

## SYMPOSIUM ON NEW DIRECTIONS IN ANTICORRUPTION LAW

### RECHARACTERIZING CORRUPTION TO ENCOMPASS ILLICIT FINANCIAL FLOWS

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Anticorruption treaties generally define corruption as the abuse of entrusted power for private gain. As such, global anticorruption efforts primarily target transactions involving the bribery of governmental officials. The definition excludes transactions in which multinational corporations deprive developing states of revenue by failing to pay taxes and other monies due. Yet such transactions are equally injurious to the development agenda of poor states. This essay argues that corruption should be redefined to encompass illicit financial flows, a term used by a [growing network of tax and economic justice groups](#)<sup>1</sup> to refer to money that is “illegally earned, transferred or used.”<sup>2</sup> Transactions such as trade misinvoicing, base-erosion, and abusive transfer pricing to illegally earn additional income undermine the ability of poor states to raise revenue for development. Expanding the definition of corruption would create a more realistic picture of the role of corporate actors and their involvement in corrupt and illicit dealings. It would also bring equivalency to the treatment of corporate actors and public officials. By focusing on illicit dealings involving corporate actors, this essay challenges the partial definition of corruption adopted in the heyday of the Washington Consensus, when skepticism about the role of the state, rather than of private actors, prevailed.

#### *The Overly Narrow Definition of Corruption in International Law*

The United Nations Convention Against Corruption (UNCAC) obliges states parties to criminalize bribery and embezzlement by government officials. UNCAC's primary anticorruption targets are public officials and employees of private companies under government contract. A major purpose of the Convention is “to promote integrity, accountability and proper management of public affairs and public property.”<sup>3</sup> The centrality of public corruption in the UNCAC and in other anticorruption treaties is reflected by their nearly exclusive focus on public officials,

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<sup>1</sup> Sol Picciotto, [Illicit Financial Flows and the Tax Haven and Offshore Secrecy System](#), TAX JUST. NETWORK (Feb. 8, 2018). For a contrasting view on the converging definitions of illicit financial flows, see Maya Forstater, [Illicit Financial Flows, Trade Misinvoicing, and Multinational Tax Avoidance: The Same or Different?](#), CTR. FOR GLOBAL DEV. (Mar. 2018).

<sup>2</sup> African Union/Economic Commission on Africa Conference of Ministers of Finance, Planning and Economic Development, [Track it! Stop it! Get it! Report of the High Level Panel on Illicit Financial Flows from Africa](#) (Addis Ababa, Jan. 2015) [hereinafter Illicit Financial Flows Report]. This definition and close variations of it have been adopted by various institutions in discussing illicit flows of finances and their effects. For purposes of my argument, I am not concerned with proceeds of crime and hiding wealth from tax agencies, acts that are often included in the definition of illicit financial flows.

<sup>3</sup> UN Convention Against Corruption art. 1(c), *opened for signature* Dec. 9, 2003, 2349 UNTS 41 (entered into force Dec. 14, 2005) [hereinafter UNCAC].

public property, and public procurement and management of public finances.<sup>4</sup> A single clause in UNCAC focuses on the prevention of corruption in the private sector. That clause does not, however, require states parties to criminalize conflicts of interest, influence peddling, nepotism, illicit enrichment, or bribery of private sector actors. In fact, while many states heavily sanction bribery of public officials through criminal law and other types of enforcement actions, states criminalize and punish private bribery, and corporate financial crime in particular, much less heavily.<sup>5</sup> Unlike public officials, corporate actors are regarded as a force for good because many view their investments as having a positive impact on national incomes, employment rates, and government revenue.<sup>6</sup>

This reluctance to treat private action as corruption is widespread. The Organisation for Economic Development and Co-operation (OECD) Anti-Bribery Convention targets the bribery of foreign government officials but does not cover private sector avoidance of foreign tax law or other financial regulations. Similarly, regional agreements focus on public action. Article 5(4) of the African Union's Convention Against Corruption only addresses internal accounting, auditing, and follow-up systems, especially with regard to public income, customs, and tax receipts in the public but not in the private sector. Even the World Bank Group (WBG) and the International Monetary Fund (IMF), which have robust sanctioning systems for contractors involved in projects they fund, did not focus on the role of corporate actors in illicit financial flows until very recently.<sup>7</sup>

Arguably, the primary reason for the focus on public sector corruption in the UNCAC and to some extent the OECD Convention is the dominance of the Washington Consensus's critique and distrust of governments as inevitably susceptible to corruption.<sup>8</sup> The rise of the anticorruption agenda was closely aligned with the agenda of rolling the state back through privatization and deregulation and the introduction of market reforms.<sup>9</sup> Under these reforms, markets and the private sector were regarded as superior alternatives to governments in their ability to efficiently allocate resources. Under the stringent macroeconomic and monetary reforms of the Washington Consensus, the private sector was regarded as a source of private investment and capital necessary for emerging economies and as such was presumed to be beyond reproach. Overall, the assumption underlying these reforms was that market-based relationships were superior to personal bonds or family, clan, kinship, or ethnicity bonds that are highly correlated with corruption and, thus, are inconsistent with public officials acting for the common good. To maintain this "arms length" principle, the WBG also proposed establishing a preference for foreign firms with no close ties in the country over local companies when awarding contracts.

<sup>4</sup> On the inadequacy of corruption treaties to address internal accounting controls, auditing, and follow-up in the private sector, see Peter Schroth, *Fostering Informed and Responsible Management: The Failure of the Corruption Treaties' Provisions on Accounting and Controls*, 17 RES. INT'L BUS. & FIN. 313 (2003).

<sup>5</sup> See, e.g., Jed S. Rakoff, *The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?*, N.Y. REV. OF BOOKS, Jan. 9, 2014. See also Peter Schroth, *The United Nations Convention Against Doing Anything Serious About Corruption*, 12 J. LEGAL STUD. BUS. 1 (2005).

<sup>6</sup> THOMAS J. BIERSTEKER, *MULTINATIONALS, THE STATE, AND CONTROL OF THE NIGERIAN ECONOMY* 18–19 (1987).

<sup>7</sup> The World Bank released in 2018 its first annual report on suspension and disbarment of firms involved in corruption and fraud in the projects it finances. See World Bank Group, *World Bank Group Sanctions System Annual Report* (2018).

<sup>8</sup> From this premise, the World Bank argued that "a crisis of governance underlies the litany of Africa's development problems." World Bank Group, *Sub-Saharan Africa-From Crisis to Sustainable Growth: A Long-Term Perspective Study* 60 (Nov. 1989). See also Int'l Monetary Fund, *Good Governance: The IMF's Role* (Aug. 1997).

<sup>9</sup> Among these reforms were deregulation, privatization, and liberalization of the economy with a view to facilitating the competitive allocation of resources in the marketplace, rather than relying on an "open ended" exercise of official discretion. See James Gathii, *Empowering the Weak while Protecting the Powerful: A Critique of Good Governance Proposals* (1999) (unpublished S.J.D. thesis, Harvard Law School) (on file with author).

*The Movement for Greater Transparency*

While anticorruption treaty regimes continue to overlook illicit financial flows, tax justice groups,<sup>10</sup> as well as the African Union and its affiliated institutions such as its Advisory Board on Corruption, have started to put tax transparency—the issue of how much multinational corporations are paying in taxes—on the global agenda.<sup>11</sup> Illicit financial flows became highly visible when states recognized them as a key constraint to domestic resource mobilization in the 2008 Doha Declaration,<sup>12</sup> which states adopted following the International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus.<sup>13</sup> The increasing attention these complex financial transactions are now receiving comes at the same time that the limitations of the Washington Consensus as development orthodoxy have become widely accepted.<sup>14</sup>

Efforts to obtain transparency about how much multinationals are paying tax authorities requires those seeking that information to overcome the high levels of confidentiality that limit how much tax information multinationals are required to disclose. These transactions are also shrouded in an opacity that is facilitated in part by tax havens and secrecy jurisdictions.<sup>15</sup> Transactions in which governments lose large amounts of revenue become public only through concerted efforts, such as when the Panama Papers were disclosed through a coordinated global media project organized by the International Consortium of Investigative Journalists in 2016.<sup>16</sup> In many jurisdictions, multinationals are only required to disclose piecemeal information that does not adequately provide “a globally comprehensive picture of their geographic operations, inter-company transfers or tax-payments.”<sup>17</sup> The importance of overcoming such secrecy was demonstrated when a leaked tax audit report showed that Zambia was collecting only a 0.6 percent royalty on the profits of its major export, copper, following privatization reforms. Under pressure from the public following the disclosure that copper exporters were enjoying high profits while paying extremely low taxes, the government of Zambia increased its royalty rates to 3 percent in 2007.<sup>18</sup>

A major premise of the campaign led by these activist groups therefore is that multinational corporations are operating in developing countries while contributing little to public revenues at a time when these firms are enjoying very large profits.<sup>19</sup> The work of these activist groups and individuals in bringing illicit financial flows to the forefront has resulted in increasing acknowledgement of these flows by the proponents of the Washington Consensus—the WBG and IMF—and even by what is often considered the de facto global tax policy-making

<sup>10</sup> See, e.g., [AFRICAN TAX ADMINISTRATION FORUM](#).

<sup>11</sup> [Illicit Financial Flows Report](#), *supra* note 2; Allison Christians, [Tax Activists and the Global Movement for Development Through Transparency](#), in *TAX, LAW AND DEVELOPMENT* 288 (Yariv Brauner & Miranda Stewart eds., 2013). Among the individuals and groups involved are Bono, Global Witness, George Soros, Mo Ibrahim, Oxfam, and Transparency International. *Id.* at 290–91.

<sup>12</sup> [Doha Declaration on Financing for Development Adopted as Outcome Document of the Follow-up International Conference to Review the Implementation of the Monterrey Consensus](#) (Dec. 2008).

<sup>13</sup> [Report Of The International Conference on Financing for Development, Monterrey Mexico](#) (Mar. 2002).

<sup>14</sup> JOSEPH E. STIGLITZ, [GLOBALIZATION AND ITS DISCONTENTS](#) (2003).

<sup>15</sup> With regard to tax matters, OECD Model Tax Treaties contain structural disadvantages to developing countries because they favor the collection of taxes in the country of a tax-payer’s residence rather than in the country in which the company earns the income that is subject to taxation.

<sup>16</sup> [The Panama Papers: Exposing the Rogue Offshore Finance Industry](#), INT’L CONSORTIUM INVESTIGATIVE JOURNALISTS (2016).

<sup>17</sup> Christians, *supra* note 11, at 293.

<sup>18</sup> Alastair Fraser & John Lungu, [For Whom the Windfalls? Winners and Losers in the Privatization of Zambia’s Copper Mines](#) (Jan. 2007).

<sup>19</sup> Christians, *supra* note 11, at 289.

body, the OECD.<sup>20</sup> In addition, the United Nations in its Sustainable Development Goals has adopted the goal of reducing illicit financial flows.<sup>21</sup>

Multinational corporations are fighting back against this effort to expand the concept of corruption to include illicit financial flows. They have argued, for example, that tax avoidance is legally permissible and should therefore be excluded from the list of targets in the Sustainable Development Goals.<sup>22</sup> In addition, the OECD has sought to limit the broad definitions of illicit financial flows made by tax justice groups. It has done this in part by limiting the direct participation of non-governmental groups in its work. Its main tax policy body, the Business and Industry Advisory Council, is made up of business representatives<sup>23</sup> and does not allow NGOs and non-OECD member countries to participate in its work.<sup>24</sup> The OECD's pushback against the illicit financial flows agenda and the fact that its main policy organs are inaccessible explains why the African Union views the United Nations as the preferable forum in which to advance its agenda.

### *Expanding Corruption's Definition to Include Illicit Financial Flows*

So far, I have argued that corruption as understood in treaties like UNCAC and in policy debates on development primarily focuses on whether there has been bribery of a public official. UNCAC has no binding provisions on internal corporate controls over financial management. This view of corruption grossly underestimates the scope of corruption. By focusing on how corruption extends beyond bribery of government officials, it becomes possible to shed light on the "corrupt" financial transactions that deny revenue otherwise due, especially to developing country governments.

One example of these illicit flows is the practice of "trade misinvoicing." Trade misinvoicing occurs when there is falsification of the quantities and values of exports, creating a difference between the declared value of exports and their actual nature, quantity, or value. Such underreporting of high value exports such as gold from African countries costs these countries billions of dollars in legitimate tax revenue.<sup>25</sup> The Tanzanian government is engaged in a multiyear dispute with a multinational corporation that it alleges did not pay export taxes on some of its exports of gold and copper for several years.<sup>26</sup> In May 2019, Tanzania saw a revenue increase of US\$100 million in the year ending March 2019 over the year ending March 2018, which it attributed to its ratcheting up surveillance, inspection, and audits of gold producers' activities associated with gold exports.

Abusive "transfer pricing" is another example of a potentially illicit financial transaction. It occurs when a multinational corporation with several subsidiaries operating in different countries engages in intrafirm transfers of earnings and income that exploit its joint assets to allocate profits with a view to reducing its overall tax liability.<sup>27</sup> Developing countries do not often have the technical expertise or full information on the assets and profits of global corporations to properly vet the prices declared by these corporations in their transfer pricing transactions

<sup>20</sup> *Id.* at 306.

<sup>21</sup> United Nations, *Sustainable Development Goal 16.4* (2016) (providing that one goal is to "by 2030 significantly reduce illicit financial and arms flows, strengthen recovery and return of stolen assets, and combat all forms of organized crime").

<sup>22</sup> Tom Murphy, *Corporations Secretly Lobbying UN to Allow Tax Avoidance in its Anti-Poverty Agenda*, HUMANOSPHERE (June 23, 2017); see also Simon Bowers, *US Tech Giants Launch Fierce Fightback Against Global Tax Avoidance Crackdown*, GUARDIAN (Jan. 21, 2015).

<sup>23</sup> Christians, *supra* note 11, at 312–13.

<sup>24</sup> Marshall J. Langer, *Harmful Tax Competition: Who Are the Real Tax Havens?*, 21 TAX NOTES INT'L 2831, 2831 (2000).

<sup>25</sup> See, e.g., *Illicit Financial Flows Report*, *supra* note 2 (noting that Africa loses more than US\$50 billion in such flows annually).

<sup>26</sup> Omar Mohammed et al., *Tanzanian Government Accuses Acacia of Mining Gold Illegally*, GUARDIAN (June 12, 2017).

<sup>27</sup> Picciotto, *supra* note 1.

within their jurisdictions.<sup>28</sup> As a result, less wealthy countries are unlikely to receive the full tax benefits of the corporate operations within their jurisdiction. According to one estimate, “corrupt activities such as bribery and embezzlement constitute only about 3% of illicit outflows; criminal activities such as drug trafficking and smuggling make up 30% to 35%; and commercial transactions by multinational companies make up a whopping 60% to 65%.”<sup>29</sup>

There are disagreements about whether transactions such as base erosion and profit shifting should be considered illicit.<sup>30</sup> Base erosion and profit shifting involve “tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid.”<sup>31</sup> Similarly, there are disagreements about characterizing offshore tax avoidance by multinational corporations that plan their tax obligations across hundreds of subsidiaries and in different jurisdictions as illicit transactions.<sup>32</sup> Another example of a tax avoidance transaction takes place when a multinational corporation resides in a developed country that has a “tax sparing” provision in a tax treaty with a developing country. In such a case, a multinational may abusively seek to extend the tax benefits to a non-resident that acts as an intermediary in the developing country in question.<sup>33</sup> The outcome of such a transaction is to deny the developing country the revenue that would otherwise have been paid by such an intermediary.<sup>34</sup>

For misinvoicing, abusive “transfer pricing,” base erosion, and profit shifting to become illegal, there would have to be coordination among states with vastly different interests. The leadership of the African Union does, however, suggest that Africa might be the first region to adopt a norm making these transactions illegal. It could then spread beyond Africa through concerted efforts of the tax justice groups that are pursuing a similar agenda in other parts of the world.

### Conclusion

This essay has argued that anticorruption efforts must be expanded beyond the narrow focus of bribery of governmental officials to include illicit flows of financial resources from developing countries to tax havens and low tax jurisdictions. Transactions such as trade misinvoicing, base-erosion, and abusive transfer pricing are, as a former WBG President argued, a form of corruption that hurts the poor.<sup>35</sup> As we move further from the era of the Washington Consensus, it is time to set aside this overly narrow focus and confront the malfeasance of corporations in the private realm. Recognizing illicit financial flows as corruption would be a significant step towards achieving this objective.

<sup>28</sup> For an example of how one developing country has adjusted, see Attiya Waris, *How Kenya Has Implemented and Adjusted to the Changes in International Transfer Pricing Regulations: 1920–2016* (Int’l Ctr. for Tax & Dev. Working Paper No. 69, 2017).

<sup>29</sup> Masimba Tafirenyika, *Illicit Financial Flows from Africa: Track It, Stop It, Get It*, AFR. RENEWAL (Dec. 2013). According to a joint report by the African Development Bank and Global Finance Integrity entitled *Illicit Financial Flows and the Problem of Net Resource Transfers from Africa: 1980–2009*, “cumulative illicit outflows from the continent over the 30-year period (1980–2009) range from US\$1.2 trillion to US\$1.4 trillion.” Dev Kar, *Illicit Financial Flows from Africa: Causes, Consequences, and Curtailment*, GEO. J. INT’L AFFAIRS (Dec. 14, 2015).

<sup>30</sup> Forstater, *supra* note 1.

<sup>31</sup> Org. Econ. Co-Operation & Dev., *Explanatory Statement to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*.

<sup>32</sup> Miranda Stewart, *Global Tax Information Networks: Legitimacy in a Global Administrative State*, in TAX, LAW AND DEVELOPMENT, *supra* note 11.

<sup>33</sup> A multinational corporation in a country with a tax-sparing treaty could use its foreign corporate subsidiary to achieve this outcome.

<sup>34</sup> See Deborah Toaze, *Tax Sparing: Good Intentions, Unintended Results*, 49 CAN. TAX J. 908 (2001).

<sup>35</sup> *Speech by World Bank Group President Jim Yong Kim: Shared Prosperity: Equal Opportunity for All* (Oct. 1, 2015).