The International Institutional Architecture and Illicit Flows: A financing for development view

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Illicit flows represent a huge transfer of financial resources out of developing economies

- Illicit outflows from developing countries averaged 590 US$ dollars between 2002-2011 and reached close to a trillion US$ dollars in 2011 or roughly 1.5% of global GDP and 5% of global savings.

Developing Countries
Average 2002-2011 (billions of US$ dollars)

Category	Billions of US$
Non-Normalized Illicit Financial Flows	590
Foreign direct investment, net inflows	406
Private financial flows, net	332
Personal remittances, received	227
ODA, All Donors	107

Source: *Global Financial Integrity, OECD, World Development Indicators (World Bank), World Economic Outlook (International Monetary Fund)*

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As in the case of developing countries illicit flows from Latin America and the Caribbean far surpass other financial inflows

- The issue of illicit flows affects not only **Low Income Countries but also Middle Income countries** such as those of Latin America and the Caribbean.
- Illicit flows represent roughly twice the amount of private financial flows and remittances and fourteen times the amount of ODA received by the region.

Latin America and the Caribbean
Average 2002-2011 (billions of US$ dollars)

Category	Billions of US$
Non-Normalized Illicit Financial Flows	**113.1**
Foreign direct investment, net inflows	**84.9**
Private financial flows, net	**63.7**
Personal remittances, received	**50.8**
ODA, All Donors	**7.8**

Source: *Global Financial Integrity, OECD, World Development Indicators (World Bank), World Economic Outlook (International Monetary Fund)*

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Illicit flows could be a 'hidden resource' to fund development goals

Order of magnitude of investment needs of main developmental objectives from the literature

Oceans
Forest
Biodiversity
Climate change mitigation
Climate change adaptation
Universal access to energy
Renewable energy
Energy efficiency
Land and agriculture
Infrastructure (non energy)
MDGS

100 1,000 10,000

Annual investment requirements (billion US$ per year)

Volume of illicit flows out of developing economies

Source: Based on UN (2014)

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The global financial architecture addresses the issue of illicit flows through the establishment of key codes and standards

- The global financial architecture consists of a set of international bodies (13) that establish codes and standards "to promote sound domestic financial systems and international financial stability."

- The key standards cover three broad areas:

  - Transparency
    - Assessment of financial stability
    - Conduct of fiscal and monetary policies
    - Disclosure and data dissemination
  - Regulation and infrastructure of the financial sector
    - Banking, securities, insurance
    - Payments and settlements
  - Market integrity
    - Accounting and auditing
    - Corporate governance
    - Insolvency and creditor rights
    - Money laundering and terrorist financing

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However the ‘international standards regime’ may not be adequate for the task at hand…

- The international standard regime is not driven by developmental concerns.

- The international standards regime was created as a by product of the crises of the 1990’s (including the Asian and Mexican crises)
  - …And by the belief that the crises were mainly driven by domestic policy failures in developing economies.

- The standards and codes were based on developed country experience.
  - The content was not appropriate for the needs and contexts of developing economies (‘One Size does not fit All’) (Jin Linqun, 2001; Brown, 1998).
  - Absence of adequate resources and capacity implementation can slow the process and not produce the desired results.
  - Lack or lack of adequate participation of developing economies in the decision making process led to legitimacy and ‘ownership’ issues.

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Since the Global Financial Crisis (2007-2009) there has been some improvement in the international standard regime

- Following the onset of the Global Financial Crisis (2007-2009) membership in several standard-setting bodies expanded to include some developing economies.

- Cases worth mentioning include:

  - The International Organization of Securities Commission (IOSCO).
  - Basel Committee on Banking Supervision (BCBS).
  - Committee on Payment and Settlement Systems (CPSS).
  - Issuing Body International Accounting Standards Board (IASB).

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But the international standards regime remains asymmetric at two levels

- The first asymmetry refers to the fact that inclusion and participation of the developing world in standard-setting bodies is limited to a handful of countries.

  - In the case of Latin America and the Caribbean, some of the major economies (Argentina, Brazil, Mexico) that are affected by illicit flows are included in several standard setting bodies.
  - However other medium sized and smaller economies of the region (including Central American countries) which are more vulnerable to illicit flows and have fewer resources to confront their effects are excluded from the standard-setting body decision making process.

- The second asymmetry refers to the incidence and design between developed and advanced economies.
  - The observance of internationally recognized standards and codes through ROSC modules serve as a 'seal of good conduct' for economies akin to 'credit rating' norms.
    - ✓ It is an input into IMF article IV surveillance.
  - This can have an impact on developing countries capacity to access financial markets and also on borrowing costs.

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Finally greater participation and balance between developed and developing country in the reports of the observance of standards and codes (ROSC) has not proven to be effective in curbing illicit flows

➢The number of total countries participating in ROSC reports increased significantly between 2002 and 2014. Illicit financial flows also increased significantly during this period.

Number of total countries that have observed ROSC modules for 2002 and 2014

ROSC module	2002	2014
Fiscal Transparency	22	61
Data Dissemination	18	62
Banking Supervision	8	37
Anti-Money Laundering and Combating the Financing of Terrorism	0	27
Monetary and Financial Policy Transparency	8	24
Payments Systems	8	21
Securities Regulation	6	15
Insurance Supervision	7	12
Corporate Governance	0	1
Insolvency and Creditor Rights	0	1

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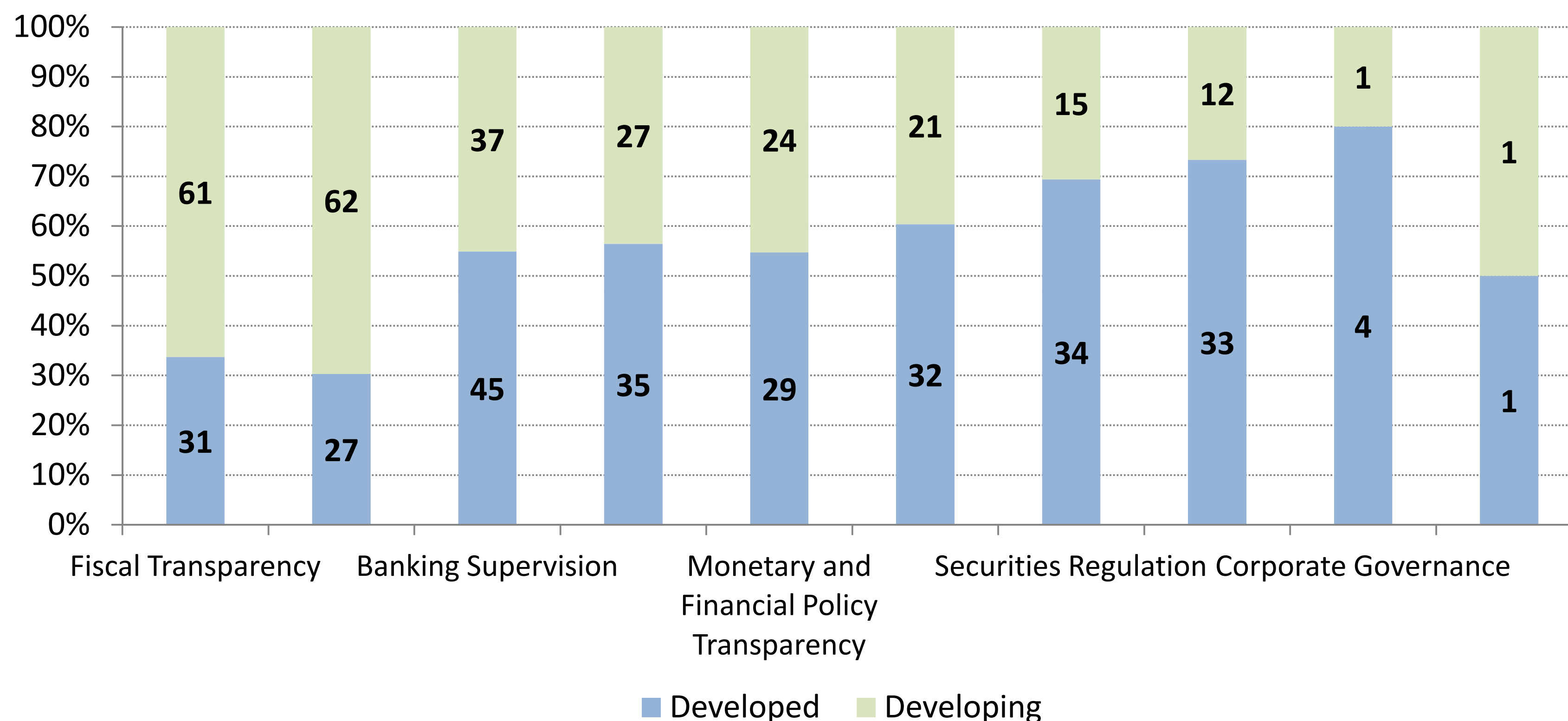
Share of developed and developing countries in the reports on the Observance of Standards and Codes (ROSCs)

➢ On average the data shows that the participation developed countries in ROSC reports has risen over time.



Source: Reports on the Observance of Standards and Codes (ROSCs)

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Conclusions

- The problem of illicit flows should be seen from a financing for development perspective.

  - A real measure of development finance should be based on the 'effective transfer of resources' (outflows and inflows) rather than measures of external and internal finance.

  - By this measure the available data seem to indicate that lower income countries transfer resources to higher income countries.

- The institutional financial architecture is not the same thing as a financing for development architecture.

  - If lower income countries transfer resources to high income countries an adequate financing for development architecture is needed.

- Greater participation of developing economies and a better balance between developed and developing economies in current standard compliance is insufficient to tackle the problem of illicit flows.

- Other forms of cooperation and coordination must be explored .