

U4 Expert Answer



Impact of international asset recovery and anti-money laundering efforts on poverty reduction and political accountability

Query

What evidence has been gathered of the impact of international asset recovery on the accountability of political elites and on poverty reduction in developing countries? What equivalent evidence exists of the impact of developing country compliance with international anti-money laundering standards? The response should consider, in particular, relevant existing data collection by the World Bank, UNODC and IMF.

Purpose

To describe the empirical evidence of the impact of international asset recovery and anti-money laundering efforts on poverty reduction and accountability of political elites.

Content

1. Introduction
2. Impact of international asset recovery on poverty reduction and political accountability
3. Impact of international anti-money laundering standards on poverty reduction and political accountability

Summary

In recent years there has been a lot of international focus on anti-money laundering and asset recovery in order to mobilise domestic resources for development. However, evidence of the effectiveness of these mechanisms to alleviate poverty and increase accountability of the political elite is few and far between.

1 Introduction

There is international consensus on the fact that stolen assets cause long-term harm to the development agenda. However, the degree of impact repatriated assets can have on poverty alleviation in their country of origin is unclear. Evidence from a few successful cases of asset repatriation show that utilisation of these funds to reduce poverty depend on factors such as political will, clear assignment to priority areas. The use of the funds needs to be monitored not only at the disbursement stage, but also throughout the project implementation process since case studies show that lack of safeguards can lead to funds being misappropriated again.

Author(s): Farzana Nawaz , U4 Helpdesk, Transparency International, fnawaz@transparency.org

Reviewed by: Dr. Finn Heinrich, Transparency International, fheinrich@transparency.org

Date: 17 January 2010 **Number:** 230

Little evidence can be found on the effect of money laundering on poverty. However, many studies postulate that money laundering has adverse effects on long-term economic growth (and, indirectly, on poverty reduction targets) in developing countries, which can exacerbate poverty. At the same time, however, international anti-money laundering standards also face criticism from experts for imposing costly reforms that are not well suited to developing economies and can contribute negatively to poverty, as well.

No empirical evidence was found regarding a potential positive link between international asset recovery or anti-money laundering efforts and enhanced political accountability. However, experts agree that lower barriers to asset recovery and robust anti-money laundering regimes can enhance political accountability by requiring more disclosure of financial information and ensuring better prosecution of the corrupt. Successful implementation of these mechanisms is also expected to deter future corrupt behaviour by the political elite.

Desk research revealed no international effort to systematically measure the impact of asset recovery and anti-money laundering efforts on poverty alleviation and enhancing political accountability. Given the importance of both these mechanisms, it is recommended that more effort be made to measure their impact.

2 Impact of international asset recovery on poverty and political accountability

Stolen assets have grave negative impact on development

Enormous amounts of development funding are lost every year due to corruption. The proceeds of corruption are often transferred from one jurisdiction to another to hide their source. The World Bank estimates that the total global cross-border flow of proceeds from criminal activities, corruption and tax evasion may reach US \$1.6 trillion per year, nearly half of which comes from developing nations. A recent study from Global Financial Integrity also found that losses from illicit flows from developing countries is nearly double that amount – an estimated US\$ 858.6 billion to US\$ 1.06 trillion annually. These figures are particularly troublesome when compared to the annual global aid

flows, which is currently estimated at around US\$ 120 billion. The international community has reached consensus that recovery of these stolen assets is of critical importance for development.¹

The true cost of these stolen assets however exceed their monetary value, they also undermine good governance and weaken a state's accountability to citizens. Long-term impact includes lost opportunity for investment in development work or alleviation of poverty and human suffering. For example, the World Bank estimates that every US\$100 million of recovered money could fund first-line treatment for over 60,000 people with HIV/AIDS for a full year, or drugs for the treatment of malaria for between 50 and 100 million people or 250,000 water connections for poor households, or full immunisations for 4 million children.²

International efforts on asset recovery

The process of recovering stolen assets is immensely complex, time-consuming and costly. Obstacles include the challenge of locating the stolen funds, inconsistent legal requirements across borders, lack of legal expertise in requesting countries, lack of political will in requesting and requested countries, and lack of coordination between national and international agencies.³

Cases where recovery efforts have been successful usually take a very long time and the amounts recovered are only a fraction of the estimated amount stolen. For example, General Sani Abacha of Nigeria is suspected to have looted between US \$3 billion to US\$ 5 billion of public money. Recovery processes started in 1999, and after 10 years of efforts, approximately US\$1.3 billion has been recovered.⁴

In recent years there have been major international efforts to focus on the recovery of stolen assets. The United Nations Convention against Corruption (UNCAC) provides the first global framework to address the issue of asset recovery. Chapter V of UNCAC is dedicated to this topic and dictates that states should take appropriate measures in accordance with their national laws to initiate cases to recover property that has been acquired through corruption.⁵

In order to facilitate the implementation of Chapter V of UNCAC, the United Nations Office on Drug and Crime (UNODC) and the World Bank jointly launched the Stolen Asset Recovery (StAR) initiative in September

2007 with the aim to ensure through international cooperation and collective action that there are no safe havens for the corrupt.

The StAR initiative has focused its work on lowering barriers to asset recovery through policy research, knowledge sharing and technical assistance and training. This has mainly been done by developing the capacity of requesting and requested states to effectively pursue cases. Capacity development initiatives have included areas such as – assistance in developing and filing mutual legal assistance requests, adopting and implementing effective confiscation measures and enhancing transparency and accountability of public financial management systems, creating and strengthening national anti-corruption agencies and monitoring recovered funds.

The success of these international efforts towards poverty reduction is however thus far unproven. The StAR initiative is currently in the process of developing a review mechanism that will evaluate, among other benchmarks, the developmental impact of international asset recovery processes.⁶

Use of recovered assets on poverty reduction – the evidence from successful cases

Monitoring the repatriated funds so that they are actually used for poverty reduction or other development goals is a substantial challenge in the asset recovery process. Little information can be found on systematic efforts to collect data and measure the effectiveness of repatriated funds in reducing poverty in the countries of origin. However, some information can be found on specific cases. Below, we will briefly discuss the utilisation of repatriated funds in Nigeria, Peru and the Philippines, the countries which have seen some of the most important and successful asset recovery cases.

Case of repatriated funds stolen by Sani Abacha in Nigeria

As mentioned above, General Abacha is estimated to have stolen between US\$ 3 billion to US\$ 5 billion of public money during his reign through embezzlement from the public treasury, inflation of the value of public contracts, bribes from contractors and fraudulent transactions. A recent paper by Ignasio Jimu for the Basel Institute on Governance focuses on the utilisation of US\$ 505.5 million which was returned from

Switzerland to Nigeria in September and November 2005.

It was agreed between Nigeria and Switzerland that the repatriated money should go into pro-poor projects under supervision of a neutral third party. The World Bank was chosen as the neutral third party to review the utilisation of resources. The Swiss government, through the World Bank, provided a grant of 280,000 to co-finance the Public Expenditure Management and Financial Accountability Review (PEMFAR) programme, which focused on reforms in budget spending with regards to Nigeria's national economic priorities in education, health and basic infrastructure – power, roads and water. These sectors were chosen by the Nigerian government based on their potential to help the country move towards achieving the Millennium Development Goals. Of the total sum of US\$505 million, US\$168.5 million was allocated to power, US\$144.5 to works, US\$84.1 million to health, US\$ 60.1 million to education and US\$ 48.2 million to water resources. A Nigerian civil society organisation, Integrity, was selected by the World Bank to monitor the use of these funds.

A review of 51 projects across the five priority sectors by Integrity (along with a civil society coalition), found that repatriated funds did in fact increase budget spending in the pro-poor development projects. Analysis of federal budget spending in the 5 MDG sectors of health, education, water, electricity and roads for the 2003 – 2005 fiscal years showed that these sectors received a considerable increase in their allocation level. Moreover, it was found that allocation of the repatriated funds attracted more federal spending to these projects since the overall increase in federal spending in the 5 sectors was substantially larger than the amount recovered from Abacha.

In spite of appropriate allocation of the funds, implementation of the projects faced myriad challenges. The projects suffered from poor budget management – despite specific targets in the five pro-poor sectors, in several instances were found where the spending agencies used their share of the Abacha money to pay outstanding arrears or make payments for ongoing multi-year projects. Sometimes already completed projects were paid for using the repatriated funds. The projects that were undertaken often suffered from weak quality control – the review found that several projects were plagued by poor workmanship, requiring major refurbishment shortly after their completion, lagged behind in schedule or were abandoned even though

they were already fully paid for. Occurrences were also found of 'ghost projects' – funds allocated to projects and sometimes even local government areas that never existed. The civil society reviewers blamed corruption and lack of good faith as major causes underlying the problems. The government itself often created obstacles by withholding funding or hampering the review process by denying access to information such as a complete list of the projects undertaken with repatriated funds.⁷

Case of repatriated funds stolen by Vladimir Montesinos Torres in Peru

Vladimir Montesinos, head of Peru's secret service during the reign of president Alberto Fujimori is suspected to have stolen over US \$220 million (only the amount of funds that could be traced), of which around US\$ 174 million has so far been recovered. The government of Peru created a special fund, the Fondo Especial de Administracion del Dinero Obtenido Ilicitamente en perjuicio del Estado (FEDADOI) to manage the recovered assets. The fund has been managed by a board of five members appointed from different government ministries.

Although detailed procedures and guidelines were developed to ensure transparent use and management of the funds, very little information can be found regarding spending on pro-poor projects. Around US\$ 8.2 million has been allocated to investment in information technology for the judiciary, however, no data could be found on how effective the investment has been so far.

It is alleged that the repatriated assets have mainly ended up supplementing budgets of public institutions that have a member on the board of FEDADOI. According to the World Bank and a report by GTZ, since spending items are not clearly set out in advance, questionable spending allocations were often made from the fund. For example, in 2004 the Interior Ministry received over US\$ 9 million from FEDADOI for the payment of vacations of police personnel for the 1995 and 1996 fiscal years. In another instance, money from the fund was used to pay for around US\$ 400,000 in legal fees towards the repatriation of former president Alberto Fujimori from Chile.

In some instances the funds were used for legitimate causes, which were, however, unrelated to the fight against poverty. For example, some funds were also allocated towards repatriation of victims of misrule during the Fujimori-Montesinos rule. Such

disbursements competed with urgent poverty alleviation programmes.⁸

Case of repatriated funds stolen by Ferdinand Marcos in the Philippines

It is alleged that Ferdinand Marcos siphoned off between US \$ 5 to 10 billion during his reign in the Philippines from 1965 to 1986. In February 2004, after a long and arduous process, the Philippines received US\$ 624 million of the funds back from the government of Switzerland. The money, initially remitted to the Philippines Treasury, was later transferred to an off-budget fund known as the 'Agrarian Reform Fund', meant for land acquisition and distribution and support services.

A number of transactions involving the fund have been questioned for mismanagement and corruption. For example, in 2006, the Commission on Audit reported that a significant portion of the funds was used to finance excessive and unnecessary expenses unrelated to agrarian reform, while other amounts were spent on procuring items at inflated prices. In March 2006, a press release from the Senate President of the Philippines alluded to massive corruption by the Department of Agriculture and some lawmakers in the acquisition of liquid fertiliser for the farmers using the Marcos funds.

Mismanagement and lack of priority setting for the funds led to expenditure such as US\$ 57 million being spent to pay cash advances to the Land Bank of the Philippines, cost of land surveys exceeding the cost of land acquisition (US \$ 33.8 million vs. US\$ 21.1 million) and little accountability and record keeping on the beneficiaries of expenditures.

Furthermore, the Swiss Court decision to repatriate the funds required that one third of it be disbursed to victims of the human rights violations during the Marcos reign. So far, no record can be found of Philippines' authorities compensating the victims.

A brief look into these three case studies demonstrates that effectively utilising recovered assets to fund anti-poverty projects require robust oversight mechanisms. In the absence of such mechanisms, such as the case of Montesinos in Peru and Marcos in the Philippines, recovered assets can be misused in projects that are unrelated to their intended purpose or may be repossessed by subsequent corrupt governments and bureaucrats. As the Abacha case demonstrates, actual implementation of the projects can also fall victim to

corruption, inefficiency and poor political will. Therefore, effective monitoring mechanisms are needed at all levels – from disbursement of resources to implementation of development projects.⁹

Asset recovery and political accountability

No evidence was found on whether successful asset recovery cases lead to greater political accountability in developing countries. International regulatory frameworks, such as the UNCAC state that to enable effective asset recovery it is essential that countries establish sound legal and regulatory frameworks. Such regulatory frameworks should oblige financial, professional and other institutions to introduce systems to ensure that there is proper identification of their clients and that all suspicious financial activity is reported in a timely fashion, among others. Additionally, UNCAC requires national legislation to provide for the tracing, [freezing](#), [seizure](#), [confiscation](#) and repatriation of assets acquired through corrupt means.¹⁰

The StAR initiative is currently focusing on three core components: lowering the barriers to asset recovery, i.e., global knowledge sharing and advocacy; building national capacity for asset recovery; and preparatory assistance in the recovery of assets. As a part of this three-pronged approach, they have devoted much resources to the issue of asset declarations, declaration of interests, and financial disclosures of politically exposed persons.¹¹

The goal of concerted global efforts to lower barriers to asset recovery through requiring financial disclosure of politically exposed persons, enhanced due diligence and “know your customer” requirements for financial institutions and intermediaries, and effective tracing, freezing, seizure, confiscation and repatriation mechanisms is to close down safe havens for the wealth of the corrupt. It is also assumed that a greater probability of being prosecuted and their corrupt proceeds being repossessed will act as a deterrent to corruption for political leaders and ensure more political accountability.

3 Impact of international anti-money laundering standards on poverty and political accountability

AML and poverty reduction

International standards on anti-money laundering (AML) include a range of instruments from the Financial Action Task Force (FATF) recommendations, Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime, the Wolfsberg AML Principles, the UNCAC, the UN Convention against Transnational Organised Crime, UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, to name a few.¹ In this section of the Expert Answer the focus will be on international AML standards in general, without specific, in depth look into any one of these instruments.

A literature review indicates that little evidence can be found on the impact of AML initiatives on poverty. Experts concur that effects of AML on poverty reduction is extremely difficult to measure. Moreover, international AML standards face criticism for their lack of applicability in developing country contexts.

J.C. Sharman of the University of Sydney argues that costs associated with implementing international AML regimes are large, they are growing rapidly and these costs negatively impact the poor by diverting resources from the development agenda, for example, money diverted from anti-AIDS programmes to meet the Financial Action Task Force (FATF) standards. Moreover, indirect costs in both rich and poor countries include higher barriers in opening bank accounts, transferring money across borders or setting up charities. Moreover, he argues that AML standards are designed to fit developed rather than developing economies, which makes them additionally cumbersome for developing countries to adopt.

Referencing a comparative study of the costs and benefits of AML regulations in Barbados, Mauritius and

¹ For a full list of international instruments on AML, please see: [An Overview of the UN Conventions and Other International Standards Concerning Anti-Money Laundering and Countering the Financing of Terrorism](#)

Vanuatu, Sharman illustrates the poor fit of international AML standards for developing countries. For example, in Vanuatu, a poor country where 80 percent of the population is involved in subsistence agriculture, a requirement for photo identification has effectively shut out the large majority of the population from the financial sector. Vanuatu spent four times as much public money regulating its International Financial Services Sector in 2005 than it did in 2000, while the sector now provides only half the money it did in 2000. In Barbados, over 27 percent of corporate service providers state that compliance costs have increased so much that they are now thinking of exiting the market.¹²

International AML standards are also seen as being ineffective in preventing and detecting money laundering in predominantly cash-based economies or in countries where reliance on informal transfer systems is the norm, as is the case in many developing countries.¹³

They are also seen as being unduly restrictive on financial service providers working with low-income people, such as micro-finance institutions. Hernandez-Coss et. al. in a 2005 paper for the World Bank postulated that AML regimes can have negative implications for low-income groups, most notably, microfinance clients who do not own assets that are conventionally accepted as collateral, may be self-employed, or may have uneven streams of income. Microfinance transactions are also generally very small – whether they are savings, credit or transfer. Thus, by definition, such institutions are at lower risk from money laundering. The main challenge for these service providers in complying with AML measures arise from the requirement to undertake customer due diligence and absorbing the potential costs involved in implementing new legislation.¹⁴

International standards such as those promulgated by the FATF also suffer from low levels of implementation and compliance, which makes measuring their impact difficult. For example, a recent report by Global Witness found that none of the 24 FATF member states are fully compliant with their own recommendation to require banks within their countries to perform due diligence on politically-exposed persons.¹⁵

A recent report by the Eastern and South Africa Anti-Money Laundering Group (ESAAML) found that there is a generally low rate of successful prosecutions for money laundering in the region. In spite of ratification of

international treaties such as the UNCAC, the implementation of measures against money laundering remains inadequate. For example, member countries have generally not yet adopted rules for the identification and application of enhanced scrutiny of politically exposed persons (PEPs) as required by the narrow approach in the FATF recommendations or the broad prescriptions of the UNCAC. The authors concluded that this points to the need for a review of the effectiveness of the implementation of anti-money laundering measures in the member countries.¹⁶

Money laundering and economic development

While a direct link between money laundering and poverty is difficult to establish, many experts have pointed out that money laundering has negative effects on economic development, which in turn impacts poverty.

B.L. Bartlett in a 2002 report for the Asian Development Bank argued that money laundering damages the financial sector institutions that are critical to economic growth, reduces productivity in the economy's real sector by diverting resources and encouraging crime and corruption and can distort long-term economic development. Effective AML policies, on the other hand, reinforce a variety of good governance policies that help sustain economic development.¹⁷

Similarly, the 2006 World Bank and IMF reference guide on AML argues that money laundering has particularly significant economic and social consequences for developing countries since those markets tend to be small and more susceptible to disruption from criminal sources. Money laundering also reduces foreign investment, weakens financial institutions and damages privatisation efforts.¹⁸

In spite of the adverse consequences of money laundering pointed out in these research pieces, no evidence was found that shows that the implementation of AML regimes has a positive effect on economic growth.

International AML standards and political accountability

Similar to asset recovery, no empirical evidence was found that indicates that international AML standards lead to enhanced political accountability in developing countries. However, as with asset recovery, it is

assumed that better legislative efforts and implementation and enforcement of AML will force better accountability on the part of the political elite. In fact, a robust AML regime is seen as a prerequisite for an effective asset recovery system.¹⁹

A comprehensive AML regime would require financial, professional and other institutions to introduce systems to ensure that there is proper identification of their clients and that all suspicious financial activity is reported in a timely fashion. International standards such as those promulgated by the FATF ensure that these requirements are harmonised between jurisdictions, denying the corrupt safe havens for their illicit wealth.

International frameworks such as the UNCAC which recommend creation of separate criminal offences for money laundering lower the barrier to legal prosecution since they do not require a conviction on a separate substantive offence. Success of these international frameworks and standards in increasing accountability among the political elite, however, is contingent upon their effective implementation and enforcement.²⁰

Further reading

[World Bank, Stolen Asset Recovery \(StAR\) Progress Report, October 2009](#)

[Marco Arnone and Pier Carlo Padoan, Anti-Money Laundering by International Institutions: A Preliminary Assessment, CIDEI Working paper No. 74 – February 2007](#)

[Ignasio Jimu, Managing Proceeds of Asset Recovery: The Case of Nigeria, Peru, the Philippines and Kazakhstan, Basel Institute on Governance Working Paper, October 2009](#)

[The World Bank and UNODC, Asset Recovery \(StAR\) Initiative: Challenges, Opportunities, and Action Plan](#)

[World Bank and IMF, "Reference Guide to Anti-Money Laundering and Combating the Financing of Terrorism", Second Edition, 2006](#)

[B.L. Bartlett, "The Negative Effects of Money Laundering on Economic Development", The Asian Development Bank Regional Technical Assistance Project No.5967, May 2002](#)

[Eastern and Southern Africa Anti-Money Laundering Group, An Assessment of the Links between Corruption and the Implementation of Anti-Money Laundering Strategies and Measures in the ESAAMLG Region, May 2009](#)

[Raúl Hernández-Coss, Chinyere Egwuagu, Jennifer Isern and David Porteous, AML/CFT Regulation: Implications for Financial Service Providers that Serve Low-income People, The World Bank, 2005](#)

[J.C. Sharman, The Global Anti-Money Laundering Regime and Developing Countries: Damned if they Do, Damned if they Don't, 2006](#)

[J.C. Sherman and P.S. Mistry, "Considering the Consequences: The Development Implications of Initiatives on Taxation, Anti-Money Laundering and Combating the Financing of Terrorism", The Commonwealth Secretariat, 2008](#)

References

¹ [Transparency International Working Paper, Recovering Stolen Assets: A Problem of Scope and Dimension](#)

² [The World Bank and UNODC, Fact Sheet on Asset Recovery](#)

³ [U4 Brief, The Recovery of Stolen Assets](#)

⁴ [Case of Sani Abacha, Asset Recovery Knowledge Centre](#)

⁵ [UNCAC, Chapter V, Article 53\(a\)](#)

⁶ [StAR Progress Report](#)

⁷ [Ignasio Jimu, Managing Proceeds of Asset Recovery: The Case of Nigeria, Peru, the Philippines and Kazakhstan](#)

⁸ [Ignasio Jimu, Managing Proceeds of Asset Recovery: The Case of Nigeria, Peru, the Philippines and Kazakhstan](#)

⁹ [Ignasio Jimu, Managing Proceeds of Asset Recovery: The Case of Nigeria, Peru, the Philippines and Kazakhstan](#)

¹⁰ [Asset Recovery: Legal and Regulatory Frameworks](#)

¹¹ [StAR: Asset and Income Declaration Guide Concept Note](#)

¹² [J.C. Sharman, The Global Anti-Money Laundering Regime and Developing Countries: Damned if they Do, Damned if they Don't](#)

¹³ [J.C. Sherman and P.S. Mistry, "Considering the Consequences: The Development Implications of Initiatives on Taxation, Anti-Money Laundering and Combating the Financing of Terrorism"](#)

¹⁴ [R. Hernandez-Coss, C. Ekwuagu, J. Insen and D. Porteous, "AML/CFT Regulation: Implications for Financial Service Providers that Serve Low-Income People"](#)

¹⁵ [Global Witness, 'Undue Diligence: How Banks do Business with Corrupt Regimes](#)

¹⁶ [An Assessment of the Links between Corruption and the Implementation of Anti-Money Laundering Strategies and Measures in the ESAAMLG Region](#)

¹⁷ [B.L. Bartlett, "The Negative Effects of Money Laundering on Economic Development"](#)

¹⁸ [World Bank and IMF, "Reference Guide to Anti-Money Laundering and Combating the Financing of Terrorism"](#)

¹⁹ [Asset Recovery: Legal and Regulatory Frameworks](#)

²⁰ [Asset Recovery Knowledge Centre: Anti-Money Laundering](#)