



GLOBAL FINANCIAL INTEGRITY



Illicit Financial Flows, Human Rights, and the Post-2015 Development Agenda

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Every year, nearly \$1 trillion in corrupt, criminal, and tax-evading money is drained from poor and emerging economies, depleting government coffers, undermining development efforts, and contributing to persistent poverty. In the past decade, international and multilateral institutions, such as the OECD, G8, G20, and United Nations, have recognized the corrosive impact of these illicit financial flows (IFFs) on developing countries and have begun taking steps to curtail this reality. Despite this growing recognition, much more work remains to fully address the challenge of IFFs. Effectively tackling the problem requires active cooperation between developed and developing countries to challenge and revise key assumptions and components of the international economic system facilitating IFFs.

Such cooperation should be easy to achieve if premised on the notion that IFFs violate fundamental human rights. The right to economic well-being is a key component of global human rights norms and IFFs are directly responsible for perpetuating economic deprivation throughout the developing world, in distinct violation of these rights. The effect of IFFs can be profound and multiplicative: the loss of capital impedes the organic growth of the economy, the loss of tax revenue resulting from IFFs hampers governments' ability to provide services and infrastructure for their citizens, and the perception of corruption and poor governance creates political instability and may discourage potential foreign assistance. The linkage of IFFs to persistent extreme poverty makes IFFs one of the greatest human rights challenges of our time.

Advocates for curbing illicit financial flows often base their arguments on one of two rationales—the economic or the ethical. Illicit financial flows deprive developing countries of crucial resources needed for development (the economic perspective), and developed countries' maintenance of the system that allows this deprivation to occur is morally unjustifiable (the ethical perspective). A rights-based approach to IFFs combines these perspectives, demonstrating the practical importance to developing countries of curbing IFFs while also providing a moral impetus for developed countries to do so. The ongoing process to establish the successors to the Millennium Development Goals presents a unique opportunity to galvanize international cooperation to tackle this issue and set a benchmark for its success. In this paper, we call upon all institutions involved in this process to make curbing illicit financial flows a key component of this landmark agenda.

I. Economic Human Rights and Development

The basic notion of human rights is reflected succinctly in Article 1 of the Universal Declaration of Human Rights: “All human beings are born free and equal in dignity and rights.”¹ Adopted by the United Nations after the conclusion of World War II, the Declaration remains the fundamental document of international human rights law, listing in its thirty articles the basic rights that all human beings are guaranteed as members of civilized society. The human rights community tends to divide these rights into two conceptual categories: i) civil and political rights, and ii) economic, social, and cultural rights. Subsequent UN instruments expanding on and protecting these rights as a matter of enforceable international law follow a similar partition. In brief, civil and political rights are those rights attendant to free expression and self-determination, the well-known freedoms underpinning all modern democratic societies.²

Economic, social, and cultural rights are introduced in Article 22 of the Declaration, which states the individual’s basic right to “social security,” and the subsequent articles make this concept explicit, particularly Article 25, guaranteeing to every human being the necessities of a dignified standard of living—food, clothing, housing, and medical care.³ The International Covenant on Economic, Social and Cultural Rights, adopted two decades after the Declaration, establishes a clear line of responsibility for ensuring these rights, obligating every state government to commit “the maximum of its available resources” to the goal of “continuous improvement of living conditions” for all its citizens.⁴

The placement of economic rights alongside and on equal terms with civil and political rights reflects a basic truth: economic well-being is as fundamental to human dignity and societal function as civil and political freedom. Nonetheless, full realization of economic human rights is still out of reach for many around the globe, and their inclusion in these instruments is often described as “aspirational.” This stems in part from the difficulties within international bodies and tribunals of enforcing these rights. While civil and political rights are “negative rights” that are violated by specific, punishable actions by governments or individuals, economic rights are typically viewed as “positive rights” that require governments or other institutions to take steps to secure.⁵

In other words, economic deprivation is often an extant condition that governments must actively work to ameliorate, and provision of food, water, education, housing, and other facets of social security for a country’s entire population requires an unavoidably large monetary investment over a substantial period of time. Despite the Covenant’s requirement that states apply all available resources to poverty-alleviating programs, international institutions are extremely reluctant to meddle in domestic government spending priorities. As a result, efforts to realize economic human rights have primarily focused on international aid from developed countries.

¹ Universal Declaration of Human Rights, G.A. Res. 217A (Dec. 12, 1948).

² See Linda M. Keller, *The Indivisibility of Economic and Political Rights*, 1 HUMAN RTS & HUMAN WELFARE 9 (July 2001) (historical and political background for division of rights).

³ Declaration, arts. 22, 25.

⁴ International Covenant on Economic, Social and Cultural Rights, G.A. Res. 2200A, arts. 2, 11 (Dec. 16, 1966).

⁵ Ellen Wiles, *Aspirational Principles or Enforceable Rights? The Future of Socio-Economic Rights in National Law*, 22 AM. U. INT’L L. REV. 35, 45 (2006).

<u>Key Statements of Economic Human Rights</u>	
Universal Declaration of Human Rights, Article 22 (1948)	“Everyone, as a member of society, has the right to social security and is entitled to realization, through national effort and international cooperation and in accordance with the organization and resources of each State, of the economic, social and cultural rights indispensable for his dignity and the free development of his personality.”
Universal Declaration of Human Rights, Article 25(1) (1948)	“Everyone has the right to a standard of living adequate for the health and well-being of himself and of his family, including food, clothing, housing and medical care and necessary social services, and the right to security in the event of unemployment, sickness, disability, widowhood, old age or other lack of livelihood in circumstances beyond his control.”
International Covenant on Economic, Social, and Cultural Rights, Article 11(1) (1966)	“The States Parties to the present Covenant recognize the right of everyone to an adequate standard of living for himself and his family, including adequate food, clothing and housing, and to the continuous improvement of living conditions. The States Parties will take appropriate steps to ensure the realization of this right. . .”
UN Guiding Principles on Extreme Poverty and Human Rights, Article 73 (2012)	“States have the obligation to progressively improve the living conditions of persons living in poverty. While the right to an adequate standard of living includes specific rights . . . , it is also an overarching right that encompasses elements essential for human survival, health and physical and intellectual development.”

The differing status of economic human rights is also due in part to fierce theoretical and political controversy over their enshrinement as fundamental rights. While the freedoms provided by civil and political rights tend to be seen as an incontrovertible core feature of modern liberal democracy, the proposition that individuals are entitled to a certain standard of living is often seen as conflicting with core tenets of classical capitalist economics. Similarly, philosophers throughout history have readily argued for individual freedoms of civil and political expression, but the question of whether society is naturally compelled to provide economically for all of its individual constituents has met with far less consensus.⁶

Yet regardless of the philosophical underpinnings, it is undeniable that economic sustenance—that is, access to the bare minimum level of food, water, and other necessities for

⁶ Dan Seymour & Jonathan Pincus, *Human Rights and Economics: The Conceptual Basis for their Complementarity*, DEVELOPMENT POLICY REVIEW, 2008, 26 (A): 387–405; David Beetham, *What Future for Economic and Social Rights?*, POLITICAL STUDIES (1995), XLIII, 41.

survival—is a prerequisite to the enjoyment of all other human rights. Without life, one cannot have liberty. And despite recent progress, there are still many people around the world who face this challenge daily.

II. Poverty and the Millennium Development Goals

Institutions involved in development generally treat poverty as not just a state of economic deprivation, but as a more complex, multidimensional condition, “characterized by the sustained or chronic deprivation of the resources, capabilities, choices, security and power necessary for the enjoyment of an adequate standard of living and other civil, cultural, economic, political and social rights.”⁷ Although this definition encompasses and often utilizes the quantitative notion of poverty used in economics, by incorporating the full spectrum of human rights it describes a qualitative standard of living that is unacceptable in modern society.⁸

In this sense, the existence of poverty reflects a structural social phenomenon, in which human rights are out of reach and economic deprivation is only one element of the problem. Although this encompasses a broad range of social situations, it is at its worst in the form of extreme poverty, in which individuals face a daily struggle to merely survive. This is often measured using the baseline of \$1.25/day or less in economic income, but in human rights terms, those in extreme poverty suffer “multiple reinforcing violations” of their rights, leading to “a vicious cycle of powerlessness, stigmatization, discrimination, exclusion and material deprivation.”⁹ This is the key feature of extreme poverty—the extraordinary difficulty of emerging from it without assistance, and the associated responsibility for others to provide that assistance.

Defining poverty in terms of human rights is not mere semantics—it also greatly extends the goal of development from ameliorating economic deprivation alone to ensuring realization of the full spectrum of human rights. Where poverty is treated as the deprivation of human rights (especially economic rights), the goal of development is seen as providing, protecting, or restoring these rights. The United Nations has been particularly active in combining these concepts, and such a human-rights-based perspective explicitly underpins all of its development and poverty reduction initiatives and is an important premise of its development-related declarations.¹⁰

These development efforts have grown progressively more expansive and coordinated, reaching the scale of the Millennium Development Goals (MDGs), a massive, fifteen-year project to raise the standard of living of the poorest worldwide. Established in 2000, the eight goals of the MDGs (most of which are split into numerous subsidiary goals or targets) each

⁷ United Nations Committee on Economic, Social and Cultural Rights, E/C.12/2001/10, at para. 8 (May 4, 2001).

⁸ Int’l Bar Ass’n Human Rights Institute, *Tax Abuses, Poverty and Human Rights* 85–86, App’x H (Oct. 2013).

⁹ United Nations Human Rights Council, *Guiding Principles on Extreme Poverty and Human Rights*, Res. 21/11 (Sept. 27, 2012). See also Arjun Sengupta, *Report to the Seventh Session of the Human Rights Council*, Rpt. 7/15 (Feb. 28, 2008) (defining extreme poverty at length as having three broad components: income poverty, human development poverty, and social exclusion).

¹⁰ United Nations High Commissioner for Human Rights, *Principles and Guidelines for a Human Rights Approach to Poverty Reduction Strategies* (2006); United Nations, *Statement of Common Understanding on Human Rights-Based Approach to Development Cooperation and Programming* (2003).

address pressing, significant development concerns, but all have two unifying factors—their grounding in basic human rights concerns and the need for financial resources to achieve them. The eighth and final goal addresses this issue, with all nations pledging to establish a “global partnership for development.”¹¹

The first goal of the MDGs targets extreme economic deprivation, seeking to halve the number of people living in extreme poverty by the year 2015. This goal has by some measures already been met in global terms, though not for every developing country on an individual basis or even every region (see Figure 1). The next six goals target further indicators of poverty and deprivation, such as education, health, and gender equality, and despite progress in all of these areas, are not expected to be met by 2015.¹²

The recognition that the MDGs would require an unprecedented level of financial investment led to not only a commitment for developed countries to provide substantially increased foreign aid, but also the expectation that developing countries would better utilize their domestic resources to reach these goals. Two landmark conferences in Monterrey, Mexico in 2002 and Doha, Qatar in 2008, produced significant declarations on the innovative steps both developed and developing countries could take to sufficiently finance international development. The Monterrey Declaration set a target for developing countries to provide at least 0.7% of their gross national income in foreign aid, but also listed a variety of other sources from which to draw necessary funding, placing an emphasis on domestic resource mobilization, curbing corruption, encouraging foreign investment and trade, and pursuing debt

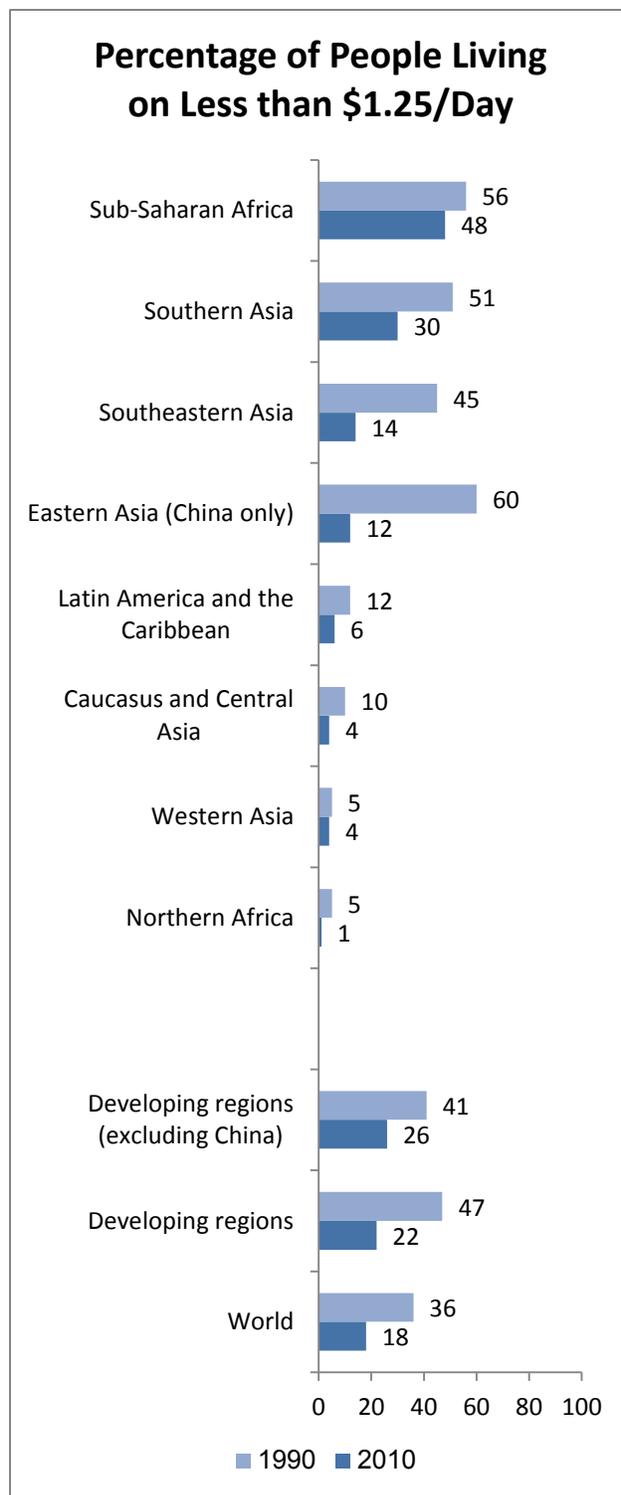


Figure 1. Achievement of MDG Target 1.A, halving the proportion of people in extreme poverty by 2015. (Data source: United Nations)

¹¹ United Nations Millennium Declaration, G.A. Res. 55/2 (Sept. 18, 2000).

¹² United Nations, *The Millennium Development Goals Report 2014*.

relief.¹³ The Doha Declaration reviewed progress under Monterrey but added further discussion on the need to address capital flight and illicit financial flows.¹⁴ Despite these important statements, the unlikelihood of achieving all of the MDGs by 2015 is in large part the result of insufficient financial resources.

III. The Post-2015 Development Agenda

Although the deadline for meeting the Millennium Development Goals has not yet arrived, their success in unifying global development efforts towards common ends has led to planning for similar worldwide coordination beyond their expiration in 2015. A UN summit in 2010 to assess progress towards the MDGs ended with a commitment to begin thinking about the future beyond the MDGs, and several parallel processes have since been put in place to work towards a future set of goals.¹⁵ Much of this conversation is geared towards ensuring that future development efforts are not only effective, but also economically and environmentally sustainable, so much so that the future development goals are generally referred to as the “Sustainable Development Goals,” or SDGs.

The agenda-setting process began in earnest at the United Nations Conference on Sustainable Development, known as Rio+20, in 2012, during which the UN set up an Open Working Group to propose specific goals by the end of 2014.¹⁶ The Open Working Group was composed of a group of representatives from a diverse set of UN member states, designed to be as inclusive as possible, and issued a set of broad proposals to the General Assembly for the SDGs in July 2014.¹⁷ Around the same time, the Secretary-General of the UN also set up the High-Level Panel of Eminent Persons on the Post-2015 Development Agenda, which issued a report in 2013 making its own recommendations for the SDG agenda.¹⁸

Alongside the Open Working Group, the UN also established the Intergovernmental Committee of Experts on Sustainable Development Financing to study options for financing the SDGs, and this group issued a report to the General Assembly in August 2014.¹⁹ Additionally, the UN established a “task team” to combine efforts across its secretariat and many agencies, and the group has researched and written on a wide range of issues related to sustainable development, issuing two comprehensive reports to the General Assembly.²⁰

These processes all culminated in discussions and presentations at the General Assembly meeting in September 2014, from which the UN Secretary-General will draft and present a

¹³ United Nations, *Monterrey Consensus of the International Conference on Financing for Development* (2003).

¹⁴ United Nations, *Doha Declaration on Financing for Development*, G.A. Res. 63/239, at paras. 20–21 (2008).

¹⁵ Keeping the Promise: United to Achieve the Millennium Development Goals, G.A. Res. 65/1 (Oct. 19, 2010); see also “Post-2015 Process,” United Nations Sustainable Development Knowledge Platform, <http://sustainabledevelopment.un.org/index.php?menu=1561>.

¹⁶ The Future We Want, G.A. Res. 66/288 (Sept. 11, 2012).

¹⁷ *Outcome Document – Open Working Group for Sustainable Development Goals* (July 2014).

¹⁸ High-Level Panel of Eminent Persons on the Post-2015 Development Agenda, *A New Global Partnership: Eradicate Poverty and Transform Economies Through Sustainable Development* (May 2013).

¹⁹ Report of the Intergovernmental Committee of Experts on Sustainable Development Financing (Aug. 2014).

²⁰ UN System Task Team, http://www.un.org/en/development/desa/policy/untaskteam_undf/index.shtml.

“synthesis report” by the end of the year to focus further discussion on the goals.²¹ Over the course of 2015, a final set of goals will be debated and eventually approved, as well as methods for how to fund the new goals, focusing especially on a July 2015 conference in Ethiopia that will reexamine the Doha and Monterrey declarations.

While the SDGs are yet to be finalized, it is clear that one of their linchpins will be the target of eradicating extreme poverty worldwide, a goal that will require immense financial resources.²² It will only be possible if the hundreds of billions of dollars that leave developing countries every year, through not only criminal but also mundanely commercial means, can instead be retained and harnessed for the good of those countries’ citizens. Curbing these illicit financial flows is an economic and ethical imperative, and should be a critical part of this discussion. While recognition of the role that IFFs play in hindering development has grown substantially, this understanding must be translated to the goals that will drive international development work over the coming decades.

High-Level Recognition of the Importance of IFFs to Development

“Institutions can and should also combat corruption, which erodes the resources needed for sustainable development. It has been estimated that every year the developing world loses an appalling one trillion dollars in illicit outflows through corruption, criminal activity, and tax evasion. – Jan Eliasson, UN Deputy Secretary-General (2014)

“Illicit flows seriously impede LDCs’ efforts to raise resources for social and economic development. These flows are often absorbed into banks, tax havens, and offshore financial centers in developed countries.” – Helen Clark, UNDP Administrator (2012)

“[W]e urge all OECD countries to recognize the cost of inaction in this vital area. Africa loses twice as much in illicit financial outflows as it receives in international aid.” – Kofi Annan, Former UN Secretary-General (2013)

“The issue of illicit financial flows is at the forefront of the international agenda. Governments worldwide are joining forces to combat money laundering, tax evasion and international bribery ... IFFs have devastating effects on developing countries.” – Angel Gurría, OECD Secretary-General (2013)

²¹ High-Level Stocktaking Event on the Post-2015 Development Agenda, Informal Summary, <http://www.un.org/en/ga/president/68/settingthestage/8stocktaking.shtml>.

²² A Life of Dignity for All: Accelerating Progress Towards the Millennium Development Goals and Advancing the United Nations Development Agenda Beyond 2015, G.A. Res. 68/202, at para. 83 (July 26, 2013).

IV. Illicit Financial Flows and the SDGs

“Illicit financial flows” refers to the movement of money that is illegally earned, transferred, or utilized. By design, this encompasses a broad range of activities: official corruption, laundering of criminal proceeds, terrorist financing, and tax evasion are all well-studied examples. Global Financial Integrity has analyzed over time the extent of IFFs through the use of international economic statistics and econometric modeling. Our most recent estimates found illicit outflows from developing countries totaled \$946.7 billion *in a single year* (2011), exceeding the amount of foreign direct investment into these countries (see Figure 2). Over the decade 2002-2011, illicit outflows totaled \$5.9 trillion, a truly staggering amount of money lost from the places where it is most critically needed.²³

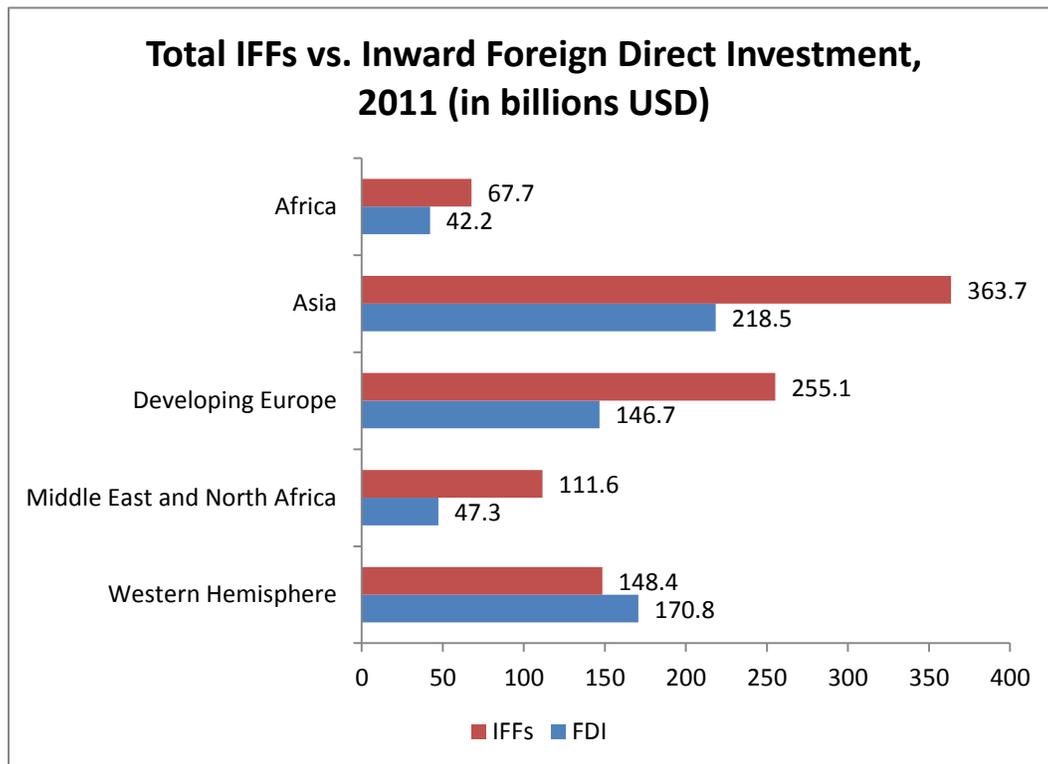


Figure 2. Comparison of illicit financial flows and inward foreign direct investment flows by region. (Data sources: GFI, UN Conference on Trade and Development (UNCTAD))

By far the largest portion of this money—over 80 percent of many countries’ measurable IFFs—is moved using common and generally overlooked practices in international commercial trade. Through “trade misinvoicing,” falsifying the values listed on commercial invoices when shipping goods across borders, individuals can conceal the movement of money across international borders and between businesses or accounts they control. This is an extraordinarily common tool by which corporations and individuals in developing countries avoid import or export tariffs, alter their income tax positions, evade foreign exchange controls, or simply move

²³ Dev Kar & Brian LeBlanc, Global Financial Integrity, *Illicit Financial Flows from Developing Countries: 2002-2011* (Dec. 2013).

their wealth from unstable economies or currencies to developed countries or tax havens.²⁴ Trade misinvoicing is also a common method of shifting the proceeds of crime or corruption and is typically referred to in these cases as trade-based money laundering.²⁵

Hence, trade misinvoicing is a relatively simple, yet very low-risk method of moving money out of developing countries for many different purposes, explaining its significant role in overall IFFs. Despite this fact, even basic policies that would curtail such activity have been slow to find acceptance. Many developing countries rightfully see increasing global trade as an important driver of economic growth and source of funding for further development, and are reticent to impose policies that could be seen to limit or hamper trade. This has led to an international economic environment with a single-minded focus on getting imports and exports through customs as quickly as possible, in which scrutiny of trade invoices is often cursory or nonexistent.²⁶

The loss to developing countries of crucial resources resulting from trade-related IFFs, in the form of economic capital flight and uncollected tax revenue, is not only substantial (and, to reiterate, substantially greater than that through crime and corruption), but can have a compounding effect. The permanent loss of capital deprives countries of the means for organic economic growth, which can cause stagnation, hyperinflation, and toxic public debt levels. The loss of tax revenue limits governments' ability to fully fund projects to develop the economy and alleviate poverty.

The linkage of illicit financial flows and persistent poverty in developing countries could hardly be clearer. The drainage of funds from these countries places developed country donors at an immediate disadvantage, requiring investment first for developing countries just to catch up. The weakening of countries' abilities to fund their own development projects damages citizens' confidence in their governments, potentially leading to political instability and further erosion of human rights. That IFFs occur primarily through international trade, an important and growing source of foreign investment to many developing countries, makes this issue truly "where the rubber meets the road" for sustainable development.

Recognition of the problems IFFs and tax avoidance pose has led to many international policies and initiatives in recent years, such as the OECD's Base Erosion and Profit Shifting (BEPS) process, the movement towards global automatic exchange of tax information endorsed by the G20 in 2013, the World Bank's Stolen Asset Recovery (StAR) Initiative, and others.²⁷ These initiatives and most studies of the issue, though, tend to focus on subsequent prosecution and repatriation of corruptly stolen funds, rather than taking the legal, policy, and oversight measures necessary to address the mechanisms that make IFFs possible in the first place.²⁸ In particular, there have been few direct efforts to address trade misinvoicing, a lack of action

²⁴ RAYMOND W. BAKER, CAPITALISM'S ACHILLES HEEL 133–161 (2005).

²⁵ Financial Action Task Force, *Trade Based Money Laundering* (June 2006).

²⁶ See Raymond Baker et al., Global Financial Integrity, *Hiding in Plain Sight: Trade Misinvoicing and the Impact of Revenue Loss in Ghana, Kenya, Mozambique, Tanzania, and Uganda: 2002-2011* (May 2014).

²⁷ Global Financial Integrity, *Worldwide Counter-Illicit Financial Flows Initiatives* (2013), <http://www.gfintegrity.org/wp-content/uploads/2014/05/GFI-Worldwide-IFF-Initiatives-2013.pdf>.

²⁸ See, e.g., Cephias Lumina, Report to the UN Human Rights Council, *The Negative Impact of the Non-Repatriation of Funds of Illicit Origin on the Enjoyment of Human Rights*, Rpt. 25/52 (May 7, 2014).

clearly reflected in the data, as our research has consistently shown that IFFs are growing, in real terms, by an average of over ten percent per year (see Figure 3).

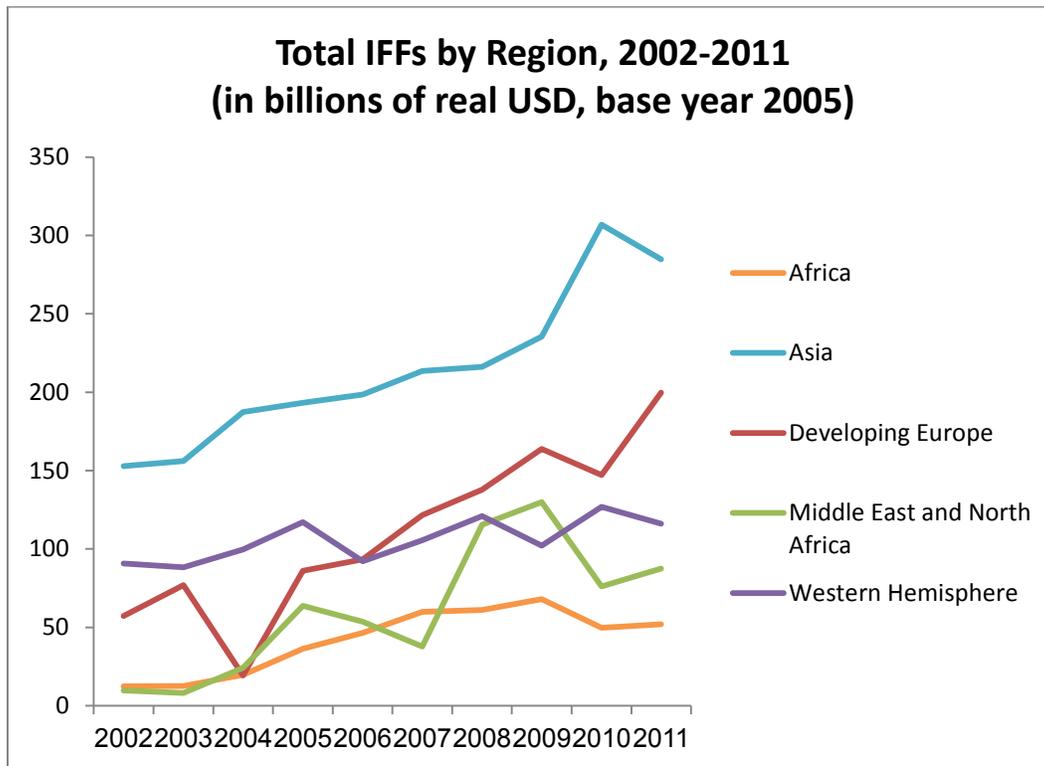


Figure 3. Illicit financial flows by region in real terms. (Data source: Global Financial Integrity data)

The post-2015 development process, however, provides a critical opportunity to refocus international attention on this issue. Instituting a clear, measurable goal on IFFs would focus policymakers on the issue and spur discussion and debate on specific policies needed to address the problem, rather than mere generalities. Further, directing this attention to the largest part of IFFs, trade misinvoicing, will also have a collateral and positive effect on curtailing the smaller components of crime and corruption. While inputs to the agenda-setting process thus far have included mentions of IFFs, it has been in non-specific, immeasurable terms.

<i>IFFs in the Post-2015 Process</i>	
<p>“The Future We Want,” Rio+20 Summit Declaration, para. 266 (2012)</p>	<p>“We stress that fighting corruption and illicit financial flows at both the national and international levels is a priority and that corruption is a serious barrier to effective resource mobilization and allocation, and diverts resources away from activities that are vital for poverty eradication, the fight against hunger and sustainable development.”</p>
<p>(continued on next page)</p>	

<p>“A Life of Dignity for All,” Report of the UN Secretary- General, para. 100 (2013)</p>	<p>“International efforts are needed to create an environment conducive to business and thus channel capital flows and portfolio investments to the sustainable development agenda, to eliminate illicit financial flows, to enhance the regulation of secrecy jurisdictions and to promote asset recovery.”</p>
<p>UN Task Team Working Group on Sustainable Development Financing Report, Chapter 2, p. 7 (2013)</p>	<p>“To enhance legitimacy and credibility of taxation systems and meet growing investment requirements, broad based national and international initiatives are required to curb illicit outflows of resources.”</p>
<p>High-Level Panel, Proposed Goal 12(e) (2014)</p>	<p>“Reduce illicit flows and tax evasion and increase stolen-asset recovery by \$x.”</p>
<p>Open Working Group, Proposed Goal 16.4 (2014)</p>	<p>“...by 2030 significantly reduce illicit financial and arms flows, strengthen recovery and return of stolen assets, and combat all forms of organized crime.”</p>

GFI is calling for the UN General Assembly to instead adopt as part of the SDGs a target to “curtail illicit financial flows related to trade misinvoicing by 50 percent by the year 2030.” Establishing a target along these lines has several significant advantages over the goal as currently written. It focuses on the activity that moves the most illicit financial flows (80%), sets a clear benchmark for success, and can be measured readily through existing statistical techniques, all important qualifications for development goals.

Effecting the necessary policy changes to meet this goal will require global cooperation to direct aid and technical assistance specifically to increasing developing countries’ ability to better track trade flows. Curtailing trade misinvoicing requires establishing systems that can effectively monitor trade valuations in individual transactions and the flow of money between importers and exporters. Implementing these systems will take time and investment, but the benefits to developing countries will be significant—many times the cost.

While the general outlines of the SDGs are becoming settled, much work remains in the process of organizing the goals and setting targets. The development community, centered in the UN General Assembly, will spend the next year establishing a final version of the goals and plan for their implementation, including specific indicators and targets for judging their success, as well as discussing methods of financing this renewed development push. Illicit financial flows must be among these targets.