Introduction

By 2030, significantly reduce illicit financial and arms flows, strengthen the recovery and return of stolen assets and combat all forms of organized crime

UN Sustainable Development Goals Target 16.4

Global agreement in 2015 on the Sustainable Development Goals framework, to guide worldwide progress in the period to 2030, includes for the first time a target to reduce illicit financial flows (IFF). But the challenge is this: without agreement on methodologies to measure the scale of IFF, how can the target be met? How, indeed, can it even be attempted, or monitored?

‘Illicit financial flows’ is an umbrella term, which came to policy prominence during the period of the Millennium Development Goals (2000–2015). Its success, in part, was due to its breadth. The term allowed a shared agenda among, for example, people who variously saw either kleptocratic leaders or rapacious multinational companies as a critical obstacle to development success. The common elements, of hidden behaviours that strip resources and weaken governance, were sufficiently clear that an irresistible momentum developed to ensure prioritisation within the Sustainable Development Goals (SDGs).

There are, however, important differences in the political sentiments underpinning support to tackle the various elements under the illicit flow umbrella. Consensus at the headline level does not necessarily imply consensus on each element.

At the technical level, there is equally great variation in the channels used for illicit flows and in the approaches to estimation and measurement that have been applied. And so while many SDG targets left open the question of definition and measurement, this is perhaps especially true in the case of 16.4. Which flows fall under the umbrella term? How will progress in reducing them be measured? How will that progress be achieved? Who should ultimately be held accountable for progress, and can the choice of indicators ensure they are?
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In this book we provide a critical survey of the evidence base to answer these questions, and present our own proposals. The book is laid out in three parts, as follows.

In Part 1, we discuss the rise of ‘illicit financial flows’. We chart the political rise of the term, and lay out the ideological differences that have to some extent been obscured. We present a typology showing the breadth of the underlying phenomena, and also highlight the important common elements and impacts. We distinguish between tax-abusive and market-abusive IFF, which tend to involve illicit transactions with capital of legal origin; and IFF related to theft and criminal markets, where the capital itself is illegal.

Overall, we confirm the substantive importance for development of illicit financial flows, and the tendency to undermine both the level of resources available to states, and the likelihood of states using their resources efficiently and for inclusive benefit. But we also confirm the inherent difficulties of tracking progress against phenomena that are, by definition, deliberately hidden from view.

For this reason, Part 2 provides a survey of the extensive literature on estimation and measurement of illicit flows. As well as underpinning the subsequent proposals, this is intended to provide a standing resource for researchers, students, policymakers and activists on the relative merits and reliability of different approaches to key elements of IFF. Each chapter in Part 2 follows a consistent format to allow easy use. For each methodology, a separate treatment is given for the quality of the data and the robustness of the methodology. These include assessments of the scope for improvement and/or the likelihood of access to better data. Each section, and each chapter, also include overview and conclusion sub-sections with key findings which can be read as standalone summaries.

First, chapter 2 evaluates the literature on trade-based IFF. Separate sections address the literature using national-level data; that using commodity-level data; and that using transaction-level data. Chapter 3 focuses on estimates based on capital accounts anomalies, with separate sections addressing the approaches of Global Financial Integrity; of Ndikumana and Boyce (e.g. 2000; 2008); of James Henry (2012; 2016); and assessing the estimates that combine trade-based and capital account components. Chapter 3 also evaluates leading estimates of undeclared wealth held ‘offshore’ specifically, the approaches associated with James Henry and with Gabriel Zucman (2013, 2015), respectively. Chapter 4 addresses the much larger and more varied literature on the extent of multinational profit shifting—from international organisations including UNCTAD, the IMF, and OECD, and key individual authors such as Kim
Clausing (e.g. 2016) and Gabriel Zucman and co-authors (e.g. Tørsløv, Wier, & Zucman, 2018).

The intention in this volume is not to provide a comprehensive overview of estimates of every IFF component, nor of every IFF channel. We focus on the main areas of the literature—academic and beyond—in which rigorous, replicable methodologies have been developed. In general, we give priority to those approaches generating global estimates based on country-level findings. We also prioritise those estimates that have been most salient in policy discussions, and those which we find to be most robust—although these are, sadly, not always consistent categories.

As a result of this approach, since estimates of illicit flows associated with illegal markets are generally made at the national level, and tend not to be widely replicated across countries, this literature is largely excluded from consideration. Estimates of undeclared assets held offshore are included, however, and these include much of the ultimate proceeds of illegal market IFF. We also do not address the literature on national tax gaps. This is in part for the same reasons of global comparability and policy salience, and in part because tax gaps may be purely domestic rather than necessarily reflecting the cross-border transactions that characterise IFF.

We reach a number of conclusions from Part 2. The most extensive, rapidly developing literature, with relatively robust results, relates to multinationals’ profit shifting. Of the many approaches here, those which provide most confidence are based not on regression analyses but on direct measures of the gap between where economic activity takes place, and where the resulting profits are declared. This insight also provides an indication, exploited later, of how scale measures could be constructed for other IFF.

In Part 3, we look beyond the current estimates and set out various alternatives, including our proposed new, direct measures of scale for use as SDG indicators. In chapter 5, we consider two main types of non-scale alternative IFF indicators. First, we present a set of policy-based indicators that were originally proposed before the SDG process settled on a scale measure. These offer the scope to track global progress on transparency measures that are key to curtailing illicit financial flows, and also offer the jurisdiction-level disaggregation to support accountability for policies that maintain opacity.

Chapter 5 also includes two related sets of IFF risk measure, which follow the same logic but combine the policy-created opacity of jurisdictions with bilateral data on economic and financial transactions between jurisdictions, in order to evaluate the exposure of each country to IFF-facilitating secrecy elsewhere. Both approaches build on the global ranking constructed by the
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Tax Justice Network, the Financial Secrecy Index. The first, pioneered by the High Level Panel on Illicit Financial Flows out of Africa, emphasises granular analysis of each countries’ vulnerabilities to IFF, to support policy prioritisation. The second, operating in a similar way, is a Bilateral Financial Secrecy Index, replicating the global approach at the national level.

In chapter 6, we present our proposals for SDG 16.4, which were developed as part of the UN process. These proposals build on the findings in relation to scale estimates, and on insights from the non-scale approaches. We propose two indicators. Both are direct measures, rather than estimates, in keeping with the conclusions from Part 2 on the robustness issues of many of the estimates.

The first proposed indicator relates to tax avoidance by multinationals. The proposal follows the stronger of the approaches surveyed in chapter 4 in preferring a measure of the broader phenomenon of profit misalignment, to a less certain estimate of the somewhat narrower phenomenon of profit shifting. It is proposed to construct the measure on the basis of newly available data following the introduction of a country-by-country reporting requirement for multinationals. Alternative ‘workaround’ approaches are also discussed, should data access prove problematic.

The second proposed indicator takes a similar approach, constructing a direct measure which also works on the basis of newly available data—in this case, data resulting from the introduction of multilateral, automatic exchange of tax information between jurisdictions. Following the insights of Henry (2012) and others surveyed in chapters 2 and 3, we propose an overarching measure for a common result of most illicit flows other than multinationals’ profit shifting: the volume of undeclared offshore assets.

The two proposed indicators share a valuable feature of the policy- and risk-based measures set out in chapter 5. This is that they can be fully disaggregated to the jurisdiction level in a way that will support accountability both for jurisdictions that benefit from provoking illicit outflows elsewhere, and for effective policy responses from those that suffer.

Finally, chapter 7 presents the overall conclusions of the book and makes recommendations for the most promising directions for future research, and the most pressing and realistic priorities for data collation and data access. We highlight the most robust estimates currently available, and draw out the implications of our analysis for target 16.4 of the Sustainable Development Goals. Recognising the growing momentum for wider UN measures, we also identify related proposals to improve the data infrastructure and policy instruments.