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Evidence of illicit financial flows from developing countries placed in Germany

Query

Do enough publicly available sources exist that suggest Germany is an important financial centre for corrupt elites from the developing world?

Purpose

To inform work for German authorities on Illicit Financial Flows.

Content

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Summary

Public assets illegally obtained from developing countries are often hidden in banks located in the financial centres of developed countries. Global Financial Integrity estimates losses in developing countries between USD 723 billion and USD 844 billion per year in 2009. As a key financial centre in the world, it is likely that Germany provides a stable investment environment for corrupt elites from developing countries who are intent on layering and integrating criminal proceeds. However, due to the illicit and secret nature of such transactions, it is difficult to get a precise figure, and there is very limited publicly available evidence on the role Germany plays in the process.

However, a few reports have recently uncovered suspicious transactions between German Banks and allegedly corrupt elites from Turkmenistan and Libya. Other studies have highlighted the lack of transparency of the German financial system which could leave room for the placement of ill-gotten wealth in the country.

There is limited evidence that Germany is an important financial centre for corrupt elites from the developing world. However, Germany still does not do enough to preventing illicit financial flows originating from tax evasion, corruption, and other criminal activities to enter the country.

1 Introduction

According to Global Financial Integrity (GFI), illicit money is ‘illegally earned, transferred, or utilised. If it breaks laws in its origin, movement or use it merits the label’. Given the nature of the activity, accurate measurement of the amount of illegal monies circulating at the global or country level may not be feasible (Tax Justice Network, 2011). The funds which are moved

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across borders originate from three major sources: corruption, criminal activity, and cross-border tax evasion (Tax Justice Network, 2011). The Stolen Asset Recovery (StAR) Initiative estimates that cross border illegal flows of money could add up to $1 – 1.6 trillion per year, about half of this coming from developing and transitional economies and likely linked to corruption (StAR, 2007). Global Financial Integrity estimates losses in developing countries between USD 723 billion and USD 844 billion per year in 2009 (GFI, 2011).

Public assets illegally obtained from developing countries are often hidden in banks located in the financial centres of developed countries. Examples from Nigeria, Peru, and the Philippines show that ill-gotten wealth is often laundered through the use of shell corporations, banks and front companies, as well as in real estate and other assets in developed countries, among others (StAR, 2007).

2 Evidence of illicit flows from developing countries placed in Germany

Overview

Germany is a key financial centre in the world. Economic conditions and infrastructure provide a stable investment environment for corrupt elites from developing countries who are intent on layering and integrating criminal proceeds (Financial Action Task Force – FATF, 2010). Besides being large, the German financial system is also very open. Total banking sector assets exceed EUR 8.1 trillion in 2010, and deposits by non-residents in German financial institutions exceed EUR 1.3 trillion (FATF, 2010), which makes Germany the fifth largest holder of private non-resident deposits in the world (Hollingshead, 2010).

In this context, it is likely that corrupt money passes through its banks (Tax Justice Network, 2011). However, due to the illicit nature of such transactions, it is difficult to establish a precise figure. There are only a few studies/reports which suggest that ill-gotten wealth from corrupt elites from developing countries is placed in German banks.

Evidence

Anecdotal evidences

The Financial Action Task Force (FATF) Mutual Evaluation on Germany (2010) which focus on money laundering and terrorist financing states that in 2004 EUR 7.277.041 in assets from corruption proceeds were frozen in Germany. In 2005, the amount frozen increased to EUR 12.946.661, decreasing to EUR 2.900.715 in 2007.

In 2011, several newspapers published that Mohammar Gadhafi, Libya's autocrat, had several bank accounts in Germany. According to the German Government, Gadhafi's account with the German Central Bank has a balance of EUR 1.96 billion. Other amounts are distributed among approximately 200 accounts in different financial institutions in Germany. Some of the funds are registered to the Libyan Central Bank or to the Libyan Foreign Bank. Others are registered directly at Gadhafi's name, of one of his sons, as well as of his wife (Newbacher, Schmitt and Schulz, 2011). Of those accounts, around EUR 6 billion were frozen by German authorities in 2011 (Tax Justice of Network, 2011)

In addition, a report published by Global Witness in 2009 uncovered that the Deutsche Bank has been holding accounts of the Turkmen Central Bank since the 1990's. While the bank claims that such accounts were state accounts, in practice they appeared to be under the effective control of the former President Niyazov. Niyazov's regime has been accused of numerous human rights violations and for handling the country's natural resources wealth in an opaque manner (Global Witness, 2009). Not surprisingly, the country is perceived as highly corrupt.

According to the report, Turkmenistan has one of the largest gas reserves in the world, and has earned more than USD 5 billion from gas trade in 2007. Nevertheless, it seems like the country's natural resources wealth is not part of the government's budget, making almost impossible for the population (or anyone) to keep track of how the money is actually being spent. Moreover, considering the level of human development and other socio-economic indicators, it would appear that such wealth is not being used for the benefit of the population as a whole (Global Witness, 2009), which makes even more questionable the fact that the Deutsche Bank would cooperate with the Turkmenistan's President. Deutsche Bank refused to disclosure any information on the Turkmen account, as well as on possible accounts held by Niyazov's himself or his family (Global Witness, 2009).

Financial Secrecy evidences

The Tax Justice Network Financial Secrecy Index[1] (2011) places Germany in the ninth position out of 71 countries, with 57 secrecy points (out of 100 meaning high secrecy), behind Switzerland, Cayman Islands, Luxembourg, Hong Kong, USA, Singapore, Jersey, and Japan (See Mapping Financial Secrecy, Tax Justice Network, 2011).

The country report raises several concerns with regard to the German financial sector. Of particular interest is the fact that the country has not signed effective tax information exchange agreements with a large number of countries, particularly with developing countries where a significant amount of tax-related illicit flows usually comes from. Additionally, there are concerns related to Germany's relative low level of reporting of suspicious transactions (Tax Justice Network, 2011).

Reports from the Financial Intelligence Unit (BKA) and BaFin – Bundesanstalt für Finanzdienstleistungsaufsicht - do not contain significant amounts of information related to suspicious transactions. For instance, the Financial Intelligence Unit Annual Report 2010 states that 13 cases of 'politically exposed person' out of 194 cases were selected for further monitoring, without further details. In 2009, six out of 114 cases involving politically exposed persons were monitored, and only three cases in 2008 (Financial Intelligence Unit, 2010). In comparison, in the United States, between 2009 and 2010, there were 1294 suspicious activity reports related to 'politically exposed persons' (World Compliance, 2011).

In addition, Germany also scores relatively poorly on the Basel Anti-Money Laundering Index (2012), which indicates a country's risk level in anti-money laundering/terrorist financing and other related factors such as corruption and political risk. Germany ranks 69th out of 144 countries, with a score of 5.8, on a scale from 0 (low risk) to 10 (high risk), behind countries Switzerland, Mexico, and Angola. Similarly, the Financial Action Task Force (FATF) Mutual Evaluation report on money laundering concludes that, although Germany has introduced a number of measures in recent years to strengthen its anti-money laundering framework, it is still not fully in line with the FATF recommendations, particularly with regards to sanctions for non-compliance.

While this evidence is not enough to suggest that Germany is an important financial centre for corrupt elites from the developing world, they demonstrate that the country, falls short in preventing illicit financial flows originating from tax evasion, corruption, and other criminal activities.

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[1] "The Financial Secrecy Index is a tool for understanding global financial secrecy, corruption and illicit financial flows. By ranking secrecy jurisdictions according to both their secrecy, and the scale of their activities, it allows a politically neutral ranking of the biggest players", Tax Justice Network, 2011.

3 References

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Further resources on illicit financial flows can be found online at **www.u4.no**

U4 Theme

International Drivers of Corruption

http://www.u4.no/themes/international-drivers-of-corruption/

Some global mechanisms allow corruption to be a profitable crime. Find out how to deal with the negative impact this brings to developing countries.

Globalisation has been beneficial in many ways. However, the structures that facilitate legitimate businesses and international financial transactions are also used for illicit purposes: laundering proceeds of corruption, generating illicit flows out of development countries, paying bribes or evading taxes. These mechanisms create incentives for corrupt behaviour in developing and developed countries and need solutions at local and international levels.

Explore this U4 Theme online to find out more:

- Understand the basics about how these mechanisms impact upon corruption and development
- Find out what the international community is doing to address the problem
- Learn how anti-money laundering rules can be used to counter corruption