Stolen Asset Recovery: The Need for a Global Effort

Hippolyte Fofack, The World Bank Group[1]

Hippolyte Fofack is a professional and research economist with over 15 years of experience in academia and international development. He is currently responsible for the Macroeconomic and Growth Program at the World Bank Institute, the knowledge and research arm of the World Bank Group.

"As we increase the flow of capital to developing countries, we also need to prevent its illicit outflow. We will work with the World Bank's Stolen Asset Recovery (StAR) Initiative to secure the return of stolen assets to developing countries, and support other efforts to stem illicit outflows." - G-20 Leaders' Statement, The Pittsburgh Summit, September 24-25, 2009.

Background and context

Although illicit financial outflows have been a permanent and growing phenomenon in Africa since the 1970s, the global development and research community turned its attention to the problem only recently (Ajayi and Khan 2001).[2] However, over the last decade, and thanks in a large measure to the work by Global Financial Integrity (Kar and Cartwright-Smith 2010) and by Boyce and Ndikumana (2001, 2003, 2008, 2011), more empirical evidence has emerged to shed light on the scale, magnitude, and dynamics of illicit financial outflows in the region over most of the post-independence period. According to Global Financial Integrity, the cumulative amount of illicit financial flows from Africa between 1970 and 2008 was US$854 billion (Kar and Cartwright-Smith 2010).[3]

Illicit financial outflows from Africa have consistently been on the rise, although there was a slight decrease during the HIPC debt relief implementation in the 1990s. This is in contrast with other developing regions, especially Asia, which has benefited from two positive concurrent effects: large inflows of capital in the form of FDI and significant reduction of illicit financial outflows. Over the period 1970-2010, the stock of capital flight from Africa increased from about US$2.6 billion in 1970 to more than US$1.7 trillion, an increase of over 650 times over the four decades (Ndikumana and Boyce 2012a, 2012b). This exceeds the region's total external debt outstanding of about US$293.8 billion (at end of December 2010).[4]

Economic and social costs of illicit financial outflows

Illicit financial flows undermine the ability of African countries to reach adequate levels of domestic investment needed to accelerate growth (Fofack and Ndikumana 2010). Compared to other regions of the developing world, sub-Saharan African countries recorded the lowest rates of investment over the pre-HIPC decades (Bayraktar and Fofack 2011). For instance, while the East Asian region enjoyed average public investment rates in excess of 30 percent of GDP over 1960-2000, sub-Saharan Africa's average was 15 percent

1 I would like to thank James Boyce, Léonce Ndikumana, Bamidele Olugbuyi Sanya, and Xiao Ye for helpful comments and suggestions on an earlier version of this paper. The views and opinions expressed in this paper are those of the author and do not necessarily reflect the official policy or position of the World Bank.
2 In 2001, Ajayi and Khan edited one of the first monographs ever published on capital flight from African countries, specifically looking at the dynamics of capital flight and external debt.

3 These figures are consistent with estimates derived by Ndikumana and Boyce (2008).
4 This figure excludes Equatorial Guinea, Namibia, and Libya, for which no data are available (Ndikumana and Boyce 2012, Boyce and Ndikumana 2012).

of GDP at its peak in the late 1970s, and it declined after the 1970s to a record low of 7.5% of GDP after the second half of the 1980s (Artadi and Sala-i-Martin 2003). Although investment rates have increased in the post-HIPC period, the aggregate stock of capital remains relatively low, as reflected in extremely low energy intensity and road density (Foster and Briceño-Garmendia 2010).

In the medium and long term, delayed investments owing in part to depleting savings in a context of massive capital outflows have contributed to keeping the tax base narrow in the overwhelming majority of countries, leading to twin structural deficits (fiscal and current account). There has been continued recourse to external financing to bridge financing gaps, which have persisted even in the post-HIPC debt relief era.

Illicit financial outflows also have adverse welfare and distributional consequences for the poor. In particular, they deepen income inequality as they primarily benefit the political elites and a fraction of the urban population connected to the political establishment. Illicit financial outflows jeopardize prospects for inclusive growth through perpetuating high unemployment rates. Furthermore, sustained illicit financial outflows have adverse long-term consequences for individual behavior and for the society as whole. They undermine good governance and weaken government's accountability to citizens. Indeed, one of the most insidious costs of illicit financial flows often neglected is its adverse effects on public institutions and its long-term consequences for social capital.

The Stolen Asset Recovery Initiative

In response to sustained illicit financial outflows from developing countries, the World Bank and United Nations Office on Drugs and Crime (UNODC) established the Stolen Asset Recovery (StAR) initiative, which was launched in September 2007. The link between the StAR and illicit financial outflows is direct. In effect, to the extent that stolen assets are largely proceeds from corruption, the initiative discretely covers a wide range of illicit financial outflows.[5] The proposed initiative has four pillars: empowerment, innovation, advocacy, and partnerships. In practice, StAR works with developing countries and financial centers that offer a wide range of financial services, particularly to international and non-resident clients, to prevent the laundering of the proceeds of corruption and to facilitate more systematic and timely returns of stolen assets.

The work of the StAR has encountered numerous obstacles in its efforts to stem the outflows and return the proceeds of corruption to source countries. Its actions thus far have taken the form of analytical work, partnership, and capacity building. On the latter, a number of governments in the north are organizing in-country capacity building for law enforcement agencies in originating countries on formulating formal requests to recover stolen assets and lowering barriers to assets recovery. On the non-governmental side, the International Centre for Asset Recovery launched by the Basel Institute for Governance in 2008 is assisting developing countries to build capacity through training and information sharing to trace, confiscate, and repatriate the proceeds of corruption.

The legal obstacles to the return of stolen assets include the mismatch between national laws and international agreements. For instance, countries that have ratified the UN Convention against Transnational Organized Crime (UNTOC) are not required to pass laws to criminalize some offenses included in the UN Convention against Corruption (UNCAC). At the same time, the lack of strong institutional mechanisms to ensure state compliance and accountability has also been identified as an important obstacle. For instance, a recent report by

5 Stolen assets are not restricted to financial outflows, however. In addition to money, they also include properties, or other assets amassed through corrupt acts, mainly bribery, embezzlement, misappropriation of property or funds, trading in influence, and abuse of functions in the public sector.

Global Witness found that none of the 24 Financial Action Task Force (FATF) member states are fully compliant with their own recommendations, and in particular recommendation number six requiring banks to perform thorough due diligence on politically exposed persons.

Assessment of Progress under the StAR Initiative

One successful area of intervention has been capacity building. StAR has provided training to more than 500 officials in forty countries in a wide range of areas, including legislative reforms, asset tracing, and international legal cooperation. Through close collaboration and support from StAR, six of the thirty OECD countries have been able to freeze stolen assets between 2006 and 2009, of which four returned assets to foreign jurisdiction over the same period (OECD and World Bank 2011).[6] However, relative to the scale of illicit outflows from the region, the total amount of stolen assets frozen is negligible (about US$135 million) and they include funds from only two countries (Nigeria and South Africa).

However, for the purpose of this study it is important to focus on prevention and repatriation of illicit financial outflows, the two ultimate objectives and acid test of the StAR initiative. Progress on both dimensions can be measured against benchmarks and quantitative targets. The potential benefits of repatriation have been proven to be significant, especially from the standpoint of financing a "Big Push" development model.

In effect, in an empirical study hypothetically assessing the potential benefits of repatriation of capital flight, Fofack and Ndikumana (2010) demonstrate that the gains from repatriation can be significant and largely outweigh the expected benefits from other sources such as debt relief.[7] According to that study, if only a quarter of the stock of capital flight was repatriated to source countries in Sub-Saharan Africa, the region would go from trailing to leading other developing regions in terms of domestic investments and growth.

Although a formal baseline for monitoring and assessing the impact of the StAR initiative over time was not established at inception, progress at preventing the outflows of illicit financial resources can be assessed using the end-December 2007 stock of illicit financial outflows as the baseline. A successful prevention campaign under the proposed initiative would have either completely stemmed the outflows of illicit financial resources or significantly reduced its magnitude in the years following the launch of that initiative. Under these conditions, the continued increase in the cumulative stock of the illicit financial outflows from Africa to international financial centers would have been simply due to compound interest payments, with little or no additional outflows.

However, year-to-year variations in the stock of illicit financial flows since the launch of the StAR have consistently exceeded the expected returns from interest payments. For instance, under the assumption of no repatriation and no additional outflows after end-December 2007, the total stock of illicit financial outflows from African countries, including compound interest payments, would have been about US$1.565 trillion by end-December 2010.[8] Yet, according to the most recent estimates, the stock of capital flight (end-December 2010) is

6 These countries are: Australia, France, Luxembourg, Switzerland, United Kingdom and United States of America (OECD and World Bank 2011).

7 While relief under the HIPC initiative reduces the stock of debt and interest payments, it does not automatically translate into additionality of financing. The "Big Push" option does by instantaneously raising the level of resources available to governments.

8 The figures refer to 33 SSA countries covered in Ndikumana and Boyce's series, updated to 2010, plus four North African countries (Algeria, Egypt, Morocco, and Tunisia).

US$1.685 trillion, implying that new outflows beyond interest payments exceeded US$120 billion over the same period.

At the very least, these figures suggest that illicit financial outflows from Africa have continued to grow unabated since the inception of the StAR initiative. In fact, the largest increase in the amount of illicit financial outflows occurred over the last decade (2000-10), with an annual average of US$45.8 billion, compared to about US$21.3 billion in the 1970s and about US$23.2 billion in the 1990s (Figure 1). These figures point to an overall failure to stem the illicit financial outflows in the StAR era. To the contrary, it is estimated that over US$120 billion have fled the continent as illicit financial outflows since the launch of the proposed initiative in 2007.

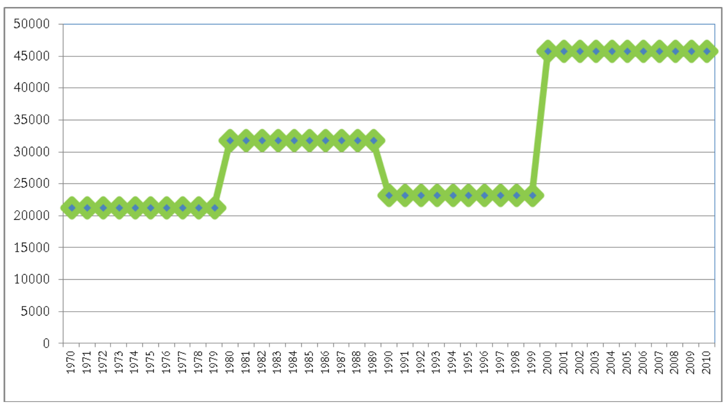

Figure 1: Decennial average annual illicit financial outflows from Africa, 1970-2010 (millions, constant 2010 US dollars)

The recovery of assets looted by President Sani Abacha of Nigeria is often singled out as a success in several reports, including those published by the StAR (Stephenson et al. 2011). That success refers to the recovery of US$505 million from Swiss banks in 2006, representing less than 10% of total resources stolen by General Abacha estimated at about $5 billion. For a country that has an estimated stock of capital flight in excess of US$381 billion (end-December 2010), the amount of recovered assets are insignificant (approximately 0.1%). Moreover the recovery cannot be attributed to the StAR as it occurred a year before the launch of the initiative.

This failure in ongoing efforts to recover stolen assets is not specific to Africa, however. The StAR estimates that at the global level only about US$5 billion in stolen assets has been recovered and repatriated to source countries over the last 15 years (1995-2010), and most of it before the launch of the StAR (Stephenson et al. 2011). In a world where conservative estimates put the stock of illicit financial outflows at several trillion US dollars, this level of recovery rate is obviously disappointing.

The Need for a Global Effort and Renewed Push

A host of reasons have been put forth to explain the relatively poor performance of the StAR at stemming the continued financial hemorrhage and at recovering a significant amount of stolen assets. This is not the place to review these reasons. A report by the StAR outlines 29 different barriers to stolen asset recovery grouped under three different categories: institutional, legal, and operational (Stephenson et al. 2011).[9] In summary, however, it is clear that the poor performance of the StAR is due to four primary factors: the lack of political will in both rich and poor countries, the collusion between the powerful bankers and countries in the north and politicians in the south, collusion between politicians and private sector operators, and absence of sanctions and punitive measures in the face of crime or violation of international conventions.

Unless the different protagonists are enticed or forced to cooperate, with dire consequences as the alternative for failure in compliance, the StAR initiative is unlikely to yield the expected results. Under the current international financial architecture and trading systems, the dominant stakeholders all have interests in preserving the

9 For further details on the different barriers to asset recovery, see Stephenson et al. (2011).

status quo. Politicians who are not exposed under the status quo will continue to accumulate personal wealth, albeit at the expenses of the state and majority of the population. Receiving countries, which benefit in terms of savings and long-term investments, have little incentives to facilitate the repatriation of these assets to source countries or to stem their inflows.[10] Bankers in onshore financial centers and offshore safe havens benefit from large deposits. Even when the funds held in these financial centers are traced, declared illicit, and ultimately frozen, banks continue to benefit from the interest the capital provides as asset recovery procedures prove to be protracted.[11]

One option for overcoming this impasse would be to adopt and institutionalize a system of 'positive conditionality' that would link future loans and balance of payments support to a prior repatriation of stolen assets. In the past such an approach worked rather well for a number of regions, and especially in Latin America where the solution to the debt crisis in the 1980s was inherently linked to the repatriation of capital flight under the Brady Plan (Pastor 1990). In contrast to that plan, the HIPC initiative, which granted debt relief to countries in Sub-Saharan Africa, was not bound by such a conditionality. This may partly explain the exponential growth in illicit capital outflows in the post-HIPC period over the last decade.

On the African side, success in recovering and repatriating stolen assets will require strong political will.[12] Strong political will to embark on a long and winding road to asset recovery by government officials in source countries is fundamental to successful asset recovery. Indeed, the willingness and ability to introduce legislative reforms and prosecute corrupt officials (current and former) despite the power and influence they might wield would be unambiguous signals that the government is serious about recovery. Strong "political will" could also stem outflows through deterrence.

African countries and governments could learn from the successful model in effect in the United States and the United Kingdom, two countries which have singularly labeled illicit capital outflows as a *national security* issue. These countries have established specialized units targeting politically exposed persons who allegedly either hold assets obtained through corruption or have moved such assets through their country (Stephenson et al. 2011). The establishment of such units, along with "positive conditionalities" could send a strong signal to parties complicit in illicit financial transactions—politically exposed persons, private sector operators, and international bankers.

To support such national efforts, the global community needs to fully cooperate by lifting bank secrecy in international cases involving all UNCAC and UNTOC offenses and imposing stiff sanctions against receiving banks in receiving countries. In fact, political will in developed countries is just as important to the process of asset recovery, and will be strengthened if government officials in receiving countries see stolen asset recovery and repatriation as a development issue. Their commitment and cooperation will signal their determination in the fight against global corruption, while at the same time potentially raising development aid effectiveness through increased amount of funds effectively allocated to growth and poverty reduction programs in developing countries.

The recent settlement between the U.S. government and the Swiss-based UBS bank highlighted the impact when there is political will to break down the walls of banking secrecy. In a landmark settlement in 2009, UBS paid hundreds of millions of dollar for U.S. taxes it failed to withhold on the

10 The Egyptian government recently criticized the UK's failure to cooperate in efforts to freeze assets illicitly acquired by the Mubarak's family.
11 The delay is due to the fact that most jurisdictions do not allow for the confiscation and return of assets on the basis of a criminal investigation.
12 Scher (2005) has attributed the inability of the Kenyan government to recover assets allegedly stolen by former President Moi to the lack of political will.

accounts of US customers, and later provided client data and account details of thousands of US clients who were suspected of tax evasion.[13]

More recently, in August 2012, regulators in New York state imposed a US$340 million penalty on Standard Chartered bank to settle allegations of illegal dealing with Iran. The prohibitive costs of such sanctions are a significant deterrent to other financial institutions that may be tempted to violate the sanctions imposed on Iran. In the case of illicit financial outflows from Africa, financial institutions in receiving countries have not faced any risks. This is a major reason for the poor record of the StAR initiative in inducing repatriation of Africa's stolen assets.

Another reason for the poor record of the StAR is overemphasis on 'big fish,' going only after leaders and heads of states. While such action may provide a strong signal and strengthen deterrence of corruption, real success for the StAR initiative will require casting the net wider to target a wider circle of government officials, private sector operators, and multinational corporations.

The evidence shows that those countries that have achieved greater success at recovering stolen assets have gone beyond focusing on the 'biggest fish' to target a much wider range of culprits. For instance, earlier this year, the U.S. government reported that the Internal Revenue Service recovered US$5 billion in back taxes, interest, and penalties from 33,000 taxpayers who admitted holding offshore accounts to avoid taxes. Successfully casting such a wider net, however, requires strengthening specialized enforcement agencies in originating countries and building a critical mass of experts, including forensic accountants, lawyers, financial services analysts, and regulators.

13 For more details, see *Wall Street Journal* article titled "Switzerland, UBS settle US tax case" at the following link: http://online.wsj.com/article/SB125007792394025747.html.

Conclusion

The establishment of the StAR initiative in 2007 was a welcome development. It signaled a recognition that illicit financial outflows have adverse effects for economic growth and development aid effectiveness. These effects take on even greater significance in a time of shrinking development assistance resources and growing budget deficits in traditional donor countries.

But the actual progress achieved under the StAR initiative in prevention and recovery of stolen assets has to date been disappointing. Even as the international development community has turned its attention to the problem, the scale of illicit financial outflows has continued to increase. The StAR has made a contribution in capacity building in originating countries and in analysis of the obstacles to asset recovery. But it has not had a significant impact on the central objectives of slowing the outflows of illicit financial resources and recovering stolen assets.

The time is ripe for a renewed effort using StAR at the global level to accelerate stolen asset recovery. One promising potential action would be the use of positive conditionality in future allocation of development assistance to provide incentives for originating countries to act. Equally essential, however, is action in the receiving countries to adopt and enforce stiff sanctions against governments and financial institutions in receiving countries that are guilty of cooperating with illicit financial transactions.

References

Ajayi, Ibi. 1997. *An Analysis of External Debt and Capital Flight in the severely Indebted Low Income Countries in Sub-Saharan Africa*. IMF Working Paper, WP/97/68. Washington, DC: International Monetary Fund.

Artadi, V. Elsa, and Xavier Sala-i-Martin. 2003. *The Economic Tragedy of the 20th Century: Growth in Africa*. National Bureau of Economic Research Working Paper No. 9865. Cambridge, MA: National Bureau of Economic Research.

Bayraktar, Nihal, and Hippolyte Fofack. 2011. "Capital Accumulation in Sub-Saharan Africa: Income-group and Sector Differences." *Journal of African Economies* 20 (4): 531-561.

Boyce, James and Léonce Ndikumana. 2012. *Capital Flight from Sub-Saharan African Countries: Updated Estimates 1970-2010*. PERI Report, Amherst, MA: University of Massachusetts (October).

Fofack, Hippolyte. 2009. *Causality between External Debt and Capital Flight in Sub-Saharan Africa*. World Bank Policy Research Working Paper No. 5042. Washington, DC: World Bank.

Fofack, Hippolyte, and Léonce Ndikumana. 2010. "Capital Flight Repatriation: Investigation of Its Potential Gains for Sub-Saharan African Countries." *African Development Reviews* 22 (1).

Foster, Vivien, and Cecilia Briceño-Garmendia, eds. 2010. *Africa's Infrastructure: A Time for Transformation*. Washington, DC: World Bank and Agence Française de Développement.

Kar, Dev, and Devon Cartwright-Smith. 2010. *Illicit Financial Flows from Africa: Hidden Resources for Development.* Washington, DC: Global Financial Integrity.

Ndikumana Léonce and James Boyce. 2003. "Public Debt and Private Assets: Explaining Capital Flight from Sub-Saharan African Countries." *World Development* 31 (1): 107-130.

Ndikumana, Léonce, and James Boyce. 2008. *New Estimates of Capital Flight from Sub-Saharan African Countries: Linkages with External Borrowing and Policy Options*. PERI Working Paper Series No. 166. Amherst, MA: University of Massachusetts.

Ndikumana, Léonce, and James Boyce. 2011. *Africa's Odious Debts: How Foreign Loans and Capital Flight Bled a Continent.* London: Zed Books.

Ndikumana, Léonce, and James Boyce. 2012. *Capital Flight from North African Countries*, PERI Report, Amherst, MA: University of Massachusetts (October).

OECD and World Bank. 2011. *Tracking Anti-Corruption and Asset Recovery Commitments: A Progress Report and Recommendations for Action*. Paris: OECD; Washington, DC: World Bank.

Pastor, Manuel. 1990. "Capital Flight from Latin America." *World Development* 18 (1): 1-18.

Scher, Daniel. 2005. "Asset Recovery: Repatriating Africa's Looted Billions." Africa Security Review 14(4): 17-26.

Stephenson, Kevin, L. Gray, R. Power, J. Brun, G. Dunker, and M. Panjer. 2011. *Barriers to Asset Recovery: An Analysis of the Key Barriers and Recommendations for Action*. Washington, DC: World Bank.