Illicit Financial Flows in Asia

Of late, there has been increasing interest in mobilizing development finance in light of the failure of aid, loans and other financial transfers from North to South to realize human development goals, including poverty reduction. The Millennium Development Goals are also coming to a close with millions still living on less than $1 a day and no clear answers in sight where to source funding for the post-2015 development agenda. One of the issues in focus is improving the capacity of developing countries for domestic resource mobilization by stemming the outflows of public financial resources.

This issue brief seeks to give a brief overview of the ways public money is siphoned out of developing countries, the actors and amounts involved, the impacts on people and countries, and the various interventions attempted thus far to curtail such financial outflows.

Cumulative Non-formalized IFFs by Region

Source: (Kar & LeBlanc, 2013)
The Scale of Illicit Financial Flows in the Region

From a recent report of the Global Financial Integrity (GFI), it is estimated that developing countries lost roughly US$5.9 trillion in illicit financial flows during the period 2002-2011. Moreover, the outflows were found to increase by an average rate of 10 percent/year. Globally, Asia has the largest share of IFFs among the regions.¹

In an earlier study focused on the group of Least Developed Countries, the UNDP found that from 1990-2008, IFFs rose from US$9.7 billion in 1990 to US$26.3 billion (rate of increase of 6.2 percent per annum, adjusted for inflation. Trade mispricing was also seen as the main culprit, accounting for 65-70 percent of illicit outflows from the LDCs. Of the LDCs, Bangladesh registered the highest cumulative outflow US$34.8 billion. Two other Asian countries were in

Illicit Financial Flows by Region, 2002-2011
(in billions of constant US dollars, base year 2005, or percent)

<table>
<thead>
<tr>
<th>Region/Year</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>Cumulative</th>
<th>Average</th>
<th>Trend Rate of Growth</th>
<th>Percent of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Africa</td>
<td>12.5</td>
<td>12.7</td>
<td>19.8</td>
<td>36.4</td>
<td>46.3</td>
<td>59.9</td>
<td>61.2</td>
<td>68.1</td>
<td>49.8</td>
<td>52.0</td>
<td>419.1</td>
<td>41.9</td>
<td>20.2%</td>
</tr>
<tr>
<td>Asia</td>
<td>152.5</td>
<td>156.1</td>
<td>187.3</td>
<td>193.2</td>
<td>198.6</td>
<td>213.5</td>
<td>216.2</td>
<td>235.5</td>
<td>240.5</td>
<td>284.8</td>
<td>214.5</td>
<td>7.5%</td>
<td>39.6%</td>
</tr>
<tr>
<td>Developing Europe</td>
<td>57.3</td>
<td>77.0</td>
<td>79.4</td>
<td>86.0</td>
<td>93.4</td>
<td>121.5</td>
<td>137.8</td>
<td>163.9</td>
<td>147.2</td>
<td>199.8</td>
<td>1,632</td>
<td>113.8</td>
<td>21.5%</td>
</tr>
<tr>
<td>MENA</td>
<td>9.7</td>
<td>8.3</td>
<td>24.1</td>
<td>63.8</td>
<td>53.7</td>
<td>115.6</td>
<td>129.9</td>
<td>76.1</td>
<td>87.4</td>
<td>606.4</td>
<td>60.5</td>
<td>31.5%</td>
<td>11.2%</td>
</tr>
<tr>
<td>Western Hemisphere</td>
<td>90.7</td>
<td>88.4</td>
<td>99.7</td>
<td>117.2</td>
<td>92.1</td>
<td>105.6</td>
<td>121.0</td>
<td>120.1</td>
<td>126.9</td>
<td>116.2</td>
<td>1,059</td>
<td>106.0</td>
<td>3.1%</td>
</tr>
<tr>
<td>All Developing Countries</td>
<td>325.0</td>
<td>344.4</td>
<td>412.4</td>
<td>498.5</td>
<td>486.5</td>
<td>540.2</td>
<td>653.8</td>
<td>701.4</td>
<td>708.9</td>
<td>742.1</td>
<td>5,413</td>
<td>541.3</td>
<td>10.2%</td>
</tr>
</tbody>
</table>

Source: (Kar & LeBlanc, 2013)

Note: These are “non-normalized” estimates which GFI explains thus: “[E]conomic methods and data sources tend to significantly understate IFFs. In order to avoid understating the problem of illicit flows, we shall always use the robust (non-normalized) estimate of IFFs rather than the conservative (or normalized) estimates.

¹GFI itself clarifies that its data is “extremely conservative” as it does not include, for instance, “misinvoicing of trade in services (rather than the trade in goods), same-invoice trade mispricing (such as transfer mispricing), hawala transactions [informal fund transfer system], and dealings conducted in bulk cash.....” including criminal activities. GFI further cautions that “much of abusive transfer pricing conducted between arms of the same multinational corporation are not captured in our figures” (Kar & LeBlanc, 2013, p. iv).
### Top 25 countries with the highest measured cumulative illicit financial outflows (2002 – 2011)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>Illicit Outflows (US$)</th>
<th>Rank</th>
<th>Country</th>
<th>Illicit Outflows (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>12.</td>
<td>United Arab Emirates:</td>
<td>US$114.64bn²</td>
<td>25.</td>
<td>Turkey:</td>
<td>37.28bn</td>
</tr>
<tr>
<td>13.</td>
<td>South Africa:</td>
<td>US$100.73bn</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: (Kar & LeBlanc, 2013)

**Notes:**
1. Data for Iraq was not available in 2002-2006, thus the average illicit outflows of US$15.76 billion reflect only the years 2007-2011. Likewise, the cumulative outflows of US$78.79 billion for Iraq are cumulative outflows for 2007 through 2011 only.
2. Illicit financial outflow estimates from the oil exporting nations of Brunei, Qatar, and the United Arab Emirates should be viewed with caution as they could be inflated due to opaque transactions with their nation’s sovereign wealth funds. GFI has flagged these countries in particular as their Net Errors and Omissions are greater than 50% of their Financial Account.

### Cumulative IFFs from LDCs by country (1990-2008)

Source: UNDP, Illicit Financial Flows from Least Developed Countries: 1990-2008 (2011)
How are these funds siphoned out of countries?

The three major tracks by which developing countries are robbed of potential revenues are through various means of commercial tax evasion and avoidance; corruption in government; and criminal activities (e.g., drug dealing, human trafficking, arms smuggling, etc.). This issue brief focuses on efforts to reduce taxable profits such as trade mispricing, which account for the biggest chunk of IFFs (Kar & LeBlanc, 2013).

**Trade Mispricing**

Transnational corporations purposively undertake measures to avoid tax, from ‘creative accounting’ to aggressive tax planning and thus further boost their profits. Although not only TNCs are involved, they are well-placed to attempt to reduce their tax obligations. In addition to having international networks, technological advances have made it possible to move money and assign taxable profits with relative ease to a subsidiary anywhere in the world.

False invoicing follows the same procedure as trade mispricing but involves different companies which agree amongst themselves in falsifying receipts. Thus, there are sanitized invoices that are shown to tax and customs offices, and a different set of invoices reflecting true sales.

Significant amounts of resources and potential revenues are also lost through other taxation measures,
such as the tax incentives granted especially to foreign direct investors or the tax privileges that can come as part of free trade agreements and double taxation treaties. The Philippines, for instance, has laws that provide for generous incentives to TNCs in the form of tax holidays of up to eight years, tax credits, tax exemptions, additional deductions from taxable income for labor expense and non-fiscal incentives. This race-to-the-bottom tax competition to attract more foreign investments is explained in more detail in the JSAPMDD Basic Issue brief on Transnational Corporations and Tax Issues.

Secrecy and impunity – the enabling environment

Lack of transparency and accountability, weak governance and legislative frameworks, and inadequate public infrastructure including lack of competencies to scrutinize tax obligations and enforce sanctions are only some of the factors that promote and encourage IFFs.

Corruption among public officials, for instance, flourishes in contexts where there is no transparency in government transactions and no one to hold those in power to account for the disposition of public funds and the accumulation of unexplained wealth. As ill-gotten funds and assets have to be stashed someplace beyond public scrutiny, for which reason tax havens or secrecy jurisdictions continue to abound despite increasing calls for their accountability.

Tax Evasion and Tax Avoidance

“Tax evasion is the general term for efforts by individuals, firms, trusts and other entities to evade taxes by illegal means. It usually entails taxpayers deliberately mis-representing or concealing the true state of their affairs to the tax authorities in order to reduce their tax liability. This includes, in particular, dishonest tax reporting.

“Examples are:
• when a company fails to declare all or part of its income,
• when a company makes a claim to offset an expense against its taxable income which did not occur or which is of a type not authorised for tax relief in the country concerned
• when a company makes a tax claim that seems legal only because relevant facts have been suppressed.

“Tax avoidance entails the legal utilisation of the ambiguities and indeterminacies of tax rules and regulations to one’s own advantage, in order to reduce the amount of tax that is payable, by means that are within the law. Aggressive tax avoidance occurs when companies exploit loopholes and flaws in tax laws and international arbitration opportunities. Even though this may be legally allowed, such behaviour is in conflict with tax compliance. Because a company does not aim to pay the right amount of tax at the right time and the right place, it abuses the spirit of the tax laws.”

(SOMO, 2008, p. 6)
The Organization for Economic Cooperation and Development (OECD) has named 40 countries outside of OECD as tax havens or what it calls “harmful preferential tax regimes” on the basis of the following features.

- No or only nominal tax rates
- A lack of transparency
- Lack of effective exchange of information
- The absence of a requirement that the activity is substantial

(SOMO, p. 6)

The Cayman Islands, Bermuda, the Bahamas, Guernsey, the Isle of Man, Vanuatu and Bahrain have a top marginal corporate tax rate of 0% (Aridas & Pasquali, 2013).

It has not, however, included tax havens within its own member countries. Of the 50 to 70 secrecy jurisdictions identified by Tax Justice Network, are preferential tax regimes offered by European governments to MNCs. Among these are Ireland, Cyprus, Belgium, Switzerland, Luxembourg and the Netherlands among those that “offer low-tax regimes for specific corporate activities, or facilitate conduit arrangements….that allow dividends, royalties and capital flows to move through those states with almost no tax arising, often on their way to or from an offshore tax haven. Withholding information about their clients, they are effectively complicit in the tax dodging activities of individuals and corporations which have

The “Rewards” of Public Office

The Philippines is one such country where a Freedom of Information Bill has been languishing through several congresses now. From a year-long multi-country investigation by the Washington, D.C.-based International Consortium of Investigative Journalists (ICIJ) is a partial list of more than 500 mostly private Philippine residents with ties to offshore corporations. In the list are former and current national and local public officials who kept this information from their Statement of Assets, Liabilities and Net Worth, in violation of Philippine law.
been estimated from the Netherlands special tax regime alone to amount to more than €100 million in tax revenue in developing countries (SOMO, p. 6).

The May 2014 report of the Special Rapporteur on Extreme Poverty and Human Rights, Magdalena Sepulveda Carmona focused on tax abuse as a major obstacle to the enjoyment of human rights. She scored tax havens as contributory not only to injustices within states but also to global injustice. “[G]iven that many of them are located in – or under the jurisdiction of – wealthy countries, the global flow of money to these centres exacerbates global inequalities” (Sepulveda Carmona, 2014).

**Politisation and corruption in revenue authorities**

“Within revenue authorities, as with any institution, there is a scope for politicization, corruption and mismanagement. For example, an Indonesian tax official who was just three years into his job was found to have an accumulated wealth of more than Rp100 billion (US$10 million) – impossible on his monthly salary of about US$800. An investigation and statements of the disgraced tax official included allegations that several companies linked to a major political figure had bribed [him]...to evade taxes. Several officials have been convicted in relation to this case. Cases of corruption such as this can undermine public trust in the tax system as well as morale within the revenue authority and can lead to lower levels of tax collection Such problems [however] are not confined to southern countries.”

(Tax Justice Network, p. 11)

---

**Bibliography**


Asia remains a region with the highest number of people who live on less than US$2 a day. As growth rates rise to the benefit of a handful of elites and corporations, inequality has increased faster than other regions and resulted in deeper impoverishment for our peoples. People go without the most basic services as governments, claiming a lack of revenues and prioritization of other concerns such as debt payments, hand over public service provision to profit-driven private firms.

Fiscal instruments—revenues and expenditures—can enable the enjoyment of economic, social and cultural rights as part of gender-just, equitable, sustainable development agenda. They must work to effectively address health, education, livelihoods, disaster response and long-term resilience, energy access and other critical needs of our peoples.

- The state’s authority to tax, in particular, is a public trust that rests on fulfilling these obligations. Tax revenues come from people’s money and it is only just that these funds, with which the state is entrusted to collect, are used to their utmost benefit. The state is duty-bound to exercise its taxation powers hand-in-hand with meeting its mandate of ensuring that the interests of the majority of its citizens are promoted and safeguarded.

- Constraints on the ability of the state to raise resources from tax revenues affect its ability to meet these obligations to its citizens. Thus, it is vital that the state effectively and efficiently enforce tax policies that are just and progressive, together with other programs and policies that strengthen the domestic economy and the country’s internal capacity to provide for its own finance needs.

- People-centered and gender-aware tax policies are a vital cornerstone of a post-2015 sustainable development agenda. They can significantly contribute towards changing unequal gender relations that disadvantage women, reducing income inequality, encouraging healthy lifestyles, dismantling monopoly control over land and natural resources, redistributing wealth, regulating financial speculation, and protecting the environment against large-scale exploitation, among others. They can enable governments to move away from dependence or reliance on borrowing and aid flows.

We are committed to working for —

- Just and progressive reforms of tax policies and administration that ensure states exercise their authority to tax as an instrument to bring about the enjoyment of human rights, gender equality and social justice.

- Strong enforcement and accountability mechanisms that can put an end to the use and abuse of tax policies by corrupt individuals and transnational corporations to amass private wealth and profit.

- The sovereign right of peoples to reform their tax systems and institute policies in support of sustainable development goals, free from tax-related impositions of international financial institutions.

- Transparent and participatory budget processes that should be integral in progressive tax policies, and a spending policy aimed at attaining social and environmental justice, delivering essential public services and on the whole, supporting the realization of sustainable development agenda.

- Compliance of states with their extra-territorial human rights obligations, particularly through mechanisms of international cooperation and information to promote and defend the right of peoples to utilize public revenues primarily for their interests and their development.