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Dirty development money

TIMES FORUM

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COPENHAGEN — One of the biggest problems affecting the world's poor is one that few have ever heard about: illicit financial flows. Though such flows cost people in Djibouti, Congo, and Chad more than one-fifth of their incomes every year, they almost never make headlines. With the world preparing to establish the specific targets that will guide global development efforts for the next 15 years, the time to change that is now.

Given that the new global development targets — like the current Millennium Development Goals, which have focused on health, hunger, and education — could guide the allocation of hundreds of billions of aid dollars, choosing the right areas on which to focus is critical. The international community, swamped with hundreds of proposed goals, undoubtedly faces a major challenge.

To help guide the process, the Copenhagen Consensus Center asked 62 teams of top economists to determine where limited resources could do the most good by 2030. Some of the targets that they identified — such as increased food security, expanded educational opportunity, and improved health care — were unsurprising.

But one recommendation — curbing illicit financial flows — was unexpected. After all, at first blush, such flows do not seem to be as powerful or as urgent a threat to people's wellbeing as, say, not having enough food to survive. Many people do not realize that illicit flows are a problem at all.

Nonetheless, the economist Alex Cobham insists that curbing such flows should be a high priority. And he makes a strong case.

The Global Financial Integrity Institute (GFI) reports that, in 2011, developing countries lost almost a trillion dollars through illicit transfers to the developed world. In the same way, 20 African countries have lost sums equivalent to more than 10 percent of their GDP every year since 1980. (In a sense, this makes Africa a net creditor to the world, though it cannot expect to be repaid.) Some $85 billion flowed illegally out of India in 2011.

Where does the money go? Kleptocratic regimes often channel some of their countries' wealth into Swiss bank accounts. This, like money laundering by criminal organizations, is obviously illegal (as well as morally reprehensible).

But there is also a legal mechanism for such financial flows: tax avoidance. Though it is not a criminal offense, tax avoidance attracts widespread criticism — not least because it is common among major multinational companies, including Amazon, Starbucks, and Google. These companies minimize their tax liabilities by registering and declaring their profits in a low-tax country, despite doing most of their business elsewhere.

Yet another method for moving capital between countries is the mis-invoicing of trade, whereby companies alter the value of their imports and exports. A recent GFI study indicated that, from 2002 to 2011, $60.8 billion moved illegally into or out of Ghana, Kenya, Mozambique, Tanzania, and Uganda in this way.

Taken together, illicit financial flows currently amount to nearly 10 times the total sum of international aid. Imagine how much good that money could do if it were channeled toward welfare-enhancing projects.

That is why Cobham has proposed including in the next development agenda the requirement that all beneficial ownership information be made publicly available. By making it harder for individuals to hide behind shell companies, such regulation would make illicit financial flows significantly more difficult to accomplish — and much easier to spot.

If this effort produced just a 10 percent reduction in the average losses from illicit financial flows, compared to 2002-2012, it would save countries $768 billion — money that could be used to finance development projects. A 50 percent reduction would save a staggering $7.5 trillion.

Of course, Cobham's proposed regulation would carry significant administrative costs. But, even if the highest estimate of $66 billion proved to be correct, poor countries would gain $13 worth of extra income per dollar spent — a very handsome return. A more likely rate of return would be $49 per dollar spent.

The regulation's impact could be bolstered by two other proposals: automatic exchange of tax information among jurisdictions and a requirement that multinationals report revenues on a country-by-country basis. This level of transparency — which, in some cases, would amount to "naming and shaming" — could transform how companies manage their financial affairs. Though it is extremely difficult to estimate the precise costs and benefits, it is safe to say that such measures are likely to be highly cost-effective.

But (there is always a "but") if any of these measures are to work, they must be enforced as widely, consistently, and strictly as possible. Simply reducing the number of available channels for transferring money out of a country would direct more funds through those that remained.

Unfortunately, the existing framework for preventing money laundering does not offer an encouraging precedent. Though it is universally accepted and enforced in most countries, money laundering remains rampant. The hope underlying the current transparency proposals is that their relative simplicity would boost their impact.

Of course, nutrition, education, health, and the environment are important features of the next development agenda. But global leaders have compelling reason to add the reduction of illicit financial flows to the list.

Bjorn Lomborg, an adjunct professor at the Copenhagen Business School, founded and directs the Copenhagen Consensus Center. He is the author of "The Skeptical Environmentalist and Cool It." For more stories, visit Project Syndicate (www.project-syndicate.org).