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Illicit Financial Flows

The illusion of a common denominator

Johnny Flentø and Leonardo S. Simao

Abstract: *Illicit financial flows (IFFs) grew significantly with the accelerated liberalization of financial markets during the 1980s and 1990s. In Africa, IFFs out of the continent are believed to equal combined official development assistance and direct foreign investment into the continent. Work to conceptualize and measure IFFs is progressing and many methods for estimating them are being tested. Such methods are inherently crude, and some are questionable.*

A more fundamental question is whether the concept of IFFs as sometimes used is useful for analytical purposes. The definition adopted by the United Nations in 2020 includes a host of different flows and transactions that have very little in common other than that they are deemed illicit, primarily according to western norms, and are not based on the development effects of flows. The term "illicit financial flows" contains very many and too different types of things, which in combination with the challenges in estimating such flows makes the concept prone to instrumentalization. Defining what is illicit is ultimately a political choice. The world should take care that the work to create an institutional framework for reducing IFFs is not reduced to a platform for the most powerful alliance of governments to impose their version of what is illicit on the rest of the world.

Key Words: Illicit Flows, Crime, International Economics and Cooperation, Tax Evasion, Drug Trafficking.

JEL CODES: F02, F51, F52, F53,F54,K34

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1.0 Introduction

Much has been said and written about the malice of illicit financial flows (IFFs). Many scholars and institutions highlight how these flows can undermine development and, consequently, the large potential for financing development and poverty reduction if they can be captured and legalized. These flows are prominently mentioned in the United Nations (UN) Sustainable Development Goals (SDGs) and Goal 16.4 sets out targets and indicators for reducing them. In 2020/21 the UN attempted to operationalize SDG 16 and agree on concepts and methodology. Some progress was made, and various pilot projects are now under way.

However, while most people tend to agree about the importance of reducing IFFs, there is much less agreement when it comes to specific concepts, practical definitions and ways of measuring them, let alone how to capture them. The devil is in the detail, it is often claimed, but many more fundamental issues seem to be at stake, including whether broad consensus on an operational definition of IFF is even possible and for whom it would be useful. Scholars and journalists make great efforts to find ways to reveal and estimate IFFs. However, what we find in terms of the nature and volume of illicit flows is of course very dependent on what we actually choose to look for.

This paper reviews what the recent literature and conventions say about IFFs in terms of concepts and size and discusses what IFFs really encompass, how we try to quantify the phenomenon and why it has become important.

The first step towards finding out what characterizes IFFs is to investigate how we define them and what concepts we use to determine whether a flow is illicit. Section 2 reviews different concepts and definitions of IFFs and discusses their underlying logic and drivers. Section 3 considers the nature of illicit flows, how large these flows are believed to be, and how we try to estimate and detect them, including the challenges that this entails. Section 4 looks at the analytical value and momentum behind the concept of IFFs. Section 5 concludes.

2.0 When is it illicit?

An enormous number of international financial transactions take place every day across the world. On the electronic front alone, the SWIFT[1] international banking system cleared more than US$5 trillion every day in 2020, according to the US Treasury Financial Crimes Enforcement Network (2021). That is more than twice the size of sub-Saharan Africa's annual gross domestic product (GDP). Liberalization of the world's financial markets during the late 1980s and 1990s and the demise of the Soviet Union helped to accelerate international financial flows to unprecedented volumes. Alongside what was generally recognized as a positive development of globalization, the part of international financial flows that can be deemed illicit also grew significantly. This trend was driven to some extent by the inclusion in the liberal world's financial markets of vast fortunes siphoned off from the USSR's former state-owned assets, demonstrating a very direct link between liberalization and IFFs, including money laundering. However, also in more general terms, the liberalization and the subsequent global financial crisis in the late 2000s drew new attention to some of the illicit flows that had been around for decades, some even for centuries. But why did attention to illicit capital flows find broad traction in the 1990s when it did not in the 1970s, and who decides

[1] SWIFT was created in 1973 by American and European banks which agreed that no single bank or country should control the international financial system's main artery. It is based in Belgium and connects around 11,000 banks in almost 200 countries. SWIFT is fundamentally a secure messaging system that informs member banks when payment transfers have been sent and received. Today SWIFT is owned jointly by more than 1,500 banks and sends around 40 million messages a day. See SWIFT (2022) for more information.

what is illicit and how? The UN and other multinational bodies, including the European Union and the Organisation for Economic Co-operation and Development (OECD), are struggling to formulate definitions of IFFs which are solid enough for practical action and still widely accepted. That is an up-hill battle which is unlikely to end anytime soon and for very good reasons, which we now discuss.

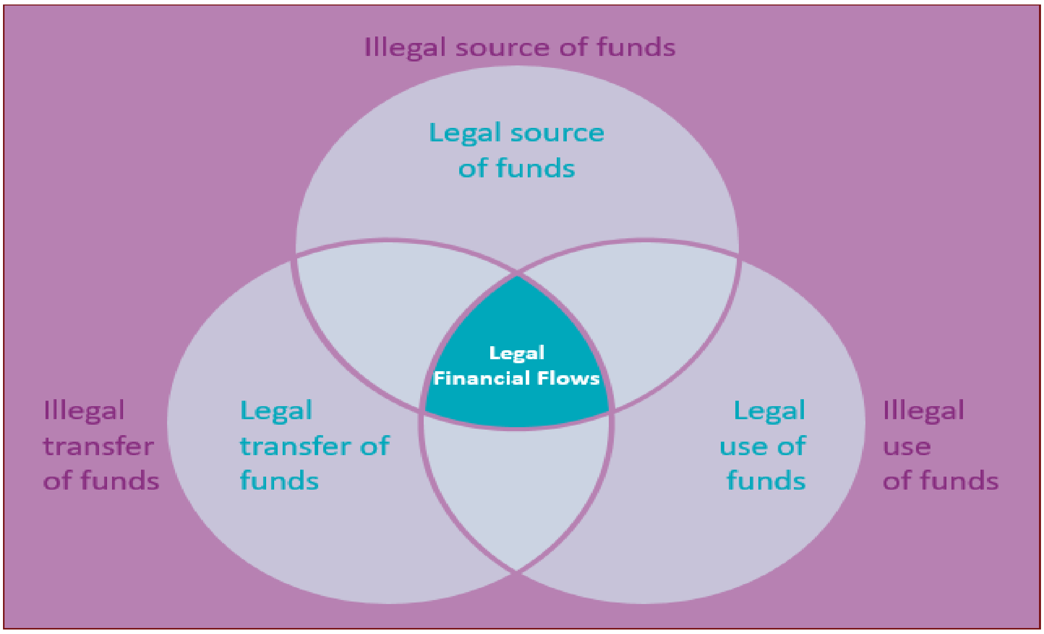
As legislation is territorial, i.e. predominantly national, and we are combining the concepts of illicit and international, there is – not surprisingly – no simple definition. Illicit means unacceptable or immoral and is different from the distinction between legal and illegal. Indeed, even the definition of illegal is not the same over time and space.

When illegal businesses transfer funds earned from crime or destined to finance crime, the flow is clearly illicit. The decline of cash and the explosive growth in electronic money as well as significant advances in technology to monitor electronic transfers have made it more attractive to try to detect the financial flows originating from crime as a way to catch criminals.

Next to traditional crime, the taxation of profit is a strong promoter of IFFs. Tax evasion, including smuggling, amounts to stealing, but from a nation rather than from a person or a private entity. When legal businesses transfer funds to evade taxes or hide fortunes and assets, the flow is illicit.

Lastly, we have the flows that originate from legal business and do not hide from taxation, but where the transfer itself is not legal. Such transfers occur when there are restrictions on capital movement, i.e. in planned economies or in relation to countries under international sanctions. Figure 1 shows the three-dimensional concept of illicit flows.

Figure 1: Three-dimensional concept of illicit flows



Source: Design by authors' research assistant A. Vienberg Hansen inspired by Chowla and Falcao (2016).

Building on this logic and these concepts of international IFFs, the UN defines IFFs as: "*Financial flows that are illicit in origin, transfer or use, that reflect an exchange of value and that cross country borders*" (UNODC and UNCTAD 2020).

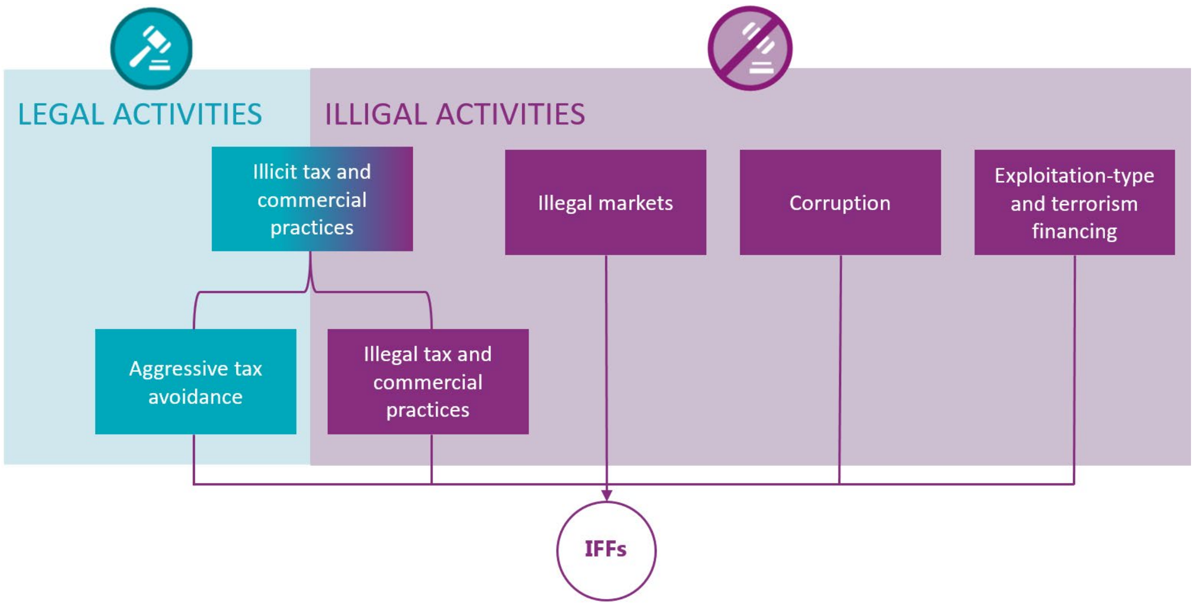
Two important features to note are the extra-territorial dimension and the fact that both how the funds were earned and their intended use count when assessing whether flows are illicit. This opens the possibility for the government in country A to incriminate economic actors in country B for something that is legal in country B but may not be legal in country A. If, for example, a person earns money from selling marihuana in a country where this is legal, that person may be prevented from transferring funds and investing in a legal business in another country where trade in marihuana is illegal.

However, it is a very long way from agreed concepts and general definition to practical interpretation of international conventions and incorporation into national legislation. The first issue to note is that the financial transfer itself is only rarely the problem. Normally, it is illegal or illicit because it represents the payment for something that is illegal – goods or services. The challenge then is to define – at large – what is illicit, where and when.

With the exception of tax avoidance, illicit funds are earned or spent in order to make something else move. It is generally this corresponding movement (of drugs, arms, stones, metals, people, corrupt government contracts, etc.) which constitutes the possible crime. A transfer of money to a Swiss or Cayman bank account for corrupt services by a public official represents payment for an illegal service. It is deemed illicit because of the illegal service it bought, although it is not illegal in itself or even illicit to stack money away in tax havens.

The UN (United Nations Office on Drugs and Crime (UNODC) and United Nations Conference on Trade and Development (UNCTAD)) recently established a conceptual framework for the statistical measurement of illicit flows (UNODC and UNCTAD 2020), which is, however, in many ways, still work in progress. The conceptualization suggested by the UN custodian agencies of SDG 16.4 is shown below in Figure 2.

Figure 2: Components of illicit activity generating IFFs



Source: UNODC and UNCTAD (2020)

The suggested conceptual framework operates with two directions of flows, i.e. inward and outward IFFs, and with two kinds of motives, i.e. income generation and income management.

Not surprisingly, there is no universal agreement on the definition of illicit tax avoidance (the green area, left), which is where the UN definition of illicit flows extends beyond illegal flows and beyond the definition favoured by some OECD countries. Political agreement has been reached among 130 nations on the OECD-led Inclusive Framework (IF) on Base Erosion and Profit Shifting,[2] but many details remain to be finally worked out. Implementation is not expected before 2024.

There are, however, many more problems with this framework than drawing the line on how aggressive tax evasion/avoidance has to be in order to fall into the category of being illicit. Almost all the concepts used, particularly those of illegal markets, corruption or conflict of interest and terror, vary significantly from country to country. Furthermore, even in each country, the concepts also vary over time. Defining what represents illegal goods and services varies over both time and space.

This is most evident as regards the concept of terror, which is the subject of a dozen UN conventions passed since the early 1960s concerning specific types of terrorist acts and the associated obligations of states. Terror was initially defined in specific contexts, such as acts against aircrafts, fixed platforms, protected persons (diplomats), hostage taking and in relation to nuclear material. In United Nations General Assembly (UNGA) resolution 49/60, adopted in 1994 on measures to eliminate international terrorism, the General Assembly argues against and describes terrorism as:

"... *criminal acts intended or calculated to provoke a state of terror in the general public, a group of persons or particular persons for political purposes are in any circumstance unjustifiable, whatever the considerations of a political, philosophical, ideological, racial, ethnic, religious or any other nature that may be invoked to justify them."* (UN 1994)

United Nations Security Council (UNSC) resolution 1373 on the financing of terrorist acts is considered a landmark resolution in relation to terror. It requires all states to:

"... *prevent and suppress the financing of terrorist acts and criminalize the willful provision or collection, by any means, directly or indirectly, of funds by their nationals or in their territories with the intention that the funds should be used, or in the knowledge that they are to be used, in order to carry out terrorist acts.*" (UNSC 2001)

Resolution 1373 was adopted in the wake of the 9/11 attack in New York, but even that fails to effectively define what terrorism is. The underlying concept of terror, as described by a UN panel in 2005, is the use of extreme violence against innocent civilians. Many Security Council members, and certainly permanent members with veto power, have bombed and killed innocent civilians and tortured prisoners of war repeatedly and are prepared to do it again should their security be sufficiently threatened. Such acts will be portrayed as collateral damage in a justified military campaign and not as terrorism, as is clear from the de facto impunity of Russian and US forces in Georgia, Chechnya, Afghanistan, Iraq and Ukraine.[3] In 2020, US Secretary of State Mike Pompeo

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[2] Under Pillar One, a formulaic share of the consolidated profit of certain multinational enterprises (MNEs) will be allocated to markets (i.e. where sales arise). Pillar One will apply to MNEs with profitability above 10 percent and global turnover above EUR20 billion. The profit to be reallocated to markets will be calculated as 25 percent of the profit before tax in excess of 10 percent of revenue. Two sectors remain carved out from Amount A of Pillar One: extractive industries and regulated financial services. Under Pillar Two/GloBE, the IF members have agreed to enact a jurisdictional-level minimum tax system with a minimum effective tax rate (ETR) of 15 percent. Companies with global turnover above EUR750 million will be within the scope of Pillar Two, with headquarter jurisdictions retaining the option to apply the rules to smaller domestic MNEs (PWC 2021).

[3] Including the USA labelling WikiLeaks journalist Julian Assange as a terrorist for telling the world about it.

even announced sanctions on two senior officials of the International Criminal Court (ICC) due to the opening of investigations into war crimes in Afghanistan (Dworkin 2020).[4]

Recognizing the insurmountable challenge of defining terrorism in objective, generic terms, resolution 1373 (chapter 6) establishes a permanent counter-terrorism commission under the UNSC which can deal with the issue on a case-by-case basis and collect reports from all nations, which by the same resolution commit to periodic reporting on their actions to stop the financing of terror. From here on, UN resolutions on terrorism are more about negotiating lists of who are terrorists, and that is an endless endeavour.

As we can witness in the daily news, leaders all over the world frequently call opponents who use violence “terrorists”, watering down the concept completely. This also has an impact on the UN resolutions which deal with the financing of terrorism, i.e. the so-called illicit flows to organizations defined as terror organizations. Using the concept of terror to objectively identify illicit flows is therefore not an option. Terrorism is a negotiated term that can only be applied on a case-by-case basis, and this again will depend on the relative strengths of coalitions of countries in the UN. In a much more subtle way, this is also generally true for the concept of crime, in relation to which the UN conceptual framework on measuring IFFs (UNODC and UNCTAD 2020, p. 7) refers to the International Classification of Crime for Statistical Purposes (ICCS). This is an international standard for data collection on crime, endorsed by the United Nations Statistical Commission at its 46th session in March 2015 and by the Commission on Crime Prevention and Criminal Justice at its 24th session in May 2015. Importantly, its primary unit of classification is the act or event that constitutes a criminal offence, and the description of the criminal act is based on behaviours and not on legal provisions. As the UNODC notes in its classification manual, version 1.0 published in 2015:

“Currently, national statistics on crime refer to criminal offences as defined by each country’s criminal law system. Without legal harmonization, differences in the definition of offences are inevitable and international comparison must always be placed in the context of these differences.” (UNODC 2015, p. 8)

This legal harmonization means that, although an act is not a crime in the country or territory where it is carried out, it may be recorded as a crime in international statistics, because these statistics use a definition of crime that is different. Examples are honour killings and the sale and use of cannabis. These acts may not be illegal where they are carried out but will still be recorded as homicide and illegal possession and trafficking in drugs, according to the ICCS.

2.1 What is crime?

There are two problems with SDG 16.4, its target 16.4.1 and indicators. Firstly, the above-mentioned concepts and definitions of IFFs are of limited operational value as they contain too many things. They include everything from tax evasion by large multinational corporations to drug and human trafficking and traditional smuggling, including informal cross-border trading where local families exchange farm products across a porous border, and a Pandora’s box of items related to intellectual property rights (Copyware).

The second and more fundamental problem arises from the fact that the official definitions of IFFs lean on another concept, that of crime, which is not defined in any consensual way. As we have

[4] Alleged war crimes of Russian soldiers in Ukraine in February–March 2022 are also unlikely to be brought to justice. See Financial Times (2022).

clearly seen with the establishment and functioning of the ICC and the Rome Statute – to which the world's three superpowers and most rogue states are not parties – defining crime in an international context entails huge challenges. That is why SDG 16.4.1 leans on the UN ICCS definitions, which have been agreed by the world's nations only for statistical purposes and only at a rather lower technical level in the UN hierarchy than where sovereignty is normally discussed. The ICCS is a normative framework and the issue of defining crime and, consequently, of IFFs is much more than just a technical one.

The definition of crime varies over time and space as a result of legislation passed by those in power at any given time and place. In other words, crime is defined according to the law in each country and territory and, as such, it is the result of the political settlement in places where the law is applicable. The case in point can be illustrated by looking back at colonial times and some of the history of smuggling.

Moving contraband is a very old business, and some would say the DNA of illicit flows. It likely dates back to the first formation of nations and early accumulation societies built on protection economies, which normally included taxation and thus the desire to hide assets and wealth from taxation. It is reported during the Roman Empire and well documented in medieval times.[5] A salient feature of these illicit flows throughout history is that they have very often been associated with coercion or even oppression.[6] This was the case in relation to the British blockade of the Indian textile cottage industries in the 19th century, when the British industrial bourgeoisie persuaded their government to tax and restrict imports of textiles to Britain and, by proxy, western Europe. Geography, distance and the superiority of the British Royal Navy made smuggling of textiles from India very difficult, which led to unemployment on a prodigious scale in India, as Nehru (1947) explained. He quoted the words of British Governor General Lord Bentnick who in 1834 wrote:

"The misery hardly finds a parallel in the history of commerce. The bones of the cotton weavers are bleaching the plains of India." (Nehru 1947, p. 247)

When a Danish or Dutch commercial vessel managed to dodge the British blockade and smuggled Indian textiles to Europe, it was an illicit flow putting food on the table and saving lives in poor Indian families.

Also in the 19th century, and on the same scale of misery, the British and the French fought the opium wars with China. Opium trafficking was not invented by criminal cartels but by states, especially Great Britain, which made fortunes in the 19th century from cultivating opium in India and central Asia and selling it in China. When the Chinese emperor decided to outlaw opium for recreational use, as its widespread use was having a negative effect on the nation's health, he informed Queen Victoria by letter in 1829 that smugglers would be decapitated. Britain went to war to protect its right to transport and trade opium into China and because the British won the war (in the name of free trade in 1834) they did not become smugglers. On the contrary, the British rule of Hong Kong and increased trade of opium into China were parts of the peace treaty China had to endure after the first opium war (Treaty of Nanjing 1842).

These events show that the concept of illegal markets changes over time and even that the same ruler can adopt very different definitions of illicit flows, according to their commercial and security needs in different places at the same time.

[5] See Platt (2007).
[6] Slavery in the 19th century abolished by some states in 1804 is another example.

The concept of illegal markets and flows generally evolves gradually and in a national context where laws are passed and become applicable in a territory. The law should supposedly follow the evolution of the morals and ethics of acceptable economic behaviour. Thus, some of the terrain we perceive as the difference between illegal and illicit can stem from the time it takes the law to catch up with society's new norms.

Lynch et al. (2015) refer to the work of Edward Alsworth Ross (1907) who provoked one of the first academic discussions about the need to widen the modern definition of crime. He advocated that the term should cover harmful acts by corporate managers, bankers, officials and others in positions of power, a class of people Ross referred to as the criminaloid. As Lynch et al. (2015) explained, Ross had already argued at the beginning of the 20th century that not enough attention was being given to this particular class of criminals. Ross noted that:

"[t]he immunity enjoyed by the perpetrator of new sins has brought into being a class for which we may coin the term criminaloid. By this we designate such as prosper by flagitious practices which have not yet come under the effective ban of public opinion." (Lynch et al. 2015, p. 27)

In the 1940s, Edwin H. Sutherland again encouraged the criminology discipline to more seriously consider white-collar crime, but this was fiercely countered by other scholars who claimed that this would water down the discipline which should concentrate on stealing and killing and their derivatives. This debate is still ongoing, and the concept of crime is continuously being challenged, both across and within cultures. As Lynch et al. (2015) explain, legislation cannot define a scientific discipline. As long as this happens, the concept of crime is a negotiated one and has no first principle to build on.

Today, white-collar crime is an integral part of almost any country's criminal law, and most law enforcement agencies have specialist departments dealing with economic and international crime. Yet, stealing from the state is sometimes seen as a crime and sometimes seen as a clever and sensible business decision, depending on who does it and where and how it happens. Sometimes states even encourage companies and individuals to steal from other states by offering to shelter money and assets in their own state, in secrecy and without taxes. So far, this has not been considered a crime, although the public outcry after the revelations in the Panama and the Pandora papers clearly shows that many think it should be.

Defining acceptable behaviour, including economic activity, is embedded in nation building and the moral concepts that underpin any given society. As Piketty (2019) explains, what constitutes acceptable economic behaviour in a society depends on whether the apparatus of oppression and persuasion which the leaders have institutionalized manage to unite the society and maintain the balance in it. This system sometimes takes the shape of outright oppression and sometimes it happens more subtly, in peaceful national political settlements. These are influenced by international fora, where nations discuss, for example, how we make the world a better place with peace, justice and strong institutions (SDG 16).

Promoting or, at times, imposing the prevailing norms of the dominant coalition of countries on the rest of the world is very much what the so-called rule-based international system is about. However, adopting the norms by accepting to implement the international rules may not solve the problems of poor countries and, indeed, may not be at all in the interest of these countries. The norms on crime, including tax avoidance, may be designed to solve very different challenges which the rich world is facing. They may exacerbate the challenges the poor countries are facing, including opening a Pandora's box of intellectual property rights, from drugs to fashion brands –- rules mostly designed to protect the profits of companies in the rich countries, even at the cost of well-being in poor ones. When Marco Polo brought back silk and garments to Venice and Italian tailors copied the designs, it was a commercial success and not a crime. Today Chinese tailors and garment factories which copy Italian garment brands are deemed criminal by international conventions on intellectual property.

All general rules have different specific consequences according to where they are implemented. When we lean on the UN definition of illicit flows and crime as defined in the ICCS, we get an explicitly normative perspective on illicit flows. This is rooted less in outcome-oriented models of economic growth and development than in the rule-based liberal model of good governance, believed by the dominant coalition of countries to be a necessary condition for development and social progress. This group of countries, although not as dominant as 20 years ago and increasingly challenged by China, is the OECD group of countries.

The ICCS has been 70 years in the making since the UNSC first stressed the importance of a standard classification of offences in 1951. Little or no progress was made during the first half century, when a bipolar world and two different mindsets on economic activity and security concerns prevailed.

When progress was finally made from the early 2000s, it was pushed by the western powers. The Conference of European Statisticians established a task force, led by UNODC and the United Nations Economic Commission for Europe (UNECE), to develop a crime classification framework based on behavioural descriptions rather than legal codes. It is this work which was adopted as the ICCS in 2015.

Defining crime for statistical purposes is one thing, and a definition based on behaviour may find sufficient international support to be approved by the UN's technical agencies on statistics. However, when this definition is then used to underpin and measure progress towards an international convention on world goals, it means that these standards become a reference for combating IFFs. These definitions are overwhelmingly based on western legal standards, embedded in western culture. Making them the world reference for SDGs is a political rather than a technical project.

Khan and Blankenburgh (2013) explain how many definitions of illicit flows are founded in norms for development and implicitly assume that damage to development can be prevented by a rule of law which should be enforced at a global level, making illicit capital flows relatively easy to identify and target. They dismiss this analysis of damage to development primarily because the fundamental economic structures and societal contracts of rich, advanced countries are very different from the ones prevailing in low-income countries:

"*This analysis makes sense at the level of individual advanced countries; it falls apart as an analytical framework at a global level. It ignores the obvious fact that global laws guiding economic policy or capital flows would only be legitimate if there were a global social consensus based on the same principles of redistributive taxation and social provision on which cohesive societies are constructed at the level of individual countries.*" (Khan and Blankenburg 2013, s. 15)

As we have seen with the ICC, no global agency would be given the mandate and resources to enforce laws at the global level in the same way that individual advanced countries can enforce national laws. Given the current global gaps between countries, in terms of economics and politics and the absence of a sustainable global political settlement based on global redistributive and enforcement capabilities, any attempt to define IFFs at the global level is highly problematic.

As a justification for combating illicit flows, damage to development is nevertheless very important. However, if the drain on development that IFFs can cause were the primary concern about illicit flows, how would one define them? Khan and Blankenburg (2013) argue for a concept that would take its point of departure in economic development and suggest that illicit flows be defined as those:

"that cause damage to the economic development of the country, taking into account all direct and indirect effects that are likely, given the specific political settlement." (Khan and Blankenburg 2013, p. 12)

They are specifically concerned with the dynamic and indirect effects of the so-called rule-based, normative approach to defining illicit flows as, in some settings, this can be upsetting to the stable, political settlement in a country and can cause or promote violent conflict. They argue that the slippage between illegal and illicit is larger in low-income countries, which often have legislation partly inherited or copied from colonial powers and a wide acceptance in society that acceptable economic behaviour by elites as well as poor people may at times necessarily be at odds with the law.[7]

Damaging developmental outcomes often have little to do with violation of the law in the poor and fragile countries. Identifying and estimating illicit flows, as defined by Khan and Blankenberg (2013), will produce very different results from approaches guided by the normative rule-based approach suggested by the UN. This begs a question about what the proponents of the two approaches expect and indeed want to find. Exactly because any global normative definition will produce different results in different places, one should expect that such outcomes can be conflicting. The issue with normative definitions of illicit flows is thus not just that they may not solve the problems and promote development in low-income countries if they are designed to address issues in rich developed countries. Such normative definitions may help to address important issues in one place, while making development more difficult in other places. At the same time, normative approaches assign responsibility or fault to those not implementing them, i.e. if a low-income country does not write and pass legislation based on so-called international standards or fails to enforce it, the lack of development is attributed to structural and institutional deficiencies in that country. This implies that its poverty is fundamentally its own fault and draws attention away from the fact that the very international rule-based system itself could very well be an important part of the problem, as Stiglitz (2020) suggests.

Such important issues are in the balance when the UN adopts resolutions and subsequently defines what this really means. There is always a fundamental and inherent risk nestled in a common denominator. Formulating SDG 16 is not an issue, as the wording is so general that we can all read into it whatever we like. Who is not in favour of better and more safe societies? The challenge arises when we define – in specific normative terms – how to measure SDG target 16.4.1. Only then do we know what we are really looking for and hoping to end.

We are trying to identify and estimate the value of the illicit flows we can see, but we also need to estimate the value of the flows we cannot see because they are deliberately and energetically hidden from law enforcement. This is hard enough, technically, but two other questions remain. As suggested above, one relates to whether the illegal flows are actually bad for economic

[7] Everything from an autocratic regime disowning the laws of democracy, but ensuring peace, to poor farmers selling their produce in the nearest town, even though it happens to be across an international border, or a bus driver of a minibus exceeding the passenger limit by 100 to 150 percent if he wants to keep his job.

development and, if so, where. The other question relates to the embedded dynamics of illegal economic activity. Many of these flows look as they do exactly because we have outlawed them. How would they look if we did not outlaw them, and what would that entail for development?

2.2. The economics of prohibition

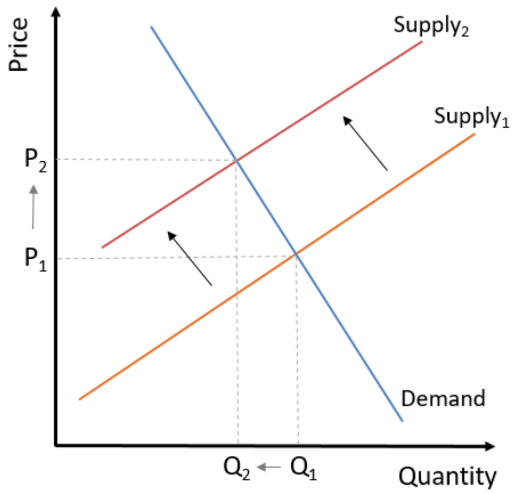
Before we discuss how to detect and measure IFFs, it is useful to recall a few basics about the economic nature of illicit and illegal financial flows.

Fundamentally, when profitable business is outlawed, there will be IFFs! The slave trade after abolition, gold, ivory, cotton and clove smuggling in Africa, trafficking of alcoholic beverages in the USA in the 1920s and of drugs and people today clearly show that when profitable business is outlawed, some of it will continue to thrive underground in illicit flows.

Eliminating or severely restricting supply is the objective of most prohibition. This simply increases the risks and the costs of supply and thus shifts the supply curve to the left. The actual restriction of supply will vary depending on the nature of demand. If the demand curve has very low numeric elasticity, attempts to limit supply will primarily raise the price of the commodity or service in question, with just a small effect on volume. In itself, this shift will make supplying the commodity more profitable and attract suppliers with low risk aversion and systems in place to circumnavigate and dodge law enforcement. Such suppliers will often be organizations which already operate in illegal markets, including organized crime. In this way, prohibition is a sure way to offer criminal networks more business and profit.

Moreover, the structure of the value chain in question may also cause prohibition to lower the price to primary producers – or the volume if they are price takers – while the intermediaries or traders take the profit because they are few in the market, as is frequently the case where organized crime is involved. These organizations simply control entry-level requirements to prospective operators through fear and violence. This structure often prevails in relation to illegal drugs, ivory and other wildlife products, clandestine mining in gold and precious stones, as well as copy-righted products. It is the intermediaries, not the farmers, the poachers, the miners or the sweatshop workers, who get wealthy from illicit flows, and value addition grows the closer the products get to consumers or end users. The UNODC (2020) estimated the farm gate price of dry opium in Myanmar to be US$144,000 per ton in 2020, while the export price of heroin was estimated at US$23 million per ton. The street price in the USA at the same time was US$150 per kilogram or US$150 million per ton. Although dry opium weighs more than heroin and some processing and other chemicals are needed to transform opium into heroin, this clearly shows that farmers only earn less than 1 percent of the final product price and that more than 75 percent of the value addition happens in the country of end use.

Figure 3: Effect on market of prohibition



Source: Design by authors' research assistant, A. Vienberg Hansen.

Taxes also shift the supply curve to the left and make the taxed items more expensive. By how much depends on the numeric elasticity of the demand curve. The demand curve has, as we know, a budget and a substitution element, which is why certain types of goods are easier to outlaw and more difficult to tax than others. True addiction makes substitution very difficult and goods that extremely rich people want, or that are a small necessary part of or ingredients in something much bigger, are also very difficult to stop because the price can go up sufficiently to compensate the suppliers for risk and extra cost. What is more intriguing is that governments know this very well and tax items like tobacco and alcohol heavily because the revenue is guaranteed. When it comes to prohibition, however, many governments seem to ignore this fact.

Smugglers do business in both tax evasion and the trafficking of illegal goods like drugs and arms. A fundamental feature of smuggling is, however, that smugglers move goods and people as their fundamental business. The ensuing financial flow is not their core business, just the payment for the service. False declaration of volumes or value in international trade (mis-invoicing) is just one way of smuggling; the illicit flow of money is related to a movement of something else – goods or services.

When corporations shift profit to avoid tax, they are committing the same crime as some smugglers, those who dodge the customs services collecting taxes and duties. Although one kind of tax evasion may be performed by armed men in fast boats at night and the other by white-collar accountants and lawyers during office hours, the two are doing the same thing – they are stealing from the state. In principle, the penal codes of many countries recognize this, although traditional smugglers moving contraband may often be charged with additional offences such as illegal entry and arms possession.

While the crime is fundamentally the same, the channel is different. Tax evasion, other than smuggling, differs from other kinds of illicit flows insofar as the flow itself is illegal. The money itself is the contraband. It is not payment for some illegal activity but consists of (partly) stolen money. When a corporation shifts profit from one constituency to another for tax evasion – say from Tanzania to the Cayman Islands – the part of the profit shifted which corresponds to the corporate tax rate in Tanzania is stolen money, i.e. 30 percent of the profit shifted. There are no real value chains and the IFF in tax evasion has more in common with money laundering than with other illegal or illicit flows.

3.0 How do we attempt to measure it?

In July 2017, the United Nations General Assembly adopted the indicator framework for the monitoring of progress towards the SDGs. Indicator 16.4.1, "Total value of inward and outward illicit financial flows" was selected as the indicator to measure progress towards target 16.4. At the time, there was no universal agreement on what should be included within the scope of IFFs, and it was only in 2020 that the UN custodian agencies proposed a framework and definitions to be used when measuring progress against the target. This framework, referred to above, has been accepted and the indicator moved from Tier 3 to Tier 2 as stated by the UN:

"*Based on the discussion, the IAEG-SDG voted to elevate indicator 16.4.1 to Tier 2 status, meaning the indicator is conceptually clear, has an internationally established methodology and standards, but data are not regularly produced by countries.*" (UNCTAD 2019)

As we saw in the previous section, there is no universal agreement on what IFFs encompass. Even at the conceptual level, the term disregards the fact that crime is a social construct based on value judgements and, as such, necessarily varies over time and place. The definition of IFFs is based on normative concepts of crime that have only been agreed for statistical purposes and are obviously refused in many national legislations. Most blatant is the lack of consensus on the definitions of terror, which is highly politicized, and of tax avoidance, but a wide range of other acts are also disputed as criminal acts.

It is not surprising that it took a long time to define a target and indicators for SDG 16.4. When it finally came, the target indicator that the UN chose was a single sum volume = total value of all outward and inward illicit flows measured in USD. This means that we have a world goal target based on an umbrella term of all sorts of financial flows that have very little in common other than that they are not acceptable according to primarily western values. Cobham and Jansky (2020) do not discuss the problem of the normative concept but refer to the mixture of completely different flows and arrive at the conclusion that:

"*The common feature that unites all IFF is the use of financial secrecy to obscure the true nature of the transactions, or their underlying ownership, precisely because of their socially or legally forbidden nature."* (Cobham and Jansky 2020, p. 173)

With such a broad umbrella term and a single sum volume indicator for IFFs, we add together flows that are not comparable and weigh them against each other in order to measure progress against the SDG target. A reduction in financial flows due to plant disease in opium poppies or prohibition by the Taliban of growing opium poppies can offset an increase in flows due to abusive tax avoidance and evasion.

The UN Interagency Task Force on Development Finance breaks down IFFs into four main categories according to the activity which generates them: tax and commercial practices, illegal markets, theft and terrorism financing, and corruption. However, one of the most fundamental challenges in estimating IFFs is that, while they are defined according to motive (tax evasion, terror, illicit drugs etc.), they are measured by channel (how the flow moves, not why) and/or by estimating abnormalities in aggregate holdings. As illustrated by the Inter-agency Task Force on Financing for Development (2020) in its schematic diagram, IFFs really consist of a string of events, consisting of a crime (called the component which generates the illicit wealth), which in turn needs a channel to move into the resulting asset. While certain components or criminal activities are frequently related to certain channels, there is no one-dimensional tracking and almost all kinds of illicit activities can generate income via various channels and end up in all sorts of assets.

However, despite all the limitations in concepts and data, scholars make great efforts to try to estimate aggregate IFFs, and politicians demand numbers to help underpin their different agendas in relation to policy response. What we have at play in terms of methods for estimating IFFs can broadly be viewed as three different approaches. They all rely on weak data, e.g. statistics on foreign trade, which are often not exhaustive, homogenous or comparable. Most countries simply do not have comparable or sufficient data to work with.

Even if the data were stronger, there would still be problems, as all three groups of methods have embedded methodological weaknesses. Building primarily on Cobham and Jansky (2020) and Brandt (2020), the following summary of methods shows that we are far from being on solid ground when it comes to understanding the volume and extent of IFFs.

The first group of methods for estimating IFFs rely on data for balance of payment capital accounts. This is the oldest and most traditional way of estimating IFFs, and it relies on the basic equation that changes in debt and direct foreign investment should be mirrored by shifts in foreign currency holdings and the financing of the current account deficit.

This is, however, an expression of something else and of more than IFFs. It measures capital flight in general and is rooted in the concept that capital flight is a bad thing for economic development. A country needs capital for economic growth, so losing it is bad for development. While this is true, it does not mean that all capital flight is illicit. Furthermore, the notion of capital flight as a harbinger and reinforcement of economic deroute is related to the capital flight observed in historic crisis situations, when people and corporations were trying to save their wealth from war, violent conflict and political change, etc. The underlying logic is that capital flight is the result of the elites taking their assets with them to safety when there is trouble on the horizon and thereby making things worse because rich people and corporations are characterized by herd mentality: a few start running and soon they all run.

Following this logic, we have all the models that use aggregate balance of payment data to estimate IFFs, including the “source and use” and the “hot money narrow” methods. The problem with estimates arrived at in this way is that – apart from the fact that many of the world’s poorest countries do not produce solid data on external capital accounts – they measure capital flight, much of which may not be illegal or illicit. At the same time, these methods do not capture much of the action in criminal markets. When the Taliban sells opium to western markets through Iranian and Pakistani smugglers in exchange for arms, the transactions leave no trace in any country’s capital accounts. Similarly, there were no traces in the capital accounts in 2004 when the Taliban fell and moved capital to the Gulf via informal money brokers.

Add to this that even these kinds of abrupt and massive capital flights are not always bad for economic development. Historically, such capital movements at times of crisis also gave the largest profit opportunities to investors with low risk aversion, who created good businesses and subsequently helped economic development by picking up markets in distress and inducing new dynamics in economies after capital flight. The most famous is probably Baron Rothschild, co-founder of one of Europe’s largest banking empires, who made fortunes in the French revolution and the Napoleonic Wars (1789-1815) and is believed to have said the famous words:

“*The time to buy is when there is blood in the streets.”* (Forbes 2009)

Much of Europe’s industrial revolution in ironworking, metallurgy and the railways was funded by Rothschild, who also bankrolled the British government’s share of the Suez Canal. Few would say that the capital flight that occurred in continental Europe in the late 18th and early 19th centuries, primarily from the holdings of aristocrats, was bad for Europe's subsequent economic development. On the contrary, it paved the way for the much more dynamic economic forces that would assist Europe's economic growth for centuries.

The kind of capital flight that happens at times of crisis is the extreme version of portfolio management, which normally takes more subtle forms and is generally considered good business practice. One diversifies for risk management, and indeed diversification (measured as the average item size in the portfolio) is the most important element in risk management. Having small items and limited interdependency between items is the best way of reducing risks to wealth/assets portfolios. For the individual company, this is sound management. However, for a country, it is necessary for the inflows from foreign companies to counter-balance what domestic companies take abroad, and changes in holdings should be explicable by legal economic activity.

Dangote Industries of Nigeria has invested heavily in cement and telecoms in other African countries and now has subsidiaries in cement manufacturing, sugar milling, sugar refining, port operations, packaging material production and salt refining in 17 African countries (Dangote 2020). It has done so by taking capital out of Nigeria in productive diversification and, in the long run, this is likely good for economic growth in Nigeria and sub-Saharan Africa. Furthermore, the company's founder Aliko Dangote started his business in 1977 in import–export trading in Nigeria, an economic area where the laws and regulations are often not strictly followed by all stakeholders.

The second and probably the most mediatized method for estimating IFFs is trade mirroring, which uses trade statistics to compare reported volumes and values of trade between countries to detect under- and over-invoicing. While assessing discrepancies between data produced by countries of origin and destination can certainly give a rough indication of IFFs occurring, this method is a very crude measure of illicit flows. Studies using trade mirror methods (GFI and UNITAD) report extremely high volumes of IFFs,[8] but they also suffer from major weaknesses.

This method stands on highly normative and moral ground, assuming that all mis-invoicing is bad, and uses terms such as "dirty money". For mis-invoicing to be "dirty", it should represent tax evasion or covering up of corruption or other illegal activities carried out in one country and paid for in another. This is not a safe assumption, as Johannesen and Pirttilä (2016) allude to in their review of methods and data sources for estimating IFFs:

"*… asserts that all discrepancies in trade statistics are due to mispricing motivated by capital flight whereas, in reality, there could be other reasons, for instance omissions by customs inspectors or errors at the statistical bureaus.*" (Johannesen and Pirttilä 2016, p. 8)

Trade mirrors suffer from a number of weaknesses in relation to non-comparable classification of goods and the value of insurance and freight, which makes it very difficult to compare statistics in exporting countries with the corresponding statistics in importing countries. Relying on trade data which are not really comparable and classifying all discrepancies above 10 percent between the imported and exported values assumes that real trade costs are always below 10 percent of the goods value. According to Johannesen and Pirttilä (2016), this is "highly problematic" and not a reflection of how real world trade prices vary over products and partners globally. Their conclusion about trade mirror studies is that:

[8] Sensational numbers can be one reason for the strong media coverage and vice versa.

“*The largest estimates in the literature are based on imperfect methods with a great margin for error.”* (Johannesen and Pirttilä 2016, p. 1)

Although some trade mirror studies have improved since 2016, this is fundamentally still the case. Moreover, and this is perhaps more important, the method does not detect profit shifting within companies, nor does it detect over- and under-invoicing if the trading partners agree on it and collude. Such an arrangement can often be lucrative for both seller and buyer, and it is always the case in intra-firm trading, e.g. profit shifting by multinationals.

Trade mirrors will not catch corrupt practice of false classification, such as hardwood being declared as normal timber and under-invoiced by exporters, and it may indicate that legal transactions are fraudulent. A well-known specific misinterpretation of export classification was UNCTAD’s report on missing or under-invoiced gold exports from South Africa, which was due to confusion between monetary and non-monetary gold exports in the study. Last but not least, the method faces challenges in relation to transit trade and exchange trading, especially so-called merchanting, which is very common in mineral trade and thus a large part of developing countries’ exports. Merchanting means that goods will not go to the country of domicile of the buyer to whom the export is recorded; it may be stored in and transit a second country and end up being imported into a third country at a quite different point in time to the original export. Merchanting also includes services. Merchanting traders do not just buy and sell commodities; they are also engaged in transport in connection with the transaction, insurance against loss of or damage to the goods, storage and the financing of their capital-intensive commodity transactions. However, all these services are recorded in the traded price of the commodity when it is sold to the final customer/importer.

Apart from South Africa’s gold, a large part of mineral exports from Southern Africa is copper from Zambia, which is sold to a broker company in Switzerland by its own subsidiary in Zambia which produces and refines copper. At the time of export, the copper is recorded as being exported to Switzerland, but it never actually goes to Switzerland, going straight to China instead, where the buyer may be paying a very different price for the copper than it was sold for by the mining company in Zambia to its holding company in Zurich. These errors in trade mirror studies can be very significant in volume. Olle Östensson, one of the most experienced scholars in mineral trading, has argued that some trade mirror studies publish grossly exaggerated estimates. He points to the fact that the GFI studies are general in nature and do not directly offer proof of criminal behaviour by specific companies in specific countries. In relation to certain studies about mis-invoicing in African countries, Östensson goes even further:

“*… estimates for trade mis-invoicing of minerals have to be drastically revised downwards and that very little remains of the total.*” (Östensson 2018, p. 86)

Like most other methods, the trade mirror method faces huge challenges in relation to trade in services in general, and some estimates use indices of normal or reference prices in addition to comparing data from exporting and importing countries. Trade in services is generally very challenging to measure and therefore has the potential to be a large carrier of IFFs. The UN and OECD are trying to find ways to address this problem, but the bottom line is that there are no effective ways to measure the value of a service and whether a service has been delivered/rendered in full or at all. This is particularly so in relation to what it should cost. From hairdressers and prostitutes to large multinational corporations paying for intellectual property and quality assurance, maintenance and other advice from their sister or holding companies, authorities will find it very difficult to prove mis-invoicing in services. A frequently used way of getting money out of a corrupt country is to employ the offspring or other family members of high-ranking government officials in ridiculously well-paid jobs as consultants or advisers. Multinationals have no problem in legally attaching such jobs to their headquarters or other branches in a country with low taxes.

The third group of methods for estimating IFFs is to investigate how much money is stashed away in tax havens and secrecy jurisdictions and to assume that it is all illicit proceeds from criminal activity in illegal markets or tax evasion. While this assumption may well be true, there is a huge challenge in knowing how much is from illegal markets and how much is from tax evasion. Furthermore, the balances on these hidden accounts represent stock created by earlier flows, but they may also have accumulated where they are hidden. How big was the original flow to create certain stock and was it earned from tax evasion or illegal market activity, or both?

Some scholars combine the first two approaches mentioned and some test their results against samples and shadow pricing exercises when that is possible, i.e. profitability and taxes paid in similar industries in comparable countries. Other filters and adjustments can be added by speculating about rational behaviour by economic agents and estimating elasticities in risk management.

Whether the estimation methods measure indirect evidence or are based on speculation, or both, no single method of estimating IFFs will give us a clear and reliable picture of IFFs. As Brandt (2020) concludes in a recent survey on methods and evidence:

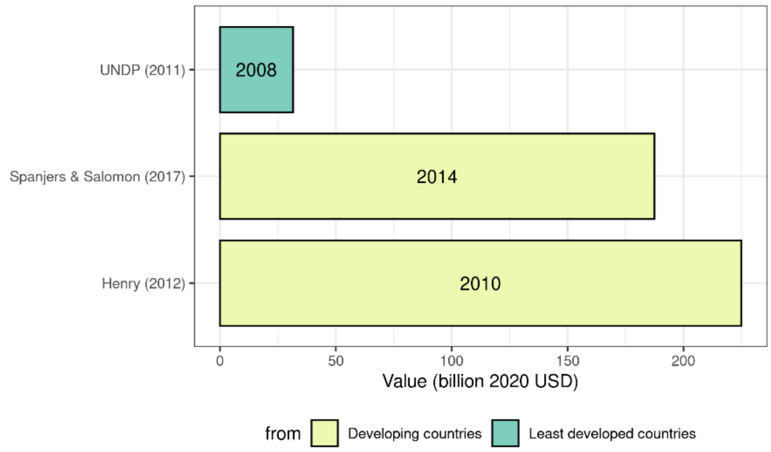
"While several methods offer to measure the extent of IFFs, each has its benefits and drawbacks. Critically, methods based on the balance of payments identity may capture licit as well as illicit flows, and a method based on macroeconomic trade discrepancies suffers from doubtful assumptions. The most convincing estimate to date demonstrates that individuals hold financial assets worth around ten per cent of global GDP in tax havens." (Brandt 2020)

In short, the state of the art in estimating IFFs is that from aggregate analysis we get, at best, a hazy and kaleidoscopic picture of IFFs. A handful of estimates shown below can illustrate this point. What the following numbers also show is that, even from inaccurate estimates, we can learn that IFFs matter, especially to poor countries.

3.1 How much and what is it?

The most conservative estimate of IFFs in relation to poor countries is provided by the UN and says that almost US$30 billion of IFFs left least-developed countries in 2011. Other scholars arrive at much higher estimates of around US$200 billion leaving developing countries each year. Figure 4 shows the estimates, which are not comparable as the groups of countries differ in the studies.

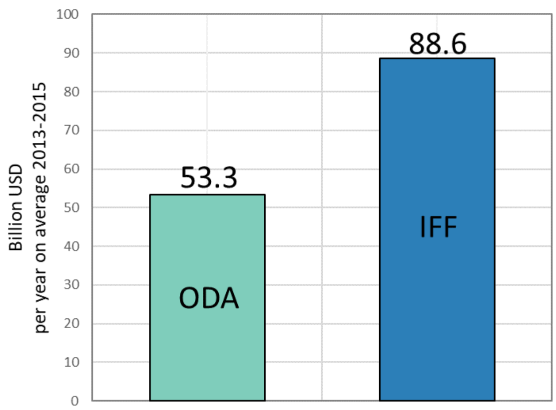
Figure 4: Estimates of illicit flows from poor countries



Source: Authors' compilation based on Henry (2012), Kar (2011) and Spanjers and Salomon (2017).

If we look at the numbers for Africa, the world's poorest continent and home to two-thirds of the world's poor, estimates from the UN say that IFFs amount to around US$90 billion. This corresponds to around 3 percent of the region's GDP and is more than 50 percent larger than the official development assistance (ODA) flowing into the continent from western donors.

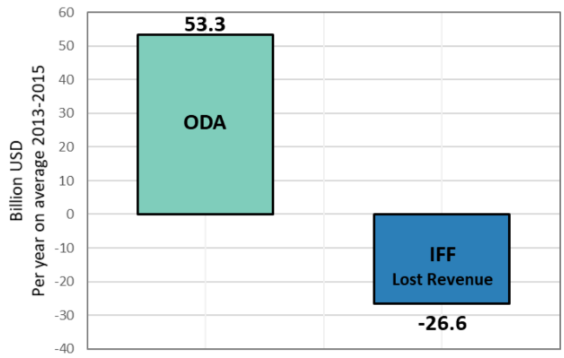
Figure 5: Illicit flows from and ODA into Africa



Source: Authors' compilation based on UNCTAD (2020) and Stats OECD (DAC2a).

As alluded to by Johannesen and Pirttilä (2016), comparing gross IFFs with ODA may not be meaningful, as the volume of capital flight does not represent revenue loss to the country of flight. Assuming an average corporate tax rate of 30 percent, a fair estimate of direct loss to revenue for African governments is that an amount equal to half of the ODA flowing into Africa is siphoned out of the continent in IFFs. This is in line with the finding of Johannesen and Pirttilä (2016) who conclude that African countries receive more ODA than they lose from tax revenues due to capital flight. We would argue that ODA as reported by the OECD does not all represent actual flows into developing countries in Africa and that the actual difference between lost revenue and ODA is smaller than the official numbers illustrated below (see Flentø and Simao 2021)

Figure 6: Revenue loss due to IFFs compared to ODA in Arica



Source: Authors compilation based on UNCTAD (2020) and Stats OECD (DAC2a).

As estimates of illicit flows are very inaccurate, some scholars prefer to gauge the value of IFFs by estimating the value of wealth hidden in tax havens and secrecy jurisdictions. Here estimates range from 10 to 30 percent of global GDP. Although not the most recent study, many scholars (including Jansky and Brandt) lean towards the conservative estimate and regard the work of Alstadsæter et al. (2017) as the most reliable, although far from accurate.

Figure 7: Estimates of hidden wealth in tax havens and secrecy jurisdictions

Source: Authors' compilation based on Alstadsaeter et al. (2017), Henry (2012) and Palan (2010).

4.0 The momentum behind and usefulness of IFFs as a concept

Why are we pursuing a UN target indicator that we cannot really measure because we have no reliable methods and insufficient data? Is it a decoy or just a detour resulting from endless negotiations in the UN which produce a compromise that we have to settle for, for the time being?

The debate on IFFs is hugely important, as agreed by world leaders. The construction of an umbrella term for the financial flows of international economic crime and crude estimates of the magnitude of these flows have certainly helped in drawing the world's attention to the malpractices and raising the issue to policy prominence. The timing has been good too. World events have made it possible to rally nations around this issue, but it has come with an embedded weakness of very different motives.

When socialist movements and non-governmental organizations criticized multilateral corporations (most famously ITT and the seven sisters in oil extraction) of corruption, transfer pricing and tax evasion in the 1970s, it was to little avail. When the National Liberation Front of Algeria bombed Paris in the 1950s, when the Irish Republican Army bombed London in the 1970s and when the Palestine Liberation Organisation bombed in the 1980s, there were no UN terror conventions against them. Although other organizations like Brigado Rosso and Bader-Meinhof were considered more domestic problems in Italy and Germany, respectively, law enforcement institutions were aware of the international cooperation between these organizations, including the finance they received from each other and from other groups sympathetic to their cause. However, there were no international conventions against it. The terror conventions of the time were all directed towards hijacking planes, kidnapping protected personnel, and protecting oil and other sensitive installations on the high seas. This was because that was what the UN, particularly the Security Council, was able to agree on in a bipolar world.

This all changed in the late 1990s and 2000s when western hegemony got new enemies who did not have seats on the Security Council and when the international financial crisis showed the world that there are many kinds of IFFs. The onset of the "dot-com economy", particularly the explosive growth of half a dozen multinational tech companies, aggravated one of the most fundamental challenges in taxation – the distinction between domicile and place of economic activity. What had been relatively effectively dealt with in the rich western world took on a completely new dimension. How does one tax the tech giants who sell everywhere and are only located in a few places where they are spoiled and protected?

After 2001, and especially after the 2007–09 financial crisis, IFFs were no longer just associated with drugs lords and extractive industries in poor countries. The development angle of tax evasion by largely western companies is likely the issue that Raymond Baker (2005) wanted to highlight with his defining work in *Capitalism's Achilles Heel*, and the World Bank also contributed to the policy prominence of the issue with a series of articles under the heading "Depleting Development" in 2008.

However, what was of enormous help in making the combating of IFFs a joint cause of sufficient UN member states to agree on SDG 16.4 was the fact that terror financing and tax evasion by the tech giants in rich countries could be fitted into this agenda. If it was the development aspects of IFFs that mattered to the rich western world, they could already have addressed this challenge much more effectively after the collapse of the Soviet Union. It was not. It was only when the IFF agenda was becoming increasingly relevant for the collection of tax revenue, and especially western security policy through terror financing, that the UN started to deal with the matter seriously. At the same time, financial flows from narcotics and illegal drug trafficking, which had long been intimately entangled with western – especially American - security policy, took on a completely new dimension in Afghanistan, where the Taliban and Al Qaida were financing an ever-increasing part of their warfare against the West with proceeds from opium.

There was a need for an international alliance against Islamic extremists, not just on the battlefield in Afghanistan but also to criminalize internationally everyone who helped or cooperated with these organizations. This is precisely what the UN conventions aim to do; they make legislation – and thus the underlying values of the dominant coalition of countries – a global reference and framework.

Advancing such motives alongside the development and equitable growth agenda under the common heading of IFFs is convenient, but fighting crime and terror as defined by western norms does not equal development, and perhaps sometimes the opposite. Policy advice and implementing tools cannot be developed at this level of abstraction. One quantitative indicator for IFFs, of which we can so far only get a hazy and kaleidoscopic view, seems to be just that – a rather abstract concept which does not offer countries much guidance on priorities. If all illicit flows are equally important, the most powerful group of countries – which are also the richest and responsible for most financial flows – will set their own targets. Judging from history, development and poverty alleviation are not at the top of this agenda.

Regardless of the advances made in methodology and data-collection techniques via pilot projects in a handful of countries, there seems to be little to be gained by developing further techniques and methods for estimating aggregate IFFs. Firstly, there is an aggregation problem with adding together such fundamentally different flows. Because the techniques often used at the aggregate level to estimate the flows are disassociated from the crime, these estimates will continue to be crude and represent the financial aspects of a mixed casserole of a large variety of more or less criminal acts committed under hugely different conditions by very different actors. Secondly, and perhaps more importantly, there are more fundamental issues related to priorities and a hierarchy of challenges buried beneath the general concept of IFFs. A single volume indicator risks diluting the policy debate and draws the focus away from the needs of governments – particularly a handful of primarily western ones – to pursue and implement policies which may be unpopular with very influential elements of their constituencies.

5.0 Conclusions and recommendations

The term “illicit financial flows” is a poorly defined umbrella term for financial flows that are deemed unacceptable by the most influential (western) group of governments in the UN. These flows have preciously little in common apart from the fact that they are unacceptable by western norms. The importance of IFFs is often related to development outcomes, but this is not substantiated in how the concept has actually been defined. Reducing IFFs may lead to more equitable economic growth or may produce more inequality; the definition is too wide to let us know. As defined by the UN, IFFs encompass all sorts of flows with very mixed damage to development and for which the policy responses are very different.

The wide definition of IFFs and the very broad wording of SDG 16.4 have been useful in drawing attention to and providing support for combating IFFs. This has happened for two reasons: governments across the political spectrum and countries at different stages of development and facing different challenges have been able to read their own needs into this agenda and help to raise the issue to political prominence on the world stage. Furthermore, the very broad and loose definition paves the way for very high, sometimes significantly exaggerated, estimates of illicit flows. However, there is no agreement as to the aggregate volume of illicit flows. The closest we get is some sort of consensus that assets equal to at least 10 percent of the world’s GDP are stashed away in tax havens and secrecy jurisdictions.

The term "illicit financial flows" and the concepts defined by the UN in relation to SDG 16 are too general for meaningful aggregation. They offer little direction and leave room for constant negotiation of real priorities. This shields the discourse that stopping illicit flows equals development and it implicitly promotes western priorities and concepts of what illicit is, including the false narrative of a rule-based and just world order. At the aggregate level, it is impossible to say who the perpetrators are and thus who can do something about it. Very different, much more focused and sector-specific analysis is required to ascertain whether the policy initiatives and tools currently employed can effectively deal with the underlying crimes of IFFs and what this means for development. Some of this research is under way including under the UNU-WIDER (United Nations University World Institute for Development Economics Research) programme "Detecting and Countering Illicit Financial Flows". As well as seeking to measure IFFs, this study also seeks to measure their specific negative impacts on development. Two of the most important IFFs appear to be related to drugs and tax evasion. We look at those in a companion paper (Flentø & Simao 2022).

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