature that covered topics on political will and IFFs, dating back for approximately two decades. The final research report itself was peer-reviewed by in-house GI-TOC experts on IFFs and related issues, in particular organized corruption.

The over-arching conclusion that this research has found is that the line between business, politics and crime has never been more blurred. As a consequence, the majority of 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. Deprived of the ability to know the provenance of funds and the sources of wealth, with no way to know who owns national assets, who directs the companies that lobby for policy or legislative change, or the real source of funds that are contributed to political parties and that finance elections, the greatest challenge to policymakers is understanding in whose interests those policies are being enacted.

It is policies and laws that determines what is illegal – if they are warped under the influence of dirty money to permit and protect those who do wrong, they may no longer be illegal, but they remain illicit: inherently wrong by the norms of democratic governance. 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. It is hard both to overstate the scale of the challenge and to metabolize the lack of political will to address the problem.

The second dominant conclusion of the research has been that the concept of IFFs is poorly and often too narrowly defined. The Organisation for Economic Co-operation and Development (OECD) defines IFFs as 'generated by methods, practices and crimes aiming to transfer financial capital out of a country in contravention of national or international law'.⁴ In practice, however, the research suggests that IFFs are increasingly being enabled by a silent tide of policies and legislative loopholes that enable IFFs to continue unregulated and unenforceable. Definitions that focus on illegality also miss funds that have been acquired through corruption and immorality, or through the distortion of state resources for political leverage in authoritarian regimes.⁵

This sort of behaviour is not illegal but is illicit. It is therefore less meaningful to understand IFFs through a technical lens, but instead to understand the spirit of the concept – that the profit of illicit behaviour is cleaned into the legitimate economy, but also that legitimate resources are being secreted out of the economy without the proper taxes or value being realized for the government and citizens in which it was created. It follows the OECD definition of 'improper, irregular, esp. not sanctioned by law, rule or custom'.⁶

In practice, our research and literature review found that the term 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.

The close association between IFFs and AML has had the further impact of pushing the Financial Action Task Force (FATF) and their anti-money laundering and countering the financing of terrorism (AML/CFT) standards to the foreground in the toolbox of responses. There are significant issues with the FATF that have been well



acknowledged, including a questionable legal status, unrepresentative membership, as well as a problematic peer-review process. But where this evidence review has added additional insight to the existing body of criticisms is that the FATF instruments focus almost entirely on state institutions and mechanisms within the formal economy. Our research suggests that significant levels of informality contribute heavily both to IFF flows and (along with corruption) undermine the efficacy of FATF style responses.

The conclusion of this research and evidence review is that in order to design effective strategies to counter IFFs, a wider view is needed. Drawing from the evidence review, this paper lays out what we have termed the 'IFFs pyramid', the three dominant means by which IFFs are enabled, moved and held: financial flows; trade flows and informal flows. As the next section shows, these three layers of the pyramid work together *by design* to ensure that illicit funds can be earned, moved and then stored in ways that are essentially untouchable, and the funding from organized criminal activities, corruption and legitimate wealth are co-mingled in ways that become entirely indistinguishable – as increasingly are those individuals who earn and invest them. The blurring of lines suggests that responses also need to offset investments into state institutions and capacity with greater emphasis on independent oversight and monitoring, whistle-blowing and investigative capacity. While there are few successes to report in the fight against IFFs, the inflection points have come more as a result of civil society efforts, exposure by investigative journalism and analysis by researchers than those of state institutions or multilateral bodies.

ENABLERS: THE ILLICIT FINANCIAL FLOWS PYRAMID

Figure 1 lays out the 'IFFs pyramid', which GI-TOC research identifies as the hierarchy of illicit flows. The hierarchy is partially symbolic, rather than describing the proportionality of the flows, which differ from jurisdiction to jurisdiction. Its intention is to suggest that it is a concentrated elite – the 'plutocrats' – that can access the mechanisms of global finance at the apex of the pyramid, while the 'bottom of the pyramid', a common idiom relating to the poorest socio-economic group in the income or wealth pyramid, are mired in informal economies, excluded from the formal financial system. Yet even there, this offers opportunities for the corrupt and criminal to profit at their expense.



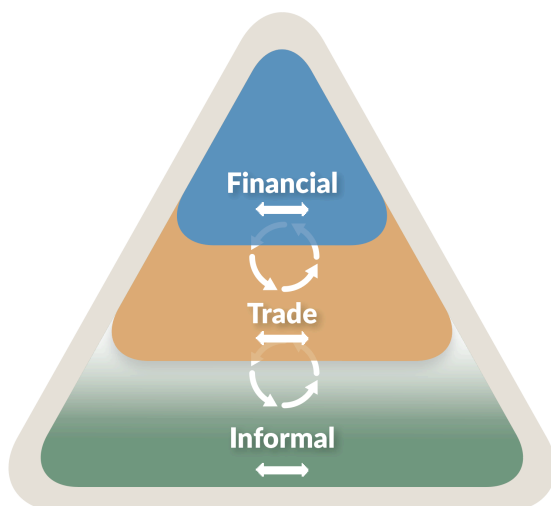


FIGURE 1 The IFFs pyramid.

The IFFs pyramid historically began with the world’s post-colonial financial centres but has expanded to encompass and compromise a far more diverse set of states, including many developing economies, that pursued a competitive tax policy as a means to attract foreign investment and achieve economic growth. The growth of the offshore financial system, and the entry of lesser-developed states with weaker institutions and capacity for regulation, not only made the international financial system more vulnerable to abuses, but also created the nexus with the other two branches of the pyramid – the trade control weaknesses and informality. For trade flows, developing economies seeking infrastructure investment were induced to concede their rights to govern trade within their borders in exchange for infrastructure financing, often by China as part of the Belt and Road Initiative (BRI).

The pyramid is vertically integrated, where institutional distortions travel in both directions and reinforce each other: it is clear that the actions of a kleptocratic elite siphon money from state coffers for private enrichment, typically at the expense of the most vulnerable; but conversely, payments at the street level can be linked and reach up to the highest levels of the state, as protection payments are paid up the line of command.⁷ Similarly, it is the systems of shadow banking that allow the offsetting of value against trade-based money laundering (TBML) systems and thus underpin the movement of both goods and funds.

The GI-TOC’s extensive work in the Western Balkans found that the confluence of widespread economic informality, a proliferation of special economic zones, weak border controls and significant levels of corruption created a system by which IFFs are rampant. Profits from the drug economy and other forms of organized crime are co-mingled with the profits of political clientelism, corruption and corporate tax evasion, and then secreted through a toothless system of financial regulation. A large portion of the domestic economy is maintained as cash based, with the labour force in key sectors paid in cash and ordinary people left unbanked, which ensures the reach of the formal financial institution remains highly limited. A 2020 GI-TOC report concluded that:

IFFs are also enabled by chronic levels of corruption and graft that permeate every level of the state, ranging from transactional bribery to grand-mal corruption in public procurement. Kickbacks are considered a perk of office, and politically connected figures enjoy privileged access to lucrative industries and political protection for their interests. Given the widespread sense of impunity in the state, ordinary citizens see little incentive to adhere to the rule of law. Recent assessments by international bodies suggest that governments in the region are actively taking steps to reduce oversight by

independent institutions, erode checks and balances, and undercut efforts for transparency and accountability. This includes attacking the independent media and closing down space for civil society.⁸

Similar findings of this three-fold confluence of financial, trade and informal flows were found across the GI-TOC literature, from countries in Africa, Asia and the Americas. The literature review suggested that transnational illicit flows were attracted to these hubs, as it presented the optimal opportunities through which to channel financial value. Hubs such as these work as black boxes in the global systems of finance, trade and enforcement, in which anything can be cleaned, transformed or just hidden from view. Regrettably, there are so many in both developed and developing economies that together they render the entire system dysfunctional, allowing damaging free movement of capital and assets with impunity.

Financial flows

For the past few decades, the global financial system has been steadily fashioning itself around the desires of the wealthy, regardless of whether these were captains of industry, tech titans, landed gentry, drug traffickers or kleptocratic politicians and oligarchs.

A system of offshore jurisdictions with preferential tax regimes has been created and allowed to grow, with countries competing to attract the wealthy to shift their vast global wealth into those jurisdictions. These secrecy jurisdictions (used interchangeably with ‘tax haven’) specialize in enabling multinational corporations and high-net-worth individuals to hide their wealth and financial affairs from the rule of law. While sizing the global offshore sector is not without challenges, the Tax Justice Network estimates that between US\$21–US\$32 trillion in financial assets are sitting in offshore tax havens, and that US\$483 billion in taxation is lost to these jurisdictions every year.⁹ A 2017 study estimated that approximately 10% of GDP sits in tax havens.¹⁰ As the International Monetary Fund noted in 2019:

The engine of the offshore system is competition amongst jurisdictions to avoid taxes, disclosure and financial regulation ... As a general rule, the wealthier the individual and the larger the multinational corporation – some have hundreds of subsidiaries offshore – the more deeply they are embedded in the offshore system and the more vigorously they defend it.¹¹

From a developmental point of view, it is an enormously regressive system, sucking resources from the jurisdictions that need it the most, and secreting it into places where it offers little return. It is estimated that approximately one third of the wealth of the richest Africans – in the region of US\$500 billion – is held offshore in tax havens, costing governments some US\$14 billion a year in lost tax revenue.¹² Lower tax revenues in the places from where the capital has left creates weaker public services and encourages governments to compensate with more regressive taxes. Studies have shown that middle classes and the poor are squeezed to support the tax evasion for the rich, their quality of life quantifiably declines, and they are left more vulnerable to environmental, health and other development risks.¹³ Similarly, small and medium enterprises find themselves unable to compete with the multinationals who aggressively shift profits to reduce their corporate tax rates.¹⁴ Yet it is not illegal but an actively promoted and legitimate response to the power of global capital.

In keeping with the desire to ensure that the offshore system operates optimally for the wealthy, it is notable that the framework of governance and regulation over international transactions is both not legally grounded or representative but has systemic imbalances that orientate it more towards preventing capital flight from advanced economies than to identifying and penalize economic crimes. The FATF, the pre-eminent and standard setting body for the global AML regime and self-described as ‘the global money laundering and terrorist financing watchdog’,¹⁵ is a body with no formal standing in law. It was created by the G7 members,

the European Commission and eight other countries. While the membership has subsequently expanded to 37 member countries, described on their website as 'representing most major financial centres', it remains dominated by European countries and the West.¹⁶ And while the FATF's 40 recommendations are scrupulously adopted, implemented and monitored in more than 200 countries and jurisdictions, they have largely failed to show the dividends that might have been expected. In the words of the FATF's president himself, 'Overall, compliance costs are high, but confiscations of dirty money are low'.¹⁷

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 wealthy the means to bypass anti-money laundering regulations, weakening the rule of law. More importantly, they showed that these individuals use lawyers and lobbyists to ensure that their regulations stay favourable, that politicians and policymakers shape legislation towards their own ends, and in doing so, corrupt the basic pillars of democracy from within.¹⁸

The FinCen Files leaks of September 2020 showed how toothless the enforcement system has been made to combat this vast scale of economic crime. FinCen, the United States financial regulatory body, has become overwhelmed by the number of suspicious transaction reports filed defensively by banks to give the semblance of compliance with the onerous due diligence requirements. By drowning regulators in paperwork, knowing that they are insufficiently resourced to do proper investigations on that scale of reporting, banks continued to process transactions for their clients, however questionable, and offset the risks of a fine against the overall profitability of servicing the ultra-rich.¹⁹ As explained by the International Consortium of Investigative Journalists:

The FinCEN files offer unprecedented insight into a secret world of international banking, anonymous clients and, in many cases, financial crime. They show banks blindly moving cash through their accounts for people they can't identify, failing to report transactions with all the hallmarks of money laundering until years after the fact, even doing business with clients enmeshed in financial frauds and public corruption scandals.²⁰

Beneficial ownership and effective corporate registration processes that 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.²¹

Trade flows

The original coining of the term IFFs came from the work of Global Financial Integrity (GFI), a Washington DC-based think tank. In a seminal body of work, GFI laid out an analytical framework for estimating the scale of financial losses using discrepancies in international trade data. They documented the international problem of trade misinvoicing ('when importers and exporters deliberately falsify the declared value of goods on the invoices they submit to customs officials when shipping or receiving goods'),²² which they concluded was the highest value means by which criminals and the corrupt were using to move funds illicitly. In their conclusion, therefore, the scale of trade mispricing was a sufficient proxy for the scale of IFFs.

Trade misinvoicing is done by either under-pricing or over-pricing 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 quintessentially a financial flow using trade transactions. GFI’s analysis suggests that the scale of this crime is staggering:

The total sum of the value gaps identified in trade between 134 developing countries and 36 advanced economies in 2018, the most recent year for which comprehensive data are available, is USD 1.6 trillion.²³

The data also indicates that the scale of the problem is growing rapidly, with COVID-19 presenting even further new vulnerabilities to an already acute problem.²⁴ Research in Albania found that up to 80% of IFFs could be attributed to revenues from the drug trade being moved through the misinvoicing of goods and services.²⁵

There are a number of reasons to explain the growth in trade-based illicit flows. According to a former US senior customs official, the introduction of trusted trader programmes after 9/11 were an early step in the progressive erosion of the ability of law enforcement and customs to provide any meaningful oversight over global trade flows. Put in place by the US government and later the EU, after fierce corporate lobbying, to allow companies to continue to achieve just-in-time supply chains even as governments increased security protocols on borders, these programmes placed regulation and compliance into the hands of the multinationals and alleviated the ability of states’ enforcement bodies to have oversight over the contents of global trade flows to and from the world’s biggest economies.²⁶

A recent Egmont Group report highlighted the use of ‘open account transactions’, an international sale in which the goods are shipped and delivered before payment is due, which are particularly susceptible to trade-based money laundering schemes, and are used in an estimated 80% of international trade transactions. The report also found that there is a significant intersection between TBML schemes and the exploitation of shell companies, as this supports the integration of funds and obscuring the beneficial owners.²⁷

But by far the most significant enabler of trade-based IFFs is the massive proliferation of special economic zones (SEZs) or free trade zones (FTZs). There are more than 3 500 FTZs currently in 130 countries, compared to just 79 in 1975. 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 to transparency and other regulatory measures that would typically be applicable.²⁸

Within an SEZ, national laws are suspended in favour of the agreement governing the zone. In some cases, particularly in developing economies in Asia and the Middle East, SEZs also include manufacturing hubs that employ millions of workers in secondary and tertiary production, from high-tech sectors, automotive assembly, chemical processing and in the garment industry. Where national laws prevent gambling, an SEZ may allow it – welcoming into the cash-based high turnover industry that has long been recognized as a favoured conduit for laundering money. The reduction in regulatory and legal oversight also applies to illicit trade and other forms of criminality, such as fraud and money laundering.²⁹

An investigation by C4ADS into more than 100 FTZs and SEZs in the Mekong region found that while economic development was by no means guaranteed, it was clear that many of these zones were a nexus for illicit activities including corruption, trafficking, the degradation of land and marine environments, and conflict, as well as increasing the potential of governments losing sovereignty to foreign actors, and legitimacy and credibility at home.³⁰ The authors pithily observe that:

A foreign investor with a 99-year land lease and full managerial rights possesses a long-term influence over host-government territory with limited mandated oversight. In some cases, such zones can become semi-autonomous enclaves, with foreign security agencies enforcing laws within the zone.³¹



SEZs have been pushed as part of Chinese investments into infrastructure and economic development that span more than 138 countries under their flagship BRI. The BRI has provided funding and support for infrastructure development in an effort to create a new 'Silk Road Economic Belt' linking Eurasia to Africa by land and sea.³² The scale of their investments under the BRI tops US\$1.3 trillion. As an example, a recent estimate from the China Africa Research Initiative suggests that US\$148 billion of loans were made from Chinese state institutions and Chinese private banks to African governments between 2000 and 2018,³³ and some 20% of African governments' external debt is owed to the Chinese government.³⁴ It has been estimated that one in every five infrastructure projects on the continent are funded by Chinese investments, and one in three are constructed by Chinese companies. China has been Africa's single largest trading partner since 2012, sourcing massive quantities of natural resources from the continent, and returning a wide range of commercial goods onto African markets.

The Chinese requirement for the creation of FTZs and other special concessions in exchange for this level of support to states in Africa, Asia and Europe has triggered the proliferation of FTZs, which has created a network of economic corridors, hinged on connecting one SEZ to another and allowing goods and value to be ushered trans-continently almost without any surveillance or controls at all, from source to destination.³⁵ It is worth noting at this juncture that GFI found China to have the single largest trade flow gap, worth US\$305 billion in 2018³⁶ and that the OECD has stated that China is the single largest producer of fake and counterfeit goods.³⁷

It is a national policy choice to establish a free trade or special economic zone. It is a conscious trade-off of enforcement to allow the majority of trade to move seamlessly around the globe, largely without surveillance, regulation or control, and this freedom of movement of goods has become a vital instrument in the ability to move and launder massive amounts of money in a similar fashion.

Informal flows

The size of the informal economy and its continued growth is a major facilitator of IFFs and reduces 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. 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.

For example, in West Africa, it is estimated that on average 80% of households do not use the formal banking system but work exclusively off cash-based or money-transfer systems. Remittances, which are one of the largest contributors to domestic income in the majority of West African states, similarly travel outside of the formal banking system. Due to very low financial inclusion and access to banking, the majority of remittances are sent informally, which affects the capacity of governments in the region to benefit from taxation.³⁸ In the Western Balkans, on average around 10% of GDP is sent to the region in the form of remittances, and cash underpins the largest portion of daily transactions in the legitimate economy.³⁹

One of the critical ways in which the architecture governing financial flows at the top of the IFFs pyramid connects to the bottom of the IFFs pyramid and the dynamics of informality is that the stringent FATF standards and the penalties incurred on banks for money laundering violations have served to increase their risk aversion, which have resulted in a number of unintended negative consequences that the FATF have self-acknowledged: (i) de-risking; (ii) financial exclusion; (iii) undue targeting of non-profits, and (iv) a curtailment of human rights.⁴⁰

In the cost-benefit analysis conducted by those private financial institutions, their conclusion has been to cut risk at the lower end of the income scale where profits are less, while continuing to service their gold-star, high-



wealth clients. The consequence has been ‘a culture of rigid, non-risk-based “overcompliance” that makes it more difficult to provide financial services to the poor’.⁴¹

The implementation of the FATF’s AML/CFT standards and guidance have therefore prevented ordinary households and businesses from accessing the formal financial system. In the Caribbean island of Belize, for example, between 2015 and 2016, as a result of de-risking, the entire correspondent bank relationship was withdrawn, leaving the entire financial services sector cut off from the international financial payment system. This resulted in a significant increase in the costs to send and receive electronic transfers for ordinary citizens and prompted a sharp rise in the use of informal sector financial services to transfer money overseas, and an uptick in cash in the domestic economy.⁴² What this essentially means is that by offsetting risks to themselves, the banking sector pushes a greater proportion of economic transactions into the shadows, where they are completely invisible to regulators or enforcement. According to World Bank estimates, some US\$540 billion are remitted annually from migrant workers based overseas, and while there is no global estimate, a selection of country studies suggests that between 40% to 80% of remittances sent and received move through informal channels.⁴³

The two dominant forms of informal money transfer are either (a) the use of shadow banking systems such as *hawala* or *hundi* operators that deliver services transnationally and trans-continentially often along ethnic lines; or (b) the carrying of cash or other items of value cross-border, typically for inter-regional flows. In both cases, these informal flows offer significant opportunities for illicit flows to co-mingle and be concealed into remittances flows. GI-TOC research in East Africa relating to the illicit wildlife trade found that:

Hawala networks – unregulated money-transfer services – are frequently used to move money across national borders. For example, a market vendor may also act as a *hawaladar* (money merchant), who organizes the transfer of funds through social network systems. The *hawaladar* may be given cash and then, in return, sends funds to the recipient abroad through his or her network contacts. Mobile money and social media platforms such as WeChat, LINE and M-PESA are also commonly used to move funds and facilitate communication between key players across the criminal network.⁴⁴

GI-TOC research in the Balkans found that cash transfers through cash couriers are a massive source of IFFs. Customs officials report millions of euros in cash being seized along land borders in single hauls, giving an insight into the scale of the problem. Criminal groups were also found to utilize large numbers of couriers with smaller amounts, as under a threshold of €50 000, the fine for non-declaration of cash at a border is only €500, which presents negligible deterrent.⁴⁵ Cross-border illicit financial flows also occur from the movement of high value goods across border – gold being a prime choice for laundering and a preferred currency for the criminal classes who are always prepared to buy it regardless of the provenance, and it is easily transported as jewellery or bullion.

The world’s gold markets and financial hubs frequently coincide – the US, the UK, Switzerland, the UAE and Singapore all have some form of offshore vehicle and significant capacities to trade gold as a physical asset.⁴⁶ GI-TOC research in places as diverse as Mongolia⁴⁷ and the Philippines⁴⁸ to gold-producing countries across Africa⁴⁹ have shown the informal, small-scale artisanal mining trade to be increasingly captured and transported by criminal consortia (‘downstream actors – such as gold dealers, who are reported to have strong political ties or be politicians themselves – who drive criminality’⁵⁰). Informality at source ensures that the provenance, quantity and means of extraction are unknown, can move across borders anonymously and easily comingle with legitimate gold flows.

Once again linking the top of the IFFs pyramid to the bottom, it is significant therefore that it is the countries noted for their kleptocracy and their authoritarianism who have made a point of holding and growing substantial gold holdings. China is reported to have added 900 tonnes in bullion to its reserves between 2009 and 2021;

Russia has stepped up its gold purchases since 2014⁵¹ and in 2020 exported a record US\$16.9 billion worth of gold to the UK.⁵² Creating this glittering physical reserve of wealth is a guard against financial controls, ready to provide a means to continue the theft of state wealth in the case of emergency. Since the start of the Ukraine crisis, analysts have closely watched for evidence that Russia is moving gold through the international gold hubs for evidence that the internationally applied sanctions are beginning to bite.⁵³

IFFS AND POLITICAL WILL

The legalization of a system that enables IFFs comes as a result of an increasing engagement of state actors in enabling and protecting those with money. Kleptocrats across the globe are themselves a significant source of IFFs, and as the previous section has highlighted, the global financial and trade systems have been sold to the highest bidders, and it is those responsible for policymaking and legislation who have been paid for their service. It is no longer meaningful to discuss IFFs or a response to them without acknowledging the instrumental and highly embedded role of state actors in the process.

As an example, a damning volume by the Carnegie Endowment for International Peace, focussed on the role of Dubai as a financial centre, exemplifies perfectly how these three concepts come together in a country as a calculated policy choice. It has the 'problematic behaviours, administrative loopholes and weak enforcement practices that make Dubai a globally attractive destination for dirty money'.⁵⁴ The Pandora Papers investigation showed how the royal family themselves have a clear hand in making the Emirati kingdom hospitable to corrupt and criminal actors from across the globe,⁵⁵ intentionally keeping enforcement institutions weak and offering a high-end, under-regulated property market into which to invest. Dubai is a gold-trading hub – one of the world's most anonymous and nebulous forms of value transfer driven by an artisanal trade; and there are more than 30 free trade and special economic zones in the city alone, to allow goods to be manufactured, through-put or stored without surveillance.⁵⁶

The GI-TOC's Global Organized Crime Index gives comparative scores to the types of criminal group or actor and their influence in the political, economic and social spheres of the countries they operate in. Four forms of criminal actors were identified and scored in the Index: mafia-style groups, criminal networks, state-embedded actors and foreign criminal actors. The state actor category does not describe transactional corruption (bribe taking, for example) but describes those actors in the state that have a strategic and executive role in the perpetuation in or protection of organized criminality. Of the four, state actors embedded in criminal groups were described as having significant or severe influence on society and state structures in 112 out of 193 jurisdictions covered, while a further 34 countries were rated as having moderate influence.⁵⁷ This is three quarters of the states on the globe where state actors are considered the most potent vector in the global illicit economy.

The IFFs pyramid highlights the way that many of the systems that enable IFFs have been a policy choice: the offshore financial system and failures 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.

The role of state actors in IFFs needs to be divided into two areas: firstly as one of the dominant sources of wealth through kleptocratic regimes, and secondly as the policy enablers who uphold the infrastructure to maintain it.

Kleptocracy

The term 'kleptocracy' literally means 'rule by thieves', but describes the phenomenon by which resources are stolen by the heads of state and high-level officials who have a part to play in governance of the state. Kleptocracy is an outflow – while there is some relevance for domestic debates, the majority of the discussion centres around the value transfer of national assets overseas as an illicit flow,⁵⁸ and all evidence suggests that it is occurring at a staggering scale, with evidence of it on every continent. Kleptocracy is the apex of the age-old problem of corruption, and 'the rise of offshore finance enabled corruption at the national level to metastasize into a far more complex and vexing international problem'.⁵⁹

The provenance of kleptocratic wealth is the pillaging of natural resources, whether that is oil wealth, mineral and mining wealth, the plunder of forests, timber or fisheries. These commodities are subject to corrupt tendering processes and trade deals with foreign investors whose payments are turned into private rather than state assets, as well as legitimate market trade that in turn is used to line private rather than public coffers. State officials have also been documented as having tapped resources in the illicit economy for personal gain. There are, for example, a number of Latin American political figures that have been connected into drug trafficking, wildlife crime and other forms of illicit trade.⁶⁰ In the concluding days of writing this report, the former Honduran president, Juan Orlando Hernández, was arrested and indicted on drug trafficking charges.⁶¹

In Guinea-Bissau, the tiny country famed for its chronic political instability that came as a result of its positioning as the hub of the West African cocaine route, also used illicit logging instrumentally to fund elections, to buy political support and to consolidate power. Despite an announced national moratorium on logging exports, logging and exports continued unabated 'enabled in part by patchy and politically motivated enforcement'.⁶² Gambia's former dictator, Yahya Jammeh, was also widely believed to have been personally involved in illicitly importing timber from neighbouring countries and then laundering it internationally:

Parastatal companies set up by Jammeh to coordinate his illicit logging activities imported timber worth an estimated US\$365 million from Casamance and Guinea-Bissau during Jammeh's tenure. Yet timber was not the only commodity in their portfolio: under full protection of the Gambian state colours, the companies transported drugs (including cannabis and cocaine), arms and timber ...⁶³

Yet despite the known links to criminal activity and his autocratic rule, Jammeh and his family were allowed to invest their wealth and enjoy the privileges of Western society. He owned mansions in the US, his family spent money in the malls of the nation's capital, and his daughter enjoyed the privilege of a private school education in New York City.⁶⁴ The practice of corrupt foreign elites being able to use their stolen wealth to purchase expensive educations for their children in Western countries is a noted IFFs weakness.⁶⁵

Kleptocracy is so widespread that it has increasingly become legitimized, where kleptocrats enjoy all the vestiges of high society, culture and glamour. Their excesses have become the stuff of Netflix dramas and caricatures: we know of their giant shoe closets, predilections for Michael Jackson memorabilia; their luxury houses, yachts and jets are featured in magazines. They start charitable foundations and have the UN name prizes after them;⁶⁶ they sponsor buildings in leading academic institutions and hospitals; throw galas; and buy iconic works of art or entire wings of galleries.⁶⁷ Financial crime journalist and author Oliver Bullough argues that it is in fact the ability of kleptocrats to spend their money which is the defining hallmark of the offshore system and what distinguishes contemporary kleptocracy from traditional corruption. The offshore system has allowed the corrupt and the criminal to obscure the connection between the assets and their owner thereby allowing them to use the proceeds with impunity.⁶⁸ Fascinating research forthcoming from Global Integrity ACE has shown across 30 years of data that the incorporation of offshore corporate structures consistently

falls during a political regime change.⁶⁹ It is possible to infer from this, therefore, that offshore vehicles are primarily a means for those in power to move the assets of the state.

State enablers

What becomes important in the discussion on kleptocrats is what they chose to spend their money on. Regardless of the provenance of wealth, acting as one, elites whose wealth emanates from a range of sources, both legitimate and illicit, and are sufficiently moneyed to be able to access the offshore financial system have lobbied extremely hard through means both transparent and opaque to ensure that the system is maintained and protected. Through funding to political parties and individual candidates, lobbying firms and industry bodies, and innumerable acts of corruption, elites have kept the doors to the offshore system and other vehicles to launder wealth wide open.

The systemic threat posed by corruption in the region is also evident when individuals or entities finance political parties in return for favours. These include undeclared sources of funding; the buying of political support by handing out gifts and favours; and using public funds, and appointments in the civil service or state-owned enterprises as tools to build a patronage network of political dependency. In this way, political, business and criminal elites collude to preserve and protect their interests and influence over public functions and resources. These practices create a fertile environment for corrupt officials to operate with impunity.⁷⁰

As a small example of a widespread problem, in 2017, the yachting industry body lobbied the British government to waive a proposed regulation that yacht brokers should be registered with Britain's financial regulatory authority before being able to set up client accounts.⁷¹ This would be a very basic requirement in most sectors where transactions of this scale take place, notwithstanding the huge risks of money laundering that these luxury purchases are known to represent. Superyachts are a notable icon in the world of offshore finance, as not only are they a status symbol in their own right, but purchased under a range of anonymous shell companies they also offer immense opportunity to serve as a vehicle for money laundering.⁷² Beyond even that, yachts offer their owner a chance to move out of their national jurisdiction into international waters, to re-flag and re-name easily in another jurisdiction, thereby de facto moving wealth offshore. Similar value transfer schemes happen on the sale of high-value real estate, art and other luxury goods.

The best lawyers, bankers and other service providers are bought into service of the wealthy to bring pressure to bear across different institutions of the state that might be in a position to set or enforce policy, either overtly or discretely. The World Economic Forum identified these professional classes as 'gatekeepers' able to decide whether the doorway should be open or closed to the flow of illicit money.⁷³ Incentives are offered through legal or illicit channels to key influencers, decision makers and the gatekeepers, until the state itself bends to serve the system. What is created is often called a 'revolving door', where individuals move between key positions of influence in state institutions, to well remunerated private sector jobs where access to and lobbying of their original departments, colleagues and networks is central to the terms of reference.⁷⁴ At a lower level to the kleptocrats, these functionaries of the state serve to perpetuate a system from which they also profit.

In a number of developing economies this system of gatekeepers extends to the security sector and the armed forces, in particular where the physical movement of commodities is a key feature of IFF flows. Across West Africa, it is high-level members of the military who are involved in illicit logging and drug trafficking, for example, as they have the capacity to monitor borders and provide physical protection for illicit goods in transit. GI-TOC research on IFFs relating to the illicit wildlife trade in Thailand found that criminal syndicates were working with

the banks to ensure the smooth flow of funds in and out of the international banking system, but also with the Royal Thai Police and members of the military to ensure the flow of physical goods through Thailand to the neighbouring countries of Laos and Vietnam.⁷⁵

For the kleptocrats and illicit financial flows, the target of corruption has been to be able to move more freely in the stable democratic states where the privileges of wealth can buy security, luxury and high-level services. Over the past few decades, kleptocrats from Africa, Asia, Central Asia and the Americas have targeted Western economies to channel their funds and provide them a friendly jurisdiction in which to spend their money. In doing so, they have instrumentalized the process of corruption. As has been argued, 'politically directed or "weaponized" corruption has been used to interfere in elections in the United States and in European allies and to build bulkheads amongst political elites'.⁷⁶ Russia analyst Mark Galeotti had foreshadowed the way that President Vladimir Putin strategically used kleptocracy to penetrate and undermine Western institutions from the inside:

At home, kleptocracy tends to trump state interests; abroad, kleptocracy is mobilized for the state. It is not just that corrupt Russians rig deals, covertly buy assets and launder their dirty cash in global markets... The Kremlin also uses these methods and connections, and the power and influence they generate, to advance its agenda abroad. The essence of Putin's notion of a mobilization state is precisely that nothing is beyond his reach; that anybody, any institution, from companies to criminal gangs, can be called on to carry out missions for the Kremlin.⁷⁷

In a similar way, Chinese investments in Africa and elsewhere have followed a pattern of buying influence at a strategic level. Instead of operating within multilateral official development assistance frameworks, China prefers to give its aid directly to a country's leaders who can then do whatever they want with it. More than half of this 'no-strings-attached' aid goes to Africa, whose leaders are three times as likely to distribute these Chinese funds to regions (and loyalists) that they have ties to, rather than the areas that most need it.⁷⁸

State actors also have an interest in perpetuating informality where it offers them benefits, particularly in being able to force financial concessions or tributes from workers and businesses in the informal economy, or to take advantage of the under-regulation of artisanal industries or informal economies to avoid taxation. This was reported in GI-TOC research in the artisanal and small-scale gold mining in West Africa, and in labour intensive industries such as tourism and construction in the Balkans. Similar interests on the part of the gatekeepers were found in the Philippines, where 'illicit financiers... help to keep illicit activities and related profits, such as gold smuggling, tax evasion and money laundering hidden from governments. Thus, wide-scale formalisation of [artisanal and small-scale gold mining] is arguably not something such financiers would want to see occur, nor would they be likely to advocate in the mines they help finance'.⁷⁹ In Sierra Leone's artisanal mines, the lack of financial inclusion and formal financing options, coupled with the paucity of social safety nets provided to miners and their families, left many vulnerable to criminal exploitation, driving the growth of this illicit market.⁸⁰

Thus, the web of influence of this vested interest spreads far, wide and deep into the key financial hubs and friendly states to the point where everything from foreign policy to taxation, legislation, regulation and the design of regulatory bodies oversee the very sectors and systems they are seeking to exploit.



RESPONSES TO IFFS WHERE POLITICAL WILL IS LIMITED

New terminology of ‘organized criminal corruption’ is developing to describe the systematic way in which political, business and criminal elites collude to preserve and protect their interests and influence over public functions and resources.⁸¹ Regardless of what state-level rhetoric might suggest, this conceptual framework has significant implications for the way that IFFs must be responded to. When the institutions of the state, policymaking and laws are all being warped to extract value for self-enrichment and to protect illicit flows, then the normal rules of the game no longer apply. This section of the report examines the evidence of how the response framework falls short or is compromised by organized criminal corruption.

The headline finding across the body of GI-TOC research reviewed here, and across other thematic areas as well, is that the key challenge in the response to IFFs is typically viewed technocratically, deriving from a desire to depoliticize the problem, as can be seen in the multilateral forums addressing IFFs in Vienna, New York and elsewhere and the resultant ‘technical assistance’, which is the main practical output of these multilateral bodies. Across the body of GI-TOC research, the conclusions from studies show that a technocratic response often results in disjointed or ineffective policy responses, lacking sensitivity to local needs and conditions, or failing to address the local political issues and underlying organized criminal corruption. As Ian Tennant summarizes:

All efforts, from local law enforcement to regional cooperation mechanisms and multilateral treaties, are hampered by the culture of organized corruption, which ensures that loopholes are maintained, prosecutions are not pursued, offences are overlooked, money is moved, officials are paid off, threats to power in the form of journalists and activists are silenced, and meaningful evaluation and enforcement of international measures are not prioritized by states. We are also unable to penetrate the protective layer provided by organized corruption because our responses are too diverse and fragmented, and they approach organized crime as a primarily a technical issue that can be tackled through legislation, technical assistance and implementation of action plans.⁸²

Across the board, and particularly in the developing economies where many of the sources of illicit value are extracted, evidence shows that the culture of organized criminality and corruption acts as a spoiler to the implementation of effective political responses, an issue that has been exacerbated during the COVID-19 pandemic, and where kleptocracy and authoritarianism combined can result in grave consequences for civil society.

Responses on paper, but not in practice

Consistent evidence across the GI-TOC body of research shows how far short the traditional responses to IFFs, embedded in the implementation of the FATF recommendations, are falling. In all of the case studies and research reports reviewed for this paper, corruption was consistently cited as the primary enabler of IFFs.

In East Africa, research teams reported that:

Criminal groups often create a web of corrupt agents to facilitate illicit shipments to destination markets, including customs agents facilitating the shipments out of a country to local police who allow free passage of containers across borders. More worryingly, corrupt officials working in the justice system, including

arresting officers, investigations staff, prosecutors, magistrates or judges, have also been found to be a key part of facilitating networks' operations ensuring that there are no penalties or consequences to engaging in wildlife crime.⁸³

Research in Nacala port in Mozambique showed that corruption was highly organized, and directly linked to the purchasing power of criminal groups. Seizures were arranged strategically to give the semblance of law enforcement performance, while at the same time ensuring that the criminal economy could continue mostly unhindered:

Whatever seizures occur tend to be of lower-priced illicit commodities, such as garnets and tourmalines, which reflect the lesser 'buying power' of the smuggling network and its greater propensity to being disrupted. In contrast, emeralds, rubies, gold and silver – all commodities that tend to be trafficked by cash-rich networks with at least some political and bureaucratic protection – have not been recorded in police seizures.⁸⁴

In the same paper, the authors reported the capture of transportation networks between the port and the local city of Nacala, controlling everything from public transport to traffic control. They concluded that 'this enabling infrastructure of illicit trading allows the gemstone trade to thrive'.⁸⁵

Corruption and capture of the transport sector was also highlighted in GI-TOC research into the tow truck industry. Drawing on case studies in North America, Australia and South Africa, the research by Yvon Dandurand reported that 'the [transport] sector is the most frequently reported legal business structure used by criminals to facilitate crime' and that 'transport companies are often part of the logistics of organized crime, willingly or unwillingly playing the role of facilitators, as organized crime groups find ways to exploit them as front organizations or use them in other means'.⁸⁶ Leaving a key sector unregulated, or with insufficient regulation and oversight, is a key means by which a government can be nominally seen to be compliant with international norms and taking action against crime, while still leaving the system fundamentally vulnerable.

Capture of the multilateral system

The range of international organizations, frameworks, agreements, declarations, strategies and plans to address both corruption and organized crime are immense. Statements from the heads of different multilateral bodies – the UN, the Bretton Woods institutions and the OECD, among others – frequently lament the scourge of corruption, the challenge of illicit financial flows and the need to take urgent action. Each of these bodies issues resolutions, reports, toolkits. Many deliver field-based technical assistance, or deliver programmes to build the capacity in the states identified by the donor community as weak and requiring intervention. Yet the problem of IFFs has only grown in scale.

The dominant normative framework to counter IFFs is the FATF and their 40 recommendations, upheld by the peer evaluation process that produces the naming and shaming scorecards and blacklists, but as previously discussed, the FATF's approach is undermined by two core issues. Firstly, it focuses its onus on regulatory and reporting capacity in financial institutions, which in the most part are under-capacitated and under-resourced to be able to cater for the deluge of the challenge thrown at them. For example, Germany, home to Deutsche Bank, which single-handedly accounted for 62% of the suspicious activity reports that were leaked as part of the FinCEN Files in September 2020, has for years consistently understaffed its financial intelligence unit, meaning that the majority of suspicious transactions reported go unresolved.⁸⁷ In a series of almost farcical examples cited in his book about the UK's strategic enabling of the offshore industry, Oliver Bullough outlines several examples of how outgunned the public administration services are to respond.⁸⁸ Secondly, there is much to suggest that



the FATF's recommendations are less to do with preventing illicit flows than a red herring for preventing capital flight from onshore advanced financial centres in member states of the OECD to non-aligned offshore jurisdictions.⁸⁹

GI-TOC research showed that the process of meeting the FATF recommendations and getting a good score does drive government policy, but that meeting the FATF requirements meant little in terms of material impact in reducing the scale of illicit flows. Case studies from across Africa, the Balkans and Asia found that while investments had been made in building up the architecture of institutions and mechanisms required by the FATF, ratings for efficacy of those instruments were very low.

However, the single greatest shortcoming of the FATF system to monitor the movement of value around the world is that the vast majority of the offshore system is legal. The protection of the rights to situate value offshore is so far advanced that the architecture has been both technically and culturally legitimized, so that regardless of the capacity and vigilance of enforcement or regulators, in most cases those secreting the largest amount of wealth out of the economy are doing so in ways that are nominally legal. They are neither moral, equitable or arguably licit, but they are legal.

Beyond the FATF, therefore, the international normative and legislative architecture to counter the enabling environment of IFFs is probably most strongly structured by the United Nations Convention against Transnational Organized Crime (UNTOC) and the United Nations Convention against Corruption (UNCAC), which both meet annually with states parties in Vienna. Yet beyond pedalling soft recommendations and resolutions, the bodies have little to show in terms of genuine implementation achievements. Despite their obvious interlinkages, these two conventions and their governing bodies have been kept far apart, which reflects a broader lack of cooperation on organized crime and corruption issues across the UN more widely. As Tennant argues, 'in some ways, the existing response can be characterized as a "whack-a-mole" strategy – in other words deploying initiatives and conventions that focus on only some parts of the task ... To date, initiatives have not taken aim at the central core of organized corruption, which allows all of the manifestations of organized crime and corruption to thrive'.⁹⁰ The two conventions cover some aspects of IFFs, but they will not address the tax-related illicit financial flows, including tax evasion and avoidance, which are currently not covered by any international convention or framework.⁹¹

The rate of ratifications to the UNTOC and the UNCAC is high, but the ability to genuinely understand the extent to which they are implemented and adding value is far less clear. While the UNCAC was designed with an implementation review mechanism, the UNTOC was not, and it took more than a decade for member states to agree to include one. The process for review is generally considered to lack transparency and, more importantly, there are no meaningful sanctions for non-compliance. In both cases, the review mechanisms focus on technical compliance with the conventions, but that in turn offers little indication on whether the legislative or regulatory steps are having any real impact on the ability of criminal groups to operate in a specific market or jurisdiction. Where criminal justice systems and other institutions of the state are working in an environment with high-level impunity and a compromised rule of law, while the wheels may turn, in reality there is little in terms of progress. In the words of an anti-corruption activist in Kenya, John Githongo:

There has been an assumption that if you pass a law and create an institution, then you solve the problem. The normative situation has not been changed, when the same bunch of crooks can work around these bumps in the road.⁹²

At the global policy level, the weaknesses in institutional processes are replicated: represented in the consensus-based multilateral system are the same kleptocratic states and their enablers, with their vested interest to ensure that no obstacles are placed in their path. Filibustering or bureaucratizing has proven an easy way to divert the



multilateral system from taking forward any meaningful policy reform or creating systems of effective global governance. In 2020, a high-level panel on international financial accountability, transparency and integrity was convened to address illicit financial flows. The panel worked quietly in the shadow of the pandemic, issued its report in February 2021 with 14 recommendations and then disbanded in September 2021, having had no traction or uptake, and with no obvious path forward on implementation.⁹³

Un(der)acknowledged linkages to violence

While a growing body of research examines the links between organized crime and violence, urban insecurity and conflict, the focus of the research tends to concentrate on financing to armed groups (war economies), the growth of gang cultures in urban areas, the trafficking of arms and the increased risks to vulnerable persons and the displaced. It has rarely made an explicit link between IFFs and violence – economic flows are often described as ‘non-violent crimes’, or sometimes even ‘victimless crimes’, without the linkage between criminal violence and illicit value extraction being explicitly made.⁹⁴ Financial crimes are considered less seriously than violent crimes, have less social stigma, and empirical studies have shown consistently that judicial sentencing is more lenient for white collar crimes.

By contrast, GI-TOC research has shown an intimate link between violence and IFFs. This comes through the perceived inequality and impunity that elites in society operate with, which damages the rule of law and reduces the sense that ordinary people can see returns on their investments in social capital. As government revenue is reduced through tax avoidance, corruption and fraud, so their ability to deliver services is compromised. GI-TOC research has emphasized the concept of ‘criminal governance’, whereby armed criminal groups set and enforce rules, provide security or other services spanning everything from justice to humanitarian aid, or access to basic utilities, and collect local rents using violence as a means of enforcement.⁹⁵ This is governance by violence, and it develops when service delivery by the state falls short.⁹⁶

IFFs reduce economic opportunities in a number of ways, extracting wealth rather than paying back into the economy and society; FTZs and SEZs often come with labour agreements that are unfair, or which rely on external labour rather than domestic, particularly with Chinese-funded investments, or by forcing people into informality. A recent GI-TOC study on four sites in East Africa found that communities felt a paucity of economic capital, which led them to choose criminal alternatives or to ally themselves with violent groups:

Informal economic activity dominated all four locations, with a wide range of activities from fishing to hawking goods. There was a strong feeling that there are insufficient economic opportunities for young people. This was raised as a reason for youth joining gangs in Kenya and the insurgents in Mozambique. In Montepuez, people said job candidates are expected to pay a fee to access employment. In both locations in Mozambique, it is more common for people from other districts to be hired for local jobs, which isolates local youth.⁹⁷

While there has been an effort to recognize that the issue of violence and insecurity in conflict zones, but also in urban centres, is more than just a security issue and that it also requires development responses, the reality is that nonetheless, most responses to both challenges are militarized, security, criminal justice and enforcement led. Evidence suggests, however, that the responses that have efficacy and longevity of results work to enhance community security through a human rights and community led strategy, and which promote service delivery, sustainable or alternative development as a central pillar.⁹⁸



Closing space for civil society

One of the notable consequences of the increasing investment of political and policy leaders in utilizing and protecting illicit finance has been the closing space for independent actors who seek to provide greater oversight on their operations. To preserve their power and expropriated wealth, kleptocrats have attempted to silence opposition by abusing human rights and suppressing freedoms of speech, press and religion.⁹⁹ The GI-TOC's Global Organized Crime Index observed a correlation between those states highly ranked for the involvement of state-embedded actors in criminality, and the classification of those states as authoritarian, hybrid or flawed democracies by the Economist Intelligence Unit.¹⁰⁰

The attack on civil society and independent voices has occurred through legislation, regulation, constraining them economically and attacks on their reputation and legitimacy. It was noted that AML de-risking has resulted in banks shedding lower-income and community organizations as clients, leaving them vulnerable and unbanked. This has hit women's organizations and financial inclusion particularly hard as it has compounded the obstacles that they already face administratively due to their gender, but it has also significantly targeted at those organizations working in specific regions or on controversial topics such as organized crime or corruption, who in many cases have been classed as political opposition groups or even terrorist organizations by the government.¹⁰¹

These attacks have also increasingly meant violence, including deadly violence, against civil society organizations, particularly investigative journalism organizations and independent media houses, as well as vocal civil society advocates. In the GI-TOC's monitor of criminal assassinations, more than 2 700 cases of criminal assassinations of civil society actors and advocates were recorded in 84 countries in just two years between 2019–2020. Even this already high number is almost certainly an undercount, as in many countries the deaths of civil society activists is so commonplace, and the culture of fear so widespread, that they go largely unreported.¹⁰² The targeting of journalists is now intensifying, given the important role they are playing in analyzing and publishing data from whistle-blowers that reveals the scale of financial crime, investigating corruption and holding both criminals and the policymakers protecting them to account.

Preventing civil society from participating in or auditing multilateral processes is another means by which civil society space is being closed. Blocking those organizations who might provide transparency, oversight or monitoring to systems of corruption, crime or human rights abuses has become a prevalent practice that has intensified as a result of COVID-19 where virtual meetings have become the norm.¹⁰³ While the evidence may not be explicit on this and would be challenging to secure, it is difficult not to attribute these efforts to keep independent voices out of the multilateral space as an effort by state-embedded actors to ensure that there is no means of independent oversight to hold them to account.

RESPONSE ALTERNATIVES AND PROMISING PRACTICES

Responding to IFFs is a collective action problem: if all states do not 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. As a GI-TOC report on IFFs in three Balkan countries concluded, 'to make a real impact in addressing IFFs will require reducing informality, changing the normalization of corruption and clientelist politics, and breaking down protection networks at the top of the political system'.¹⁰⁴

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. The UN's Financial Accountability, Transparency and Integrity panel, for example, recommended the creation of 'an inclusive and legitimate global coordination mechanism at the United Nations Economic and Social Council to address financial integrity on a systemic level'.¹⁰⁵ They also put forward a host of other offices, structures, coordination and data-sharing mechanisms that would need to underpin a new system. While not wrong in its technical design, the report did not meaningfully speak to how to overcome the key problem that there will be limited alignment with the political will and vested interests perpetuating the system as it currently stands.

The European Network on Debt and Development, a civil society organization, has recently mooted a proposal for a framework UN Convention on Tax, responding to the need to see the harmonization of tax principles and to prevent the ongoing race to the bottom to secure the high-value clients from corporate to kleptocrat. Again, while this is a worthwhile proposal, it requires key member states most profiting from the status quo to agree to adopt such an instrument against their own interests – which there seems little indication that they would do without a change in incentives or a new form of coercion.

A more potentially tractable set of recommendations focuses on addressing the enabling environment around the states that persist in weakening the system, that works cross-sectorally with non-state actors, the private sector and aligned state actors with demonstrated integrity. These kinds of collective action solutions have proven to be potent in addressing corruption in certain contexts, and there is a considerable body of experience that can be applied on their design and implementation. However, these efforts have typically been most successful on a smaller scale, where local solutions to local challenges are required, in communities where people are known to each other.¹⁰⁶ There is no practical example of a 'grand bargain' style collective action approach working universally at a multilateral level.

The GI-TOC itself is an effort in this regard, building a trusted network (or a series of interlocking networks acting in concert) to fight a network of deviant actors, but it is a long process that is incremental both in forming and showing results. The question then is, perhaps, how to accelerate those efforts and results? The Doomsday Clock has ticked closer to midnight with every successive year, but there has been no momentum to take the collective action required to mitigate existential threats such as climate change, nuclear security, public health or disruptive technology.¹⁰⁷ It is challenging to see that addressing IFFs, where powerful people's wealth and influence are directly at stake, is likely to see a greater traction.

Promote civil society action and resilience

In regions and on issues where states are corrupt or criminalized, civil society has long been a bulwark part of accepted responses. The conclusion of this research is that there are sufficient states now that have compromised their economic and trade systems, their regulatory and security frameworks, and their democratic governance principles in order to facilitate IFFs, that is has undermined the multilateral superstructure. The multilateral systems, the systems of trade and financial oversight cannot function as there are too many spoilers. In this



context, the role of civil society has become more prominent, including playing a number of different roles as watchdog, advocate, activist and a source of resilience for those made vulnerable by the status quo.

It is clear, for example, that the most strategic inflection points in the debate have come as a result of the work of whistle-blowers and investigative journalists. The Panama, Paradise and Pandora Papers, and the FinCEN leaks have catalyzed the debate on IFFs in meaningful ways, revealing the extent of the challenge and creating profile on the problem. Yet simultaneously, press freedom and financing has been under fire in many places, as has the work of some watchdog bodies such as Freedom House, Committee to Protect Journalists and Reporters Without Borders. Freedom House's Freedom in the World report concluded that press freedom has declined consistently over the past decade, even in established democracies.¹⁰⁸

This threat extends beyond journalism to civil society activism. Human rights defenders, environmental activists, land rights campaigners, gang mediators and community mentors of all ilk are all part of the groundswell of activism against IFFs and the pressure that they have applied to communities. They are identifying the issues, raising awareness and leading the demands for change; they are also often spearheading community-led solutions to the challenges that they see, mobilizing other parts of society and calling on governments to play their role. There is, therefore, both an inherent value to supporting their efforts with resources, profile and protection, but also to capturing their experience, elevating them into higher-level bodies in the multilateral system and in the international media, and allowing those experiences to be heard. They are diagnosing the ills and proposing potential solutions, even if those in power are able to ignore their voices, or worse.

New regulatory, enforcement and development efforts in the most vulnerable communities, particularly in places where the trust in institutions is low, have built into their design a capacity for civil society oversight and a participatory decision-making process. This provides a means by which to keep state and corporate actors transparent, to give communities a seat at the table and buy-in to the process, and to offset the risks that initiatives are compromised by vested interest. This approach has shown promise in a range of interventions, such as initiatives designed to regulate natural resource extraction. GI-TOC research in Jamaica recommended the benefit of civilian oversight and civil-society monitoring:

Given that public trust in institutions can be low – particularly in the communities most affected by crime and violence, and where the perception of corruption and elite impunity is high – a civil-society-led oversight mechanism and participatory decision-making can serve to progressively allay those concerns and rebuild the trust that will be fundamental to a more constructive future.¹⁰⁹

In the Jamaican context, civil society panels helped to direct funding to communities that most required it, and then to oversee its implementation, reporting on whether initiatives were completed as planned and were having the expected results. A coalition of civil society groups, including academia, undertakes data collection and analysis on insecurity and violence trends, and infrastructure integrity, among other issues, on an ongoing basis, that can then be fed into the state-led reform process through a standing committee.¹¹⁰

Not only can civil society be used for holding public officials and institutions to account, it can also provide active support in investigations and prosecutions. Building bridges to law enforcement, finding ways to use the investigations of journalists or NGOs in criminal prosecutions, can be of assistance where integrity of the criminal justice system may be decent, but trust in institutions, capacity and resources are low. In East Africa, for example, locally embedded NGOs provide much needed funding and expertise to law enforcement agencies in everything from financial investigations to arrests and prosecutions, which has assisted with access to information, building evidence basis for key cases, thereby allowing for more successful prosecutions.¹¹¹ Research into online wildlife markets found that while communities and NGOs often had the most information about poaching, the



transportation of illicit environmental commodities and their sale, law enforcement was unable or unwilling to use their sources, or to cooperate with them.¹¹²

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 forums to raise policy concerns. That said, to prevent civil society becoming the canaries in the coal mine, as they are given additional profile and become more strategic actors in the fight against IFFs, it will be critical also to highlight cases and demand action against threats to civil society, journalists, advocates and others. They are currently being killed with impunity: of the 50 cases featured in the GI-TOC's *Faces of Assassination* book, which selected a sampling of criminal assassinations over the past 20 years, in over 90% of the cases there is no criminal justice, either because there is no trial, pending trial or no conviction. In one case was anyone successfully prosecuted for the killing.¹¹³

Promote financial inclusion and social redistribution of assets

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,¹¹⁴ there is little reason not to move this significantly up the policy priority hierarchy.

GI-TOC research into artisanal gold markets – a commodity that has become a major source of illicit value acquisition, transfer and laundering – suggests that, given their contribution to the local economy and livelihoods, gold and other artisanal industries should be reformed through legalization and regulation, rather than criminalization.¹¹⁵ Creating mechanisms for safe employment and promoting mechanisms of financial inclusion to allow those profits to be recorded into the formal economy are essential. This finding applies equally to the tourism industries in the Balkans as it does to the mines of West Africa, or any other labour-intensive formal economy.

Women have been identified as being particularly vulnerable – as victims of crime and the most detrimental effects of IFFs, as well as to financial vulnerability and exclusion.¹¹⁶ Yet they are also often the forefront of many civil society-led responses and are the primary source of resilience for their community.¹¹⁷ Therefore, as the wider evidence also suggests, ensuring that financial inclusion efforts are gender sensitive and prioritize women in the community would be a long-term benefit to building a more resilient framework of responses.¹¹⁸

In addition, as the international efforts to reduce IFFs, and to seize and confiscate assets particularly from corruption-related flows gain traction, increasingly the discussion turns to how to use those assets. There have been examples of both direct and indirect use of confiscated assets for social purposes, either to provide some redress to the victims of crime, or to provide development opportunities in areas made vulnerable by corruption and impunity. For example, the assets seized by the US Department of Justice from the corrupt Obiang family were given to the UN to support the COVID-19 response, and to a local NGO to distribute for public health activities across Equatorial Guinea.¹¹⁹ GI-TOC work in the Western Balkans suggests that civil society has a key role to play in the social reuse of confiscated assets and can greatly enhance their efficacy. Civil society involvement can attract wider attention to the practice, which both serves to amplify the investment, build trust in the state and begin to break down a perception of corruption. They can also support the direction of those resources towards the most urgent and meaningful of community priorities.¹²⁰



Strengthening the gatekeepers

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.

Even in exclusively the financial sphere, there has been a growing realization under the FATF framework that banks alone cannot stand as watchdogs in the prevention of IFFs,¹²¹ 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, to real estate agents, among others.¹²² Given that 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, and building them into networks of trust can be a more achievable target even in the current environment.¹²³

The GI-TOC argues that the net needs to be cast wider still. With IFFs flowing through trade flows and embedded in informality, responses need to build integrity across the actors who have the opportunity to engage in and regulate these flows also. In the trade sector, this includes widening the net to customs officials, ports and airport authorities, transport sector companies, regulators and individual operators.¹²⁴ Private sectors actors, including those who monitor and are control points for trade, are an overlooked priority. Several GI-TOC reports have noted that the cooperation between the private sector, non-state actors and state enforcement is often weak or confrontational, rather than collaborative. The 2017 GI-TOC foundational report on organized crime and the private sector, which engaged across a number of different corporate sectors to draw broader conclusions, found that ‘private sector organizations complain that communication with the law enforcement sector is one-way and that the regulatory reporting burden, designed to combat crime, can act as a deterrent to cooperation. Tangible results have been seen when industries take the lead on disrupting the work of [transnational organized crime] groups’.¹²⁵

An area for further exploration, then, is how to turn those actors who have a potential gatekeeper role from enablers of illicit activity into a bulwark of integrity. A better review of this is necessary than this paper has the ability to tackle at this time. Some of the issues to consider are:

- Exploring and better understanding the value of high visibility symbolic prosecutions of key individuals where possible, and ensuring those efforts are widely resonated to impact cost-benefit calculations of those vested in the chain is another strategy in changing the paradigm for gatekeepers.
- The financial penalties for banks have been an insufficient deterrent to prevent their wrongdoing.¹²⁶ How can messaging and incentives be changed to promote integrity, help individuals understand their role as a gatekeeper and feel a personal risk should they fail by design or accident?
- Furthering knowledge on how to build networks of integrity, increase transparency and reduce transactional corruption through collective action. As the GI-TOC has found in building its own network, this is a progressive process that occurs incrementally, which requires rigorous due diligence and investments into trust building. In the current climate, it may be more realistic to see responses to IFFs built from the bottom and middle upwards, rather than the top down.



CONCLUSION

Throughout the body of GI-TOC research reviewed here, complemented by other research and engagement with experts, there is little to suggest that there is currently sufficient political will to respond to IFFs in the traditional way – technocratic government or multilateral-led initiatives that are often blind to politics. In fact, the research suggests that there is instead what could be called ‘institutionalized resistance’ to these sorts of approaches. The research also suggests that there is a need to broaden the scope of concern for those tasked with developing approaches to tackle IFFs, moving beyond looking primarily at the architecture of the international financial system and its weaknesses, and instead more systematically including systems of trade and the increasing exclusion of large segments of the population and economic activity from the licit economy as a result of de-risking.

Adapting an approach first set out by Carmen Malena on moving from ‘political won’t to political will’ for introducing participatory governance approaches,¹²⁷ Heather Marquette looks at how we can better understand political will for supporting reforms on organized crime, IFFs and corruption in contexts where secrecy and violence allow powerful actors (and their enablers) to often act with impunity, as the research here has clearly shown.¹²⁸ This approach suggests that political will can come about in situations where those in power feel compelled to act because the costs of inaction have become too politically – and personally – costly.¹²⁹ Sometimes this can happen over time, such as where civil society have successfully changed the debate on what’s acceptable and have helped support reformers in changing the sense for what’s possible, but it sometimes can also happen suddenly in response to some sort of critical juncture.

One way to think about this is through the lens of a ‘black swan event’, in other words an unplanned event that fundamentally changes the working environment, investment calculations and future plans. So far, the Panama Papers and subsequent similar revelations may have generated debate, but they have not yet seemed to have changed the sorts of calculations made by the powerful. There was some speculation that the COVID-19 pandemic might prove such an opportunity, though it currently looks instead to have exacerbated and reinforced the existing dynamics rather than providing impetus for their reversal.¹³⁰

Now, the Ukraine crisis, with the strong push to find ways to punish politically connected Russian oligarchs, offers another window of hope in the fight against IFFs, though coming at a devastating human cost. A number of unprecedented steps have been taken to close down some of the IFFs loopholes in the system in order to sanction Russia’s actions: for example, Russian banks have been removed from the SWIFT system of international banking; countries that have been a haven for Russian money have frozen assets – but these actions need broader and sustainable application to be a sign of real reform that, so far, has not happened.¹³¹

Whether Ukraine does or does not provide the much needed black swan event to compel the powerful to feel that they must act because the costs for them have become too high, this publication, drawing on a range of GI-TOC research and experience, has reinforced the importance of addressing IFFs and the urgent call to action to do so. While the winds may not be blowing in favour at this time, there is mobilization at the community and civil society level, and much that can be done to prepare, build awareness and build up networks that can then be mobilized when an opportunity presents.



Notes

¹ The GI-TOC has a globally dispersed secretariate of over 100 full-time staff in 26 countries, centred around six regional observatories, and maintains a Network of Experts of over 650 individuals, including officials from governments, multilateral institutions, as well as experts from civil society, academia and the private sector. The GI-TOC 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, while our field networks channel through the observatories a constant insight into the dynamics driving the illicit economy in the world's most vulnerable places.

² See <https://globalinitiative.net/analysis/ocindex-2021>. The report includes explanation of the Index methodology and descriptions of categories and other key terms used.

³ The Index defines 'resilience' as: 'the ability to withstand and disrupt organized criminal activities as a whole, rather than individual markets, through political, economic, legal and social measures. Resilience refers to countries' measures taken by both the state and non-state actors'. See www.ocindex.net.

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