U4 Expert Answer

Anti-Corruption Resource Centre
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TRANSPARENCY INTERNATIONAL
the global coalition against corruption

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How could anti-corruption interventions tackling global corruption benefit the UK?

Query

We wish to identify areas of strong evidence that can illustrate how the UK's attempts to combat international corruption, at home and overseas, can also help to secure the UK's national interests in terms of prosperity (better business links, increasing access to open and fair markets, more trade opportunities), migration flows, terrorist threats and reputational risks.

Purpose

This request is designed to inform international anti-corruption business cases and the design of a cross-UK government anti-corruption strategy.

Content

1. Trade, growth and competitiveness
2. Overseas development assistance
3. Security, crime and migration
4. References

Caveats

There are few studies specifically related to the UK. The literature typically focusses on the benefits of anti-corruption interventions in broader terms.

Summary

As a country looking to expand and deepen trade with emerging markets, a leading player in overseas development assistance and a major destination for illicit financial flows, the UK has a crucial role to play in tackling global corruption.

Corruption has been shown to adversely affect economic growth and market demand in developing countries, while firm-level studies demonstrate corruption's detrimental effect on firm growth, innovation and productivity. Research also demonstrates how corruption undermines global trade, exacerbates conflict, and facilitates organised crime and illegal migration.

This brief discusses the numerous ways in which anti-corruption efforts are in the UK's national interest by improving the business environment, establishing fairer markets and countering security threats. In countries in receipt of UK development aid, targeted assistance can help to improve institutions and the regulatory regime, helping to build more prosperous, secure and resilient partners.

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Date: 24 August 2016 **Number:** 2016: 14

1. Trade, growth and competitiveness

There is an overwhelming weight of evidence that corruption has a detrimental effect on a range of factors key to providing economic opportunities. Corruption is harmful to:

- growth (Ugur & Dasgupta 2011; Glaeser & Saks 2006; Aidt 2009)
- international trade (Ali & Mdhillat 2015; Dutt & Traca 2010; De Jong & Udo 2006)
- market openness (Hakkala et al. 2008)
- return on investments (Lambsdorff 2003)
- foreign investment inflows (Thede & Gustafson 2012; Mathur & Singh 2013)
- and business competitiveness and productivity (Fisman & Svenson 2007)

Corruption stacks the deck against competitive, innovative and entrepreneurial companies seeking to expand their overseas operations. Revealingly, 55% of 1,400 CEOs questioned in a recent PwC (2016) survey identified bribery and corruption as a threat to their business's growth prospects.

International trade

Background: the UK in international trade

According to the latest available figures from HM Revenue and Customs, UK exports were worth £24.9 billion in June 2016, while imports were £40.2 billion (HMRC 2016). In 2015, exports represented 27% of the UK's GDP, whereas imports were equivalent to around 29% (ONS 2016a). Over the past 18 months, the value of non-EU trade has ranged between 51% to 62% of UK exports and 44% to 53% of imports (HMRC 2016).

Both the nature of the UK's top exports (mechanical appliances, motor vehicles, pharmaceutical products, electronic equipment and aircraft (HRMC 2016)) and the kinds of export markets in which UK firms operate entail corruption risks. A number of the UK's top trading partners include countries like Russia, India, Turkey, China and Saudi Arabia (HMRC 2016), in which UK companies can be exposed to elevated risks of coercive or collusive corruption (Transparency International 2014).

Alongside the trade in goods, the UK has rising stock of foreign direct investment (FDI) in markets and industries with high associated risks of corruption. In 2014, over 60% of UK FDI was outside of the EU (ONS 2016a). Between 2005 and 2014 alone, UK outward FDI to African countries doubled from £20.8 to £42.5 billion (ONS 2016b). Over half of this investment in Africa was in mining and quarrying (ONS 2016b), a sector judged to be the most corrupt in an OECD (2014a) study, which found the extractives industry accounted for 19% of all foreign bribery cases.

Corruption and international trade

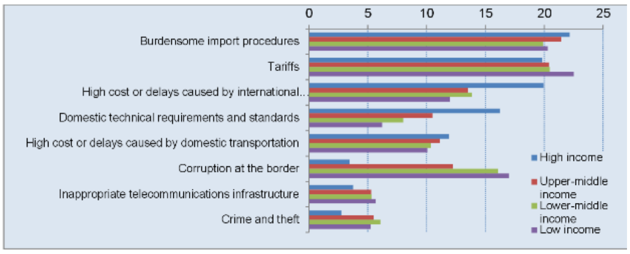
Broadly speaking, corruption functions as an obstacle to trade in two main ways.

First, corruption has a long-term detrimental impact on the regulatory environment and the efficiency of the state apparatus as it creates incentives for politicians and public officials to create more regulations, restrictions and administrative procedures to have more opportunities to extort payments from citizens and companies. This, in turn, is likely to exacerbate rent-seeking behaviour and breed inefficiencies as the practice of obstructing matters until facilitating payments have been made spreads across the public service (Argandoña 2004; Dzhumashev 2010). Unsurprisingly, studies show strong associations between corruption, protectionist regimes and opaque bureaucratic systems (Bjørnskov 2009; Bandyopadhyay & Roy 2007). This is particularly problematic for the business environment, as corruption subverts the fair awarding of contracts, reduces the impartiality and reliability of public services, distorts the allocation of credit and skews public expenditure (Transparency International 2011a).

Second, there is now a widespread view that corruption acts as a non-tariff barrier to trade, raising transaction costs and obstructing foreign investment (Zurawicki & Habib 2010; Ali & Mdhillat 2015; Dutt & Traca 2010; De Jong & Udo 2006). Firm-level data on informal payments from the 2010 World Bank Business Environment and

Enterprise Performance Survey found that in some European countries bribery imposed an additional tax on businesses representing as much as 10% of their sales (World Bank 2014).

Figure 1: The most problematic factors for importing and exporting



Source: World Trade Organisation 2015

Worldwide, 15% of firms expect to have to pay a bribe to get an import licence, and this acts as a severe deterrent to market entry (World Bank 2014). This is especially the case for UK firms; a 2015 survey found that 43% of UK compliance and legal professionals indicated they had decided against doing business in a particular country due to high corruption risks (Control Risks 2015).

Even where foreign companies are able to gain a foothold in a corrupt market, studies have shown that greater levels of corruption are associated with higher firm exit rates, suggesting that corrupt environments are highly unstable for businesses (Hallward-Driemeier 2009).

Efforts to curb corruption are a central component of measures to boost trade. This is increasingly recognised by business leaders; a survey of 390 senior executives revealed that 70% believed a better understanding of corruption would make them more competitive, help them make smarter investment decisions and enter new markets (PwC 2008a).

The UK has a range of options to pursue anti-corruption interventions abroad in ways which can benefit UK firms.

Reducing corruption in emerging markets

Particularly in transition countries, initiatives to curb corruption in public administration often involve reducing red tape and streamlining administrative processes to reduce officials' arbitrary discretion and opportunities to solicit bribes (Martini 2013). The OECD (2016) emphasises that strategies to promote integrity in trade should strike an appropriate balance between easing red tape and establishing appropriate controls which take into account local context and inherent risks.

Bilateral initiatives such as technical anti-corruption assistance or seconding officials to local administrations in emerging economies can help reduce the necessity of "insider knowledge" of bribery patterns, middlemen and intermediaries. In turn, this has potential to lower business costs, reduce uncertainties and reputational risks, lessen vulnerability to extortion and make access to capital easier (Transparency International 2009). Targeted efforts to curb corruption have been shown to yield significant benefits to improve the regulation of the business environment (Breen & Gillander 2012).

As well as helping to make the business environment more conducive to inward investment and market entry by foreign firms, measures to reduce corruption in key markets have the potential to stimulate greater market demand by unleashing greater economic growth and increasing disposable income (Aidt 2009).

A 2010 study found that more effective control of corruption in sub-Saharan Africa had the potential to dramatically increase trade volume in general and imports in particular (Musila & Sigue 2010).[1] This has the potential benefit of improving UK firms' access to existing markets and opening new opportunities in others.

Implications for the UK

UK firms are reportedly (Control Risks 2015) the most hesitant in the world to conduct business in

[1] The authors estimate that if a country with the same corruption perception index as the African average of 2.8 were to improve its corruption level to Botswana's 5.9, its exports would improve by about 15% and imports by about 27%.

countries perceived to be highly corrupt. Analysis of capital outflows confirms that businesses from countries like the UK have tended to make fewer investments in highly-corrupt environments relative to multinationals from other countries with higher levels of corruption (Sanyal & Samanta 2008; Godinez & Garita 2016; Cuervo-Cazurra 2006). At present then, pervasive corruption in foreign markets carries clear domestic costs for the UK; corruption functions as a damper on job creation which could otherwise be generated by export-led business expansion.

Effective measures to tackle corruption in overseas markets could put UK firms at lower risk of coercive corruption, encouraging them to make use of their competitive advantages on a level footing with companies from countries with higher levels of corruption. Moreover, as risks are reduced, trade opportunities open up for smaller companies which cannot afford the same level of internal controls as larger firms.

Promoting transparency and anti-bribery measures at the international level

Secondly, at the international level, the promotion of transparency and strong anti-bribery provisions helps make the global market more open and competitive.

The UK is a standard setter in this area, which brings both reputational and commercial advantages to UK firms. Particularly since the passing of the UK Bribery Act, UK firms have been compelled to implement stringent compliance programmes which mean they are well-placed to conduct business worldwide without fear of falling foul of anti-corruption provisions. Such anti-corruption legislation is increasingly viewed positively by business leaders. The majority of businesspeople surveyed by Control Risks (2015) believed anti-corruption laws improve the business environment (81%), deter corrupt competitors (64%) and make it easier for good companies to operate in high-risk markets (55%). These laws are seen to make it easier to resist coercive corruption in risky markets, as firms can use the risk of prosecution as justification to refuse, and, consequently, officials in these countries are less likely to demand bribes (Control Risks 2015).

Collective action to harmonise standards in international trade

Alongside legalistic approaches, for which it is difficult to establish a global standard, coordinated attempts to push the anti-corruption agenda forward at global forums and international conferences is an effective means of rapidly establishing such norms.

As was seen at the London Anti-Corruption Summit in May 2016, countries are increasingly prepared to enter “coalitions of the willing” to collectively pioneer higher standards, moving further and faster than more globally representative international forums. Whereas countries are rarely willing to “go it alone”, multilateral initiatives on beneficial ownership, open contracting or blacklisting corrupt companies demonstrate the effectiveness of UK leadership and extent of its normative influence. This can help allay fears that the UK is going too far, too fast.

A prominent example of how international anti-corruption initiatives can benefit businesses is the World Customs Organisation’s SAFE Framework of Standards. This can help level the playing field by standardising the submission of electronic data on inbound, outbound and transit cargo shipments. Countries joining the SAFE framework are required to implement harmonised risk management frameworks and collaborate with requests from other countries to inspect high-risk cargos. The SAFE scheme is also beneficial for compliant businesses, as they are eligible for authorised economic operator status, granting them faster processing of their goods and reduced examination rates (World Customs Organisation 2015).

More broadly, participation in good governance initiatives such as the Open Government Partnership (OGP) also has the potential to improve competition. The spread of digital technologies, such as open data and e-procurement, can help to reduce both corruption and accusations of corruption, which can result in lengthy legal proceedings. For instance, e-procurement systems can help UK firms to bid fairly with local enterprises and make the award decisions more transparent and comprehensible, helping UK companies to understand how to improve the quality of their bids. Given that between 30% to 40% of companies report losing bids due to corrupt procurement processes (PwC 2008a; Control Risks 2015), these systems can be very useful to businesses entering new markets.

Implications for the UK

Encouraging UK firms to commit to voluntary initiatives like the United Nations Global Compact (2016) or the Export Trading Group's Global Anti-Corruption Policy could also help raise awareness about the importance of anti-corruption in all aspects of a firm's business and create a culture of compliance. Business commitment to voluntary initiatives like these can also help overcome collective action dilemmas by normalising ethical behaviour (OECD 2016a).

Embedding transparency provisions into trade agreements

Transparency is fundamental to reduce information asymmetries in complex markets; it underpins the ability of companies to fully understand the conditions and constraints for entering and operating in a given market (OECD 2016a).

Improving the transparency of the trading environment is an important complement to traditional trade deals which seek to reduce tariffs and barriers. Greater transparency in trade deals can help to increase both market awareness by making trade policies better known and understood by foreign suppliers, as well as improving the predictability of trade policies by opening up the decision-making process (OECD 2016a).

Given the importance of future projections to business decisions, it is no surprise that trade agreements with extensive transparency mechanisms are found to be have a greater positive effect on trade flows than those with shallow commitments to transparency (Lejárraga & Shepherd 2013).
A study of the Asia-Pacific Economic Cooperation (APEC) countries, for instance, found that improving trade-related transparency could raise inter-APEC trade by approximately US$148 billion or 7.5% of baseline trade in the region (Helble, Shepherd & Wilson 2009).

Countries seeking trade deals are increasing using negotiations not only as a vehicle to enlarge their market access but also a means to reduce market opacity (Lejárraga 2013). The B20 Group, which represents businesses from the G20 countries, has been vocal in support of such approaches (OECD 2016a).

Moreover, the desire of some countries with high incidences of corruption to establish trade relations can provide an opportunity to table sensitive issues surrounding governance, accountability and transparency as part of the negotiations (OECD 2016a). Both bilateral and multilateral trade agreements can contribute to efforts to curb cross-border bribery by including commitments to ratify global anti-corruption conventions such as the OECD Anti-Bribery Convention or specific clauses depriving transactions found to be corrupt from the standard investment protection provided for in the agreement (Lejárraga & Shepherd 2013; Tushe 2014).

Supporting suppliers and partners to comply with anti-corruption provisions

Having been a pioneer of regulating domestic firms, the UK could support suppliers and partners in foreign markets to become fully compliant with anti-corruption standards. Not only is this in the interest of suppliers' upstream UK counterparts and partners but there is a solid business case for promoting anti-corruption measures across supply chains, regardless of the risk of detection.

Corruption commonly affects business growth and productivity, lowering performance, innovation and long-term growth prospects (Starosta de Waldemar 2012; Rossi & Dal Bo 2006). Some studies (Fisman & Svenson 2007) have shown that corruption and bribe paying has a negative correlation with firm growth: a 1% increase in the bribery rate is associated with 3% reduction in firm growth.
A lax corporate culture can inculcate unethical and unsustainable business practices or lead to internal fraud. If detected, the costs and sanctions, as well as reputational impact, can be

extremely costly for companies, who in many cases see their average shareholder value plummet. Revealingly, 55% of business surveyed by PwC (2008b) stated that reputational fallout was the most damaging aspect of corruption cases.

Companies which comply rigorously with anti-corruption stipulations can reap substantial benefits, such as reduced exposure to internal fraud, greater confidence in the integrity of business partners and lower sanctions in legal proceedings due to self-reporting (Wickberg 2012). In some emerging markets, such as the Philippines and Brazil, a reputation for compliance with anti-corruption standards can grant companies a “preferred supplier status”, giving them preferential access to procurement processes (Wickberg 2012). Likewise, both the WTO Agreement on Trade Facilitation and the European Union’s Community Customs Code require member states to provide authorised economic operator (AEO) status to firms who had established internal integrity controls, supply chain security and compliance with customs requirements (World Trade Organisation 2014). This status often permits AEO firms to profit from simplified import and export procedures (OECD 2016a).

Implications for the UK

Measures by the UK government to support anti-corruption among the suppliers and partners of UK multinational corporations are in the interest of all parties. Not only does it check potentially damaging business practices and reduce companies’ exposure to corruption risks, it could enable UK firms to expand their market presence to new parts of the world while still meeting international stock exchange demands for supply chain control (OECD 2016a).

Such efforts are, however, dependent on the continued effective enforcement of legislation with extraterritorial reach, such as the UK Bribery Act and the US Foreign Corrupt Practices Act (FCPA).

Active enforcement of existing anti-corruption measures

Legislation implementing the OECD’s Convention on Combatting Bribery of Foreign Public Officials in International Business Transactions, such as the UK Bribery Act or the US Foreign Corrupt Practices Act, have influence beyond their borders, especially with multinationals. As the UK Bribery Act also applies to all non-UK companies with UK operations, the act has created a compliancy standard for major western companies (Cooper 2011). Given that the nationality of investors and owners of foreign affiliates is becoming increasing blurred, and multinationals involve on average three jurisdictions (UNCTAD 2016), the interlinked nature of global commerce means that national legislation has ever-greater potential for global impact. JPMorgan Chase, for instance, requires companies that want to become suppliers to comply with their anti-corruption policy that refers to the FCPA and the UK Bribery Act (Wickberg 2012).

Active enforcement of the Bribery Act, alongside efforts to detect and prosecute those who break the law has the potential to establish a strong, global anti-bribery “norm”, which in the long term could ease businesses’ entry into difficult markets and create fairer marketplaces.

Some businesses nevertheless view the Bribery Act as an unfair handicap to UK firms seeking to do business abroad, particularly in tough markets like the BRICS countries: Brazil, Russia, India, China and South Africa (FTI Journal 2013). Such criticism is in line with several academic studies which suggest that international anti-bribery conventions have increased transaction costs between signatory countries and importers from highly-corrupt countries (D’Souza 2012).

However, recent surveys of businesses have found that although UK companies are cautious about investing in risky markets, this was the case before the Bribery Act came into force (Control Risks 2015). Moreover, after an initial period of wait-and-see, it seems that companies from the countries with the toughest laws and enforcement, such as the UK, are increasingly willing to take bold investment decisions (Control Risks 2015). The suggestion is that stringent legislation has compelled companies to adapt their business practices, and anecdotal evidence indicates that comprehensive risk management strategies, compliance training and internal audits are enabling the best companies to negotiate corrupt marketplaces more successfully than their competitors (Control Risks 2015).

Moreover, by factoring corruption risks into their investment decisions, companies are becoming more efficient; firms from countries with stringent anti-corruption provisions are reporting fewer losses to corrupt competitors compared with a decade ago (Control Risks 2015). According to a recent OECD (2016) report, a reputation for probity can be useful in helping firms to win public tenders and secure lucrative joint ventures.

Foreign direct investment

Corruption is a key determinant of FDI origin and destination (Cuervo-Cazurra 2006), and there is substantial evidence that corruption acts as a tax on FDI (Thede & Gustafson 2012; Mathur & Singh 2013). Indeed, in high-growth transition countries, corruption has been identified as the most important determinant of investment growth – ahead of firm size, ownership, trade orientation, industry, GDP growth, inflation and openness to trade (Asiedu & Freeman 2009).

Datasets (Belgibayeva & Plekhanov 2016) confirm a virtuous cycle between investment flows and control of corruption:

- there are greater investment flows between countries with good control of corruption
- as corruption decreases, investment from countries with lower incidences of corruption increases
- as the quality of a county's institutions and control of corruption improves, the country may even attract less investment from countries with widespread corruption
- greater investment volumes from less corrupt countries can further reinforce the strengthening of economic and political institutions that keep corruption in check

Implications for the UK

Efforts to reduce corruption in high-risk markets have the potential to edge out competitors from countries with higher incidences of corruption. Moreover, the virtuous circle described above is not only good for UK business looking to invest overseas, it also implies anti-corruption interventions abroad could increase the volume of inward FDI into Britain as levels of corruption among the UK's trading partners decrease.

This is particularly significant for emerging markets, which despite becoming an increasingly significant source of FDI outflows (UNCTAD 2016) often suffer from high incidences of corruption. A survey (Control Risks 2015) found that business leaders in economies such as Nigeria, Mexico, Brazil, India and Indonesia largely welcome measures to level the playing field and address the inconsistent enforcement of domestic anti-corruption laws.

Many of these countries are involved in collective action initiatives like the Open Government Partnership, and enhanced collaboration with foreign states and businesses could potentially lead to positive spillover effects, such as closer economic ties.

Tax policies and illicit financial flows

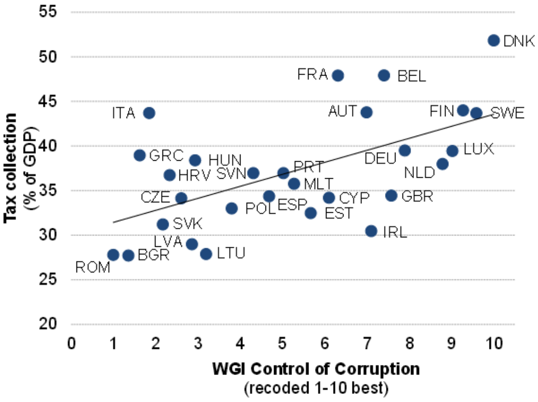
Corruption can affect government revenues in a number of significant ways. Studies have consistently demonstrated that corruption:

- reduces tax revenues (Coppier no date; Rose-Ackerman 1975; Schleifer & Vishny 1993)
- exacerbates tax evasion (Rangazas, Moumouras & Ivanyna 2010)
- inflates government spending (Hwang 2002)
- weakens tax administrations (Hwang 2002)
- undermines the productivity of "effective" government expenditure (Ghosh & Neanidis 2010; Nawaz 2010)

Other work has demonstrated that the distributional effects of corruption in the tax system are socially regressive, as the richest taxpayers have the most to gain from evading taxes and are the least vulnerable to extortion (Hindriks, Keen & Muthoo 1999).
The net effect of all this is to decrease steady-state growth rates and leads in some cases to governments raising tax rates (Ghosh & Neanidis 2010). In contrast, measures to improve control of corruption are strongly associated with better

performance in tax collection (Ajaz & Eatzaz 2010).

Figure 2: Corruption and tax collection in the EU



Source: Mungiu-Pippidi 2016

Most academic papers and NGO activism on this topic centre on the implications for developing countries, as corruption strips low-income states of revenue which could be used to finance key public services, weakens their financial systems and causes long-term damage to their economic potential (Hakenrath 2014).

However, more recent work considers both the role that industrialised countries play in enabling practices such as BEPS[2] and secrecy jurisdictions, as well as the negative impact on developed countries themselves (Hakenrath 2014).

Particularly since the 2008 financial crisis led to yawning fiscal deficits, governments of developed countries have increasingly acknowledged the need to prevent tax leakages (The Guardian 2013; Hearson 2014). Academic work confirms that these problems are not limited to developing countries; a cross-country survey found that corruption is also a significant determinant of tax performance in high-income countries (Bird & Martinez-Vazquez 2008). Another study of US counties found that taxation's marginal impact on growth depended sharply on local corruption levels, and suggested that reducing corruption would have a greater positive impact on growth than lowering tax rates (Aghion et al. 2016). Moreover, higher local corruption was found to weaken the positive effects of lowering taxation on growth, innovation and business entry (Aghion et al. 2016).

Tax, international business transactions and illicit financial flows

Certain kinds of taxation are particularly vulnerable to corruption. These are generally revenue streams with frequent interaction between different tax authorities and businesses. Analysis has shown that taxes and customs duties on international trade are among the most targeted by corrupt officials (Imam & Jacobs 2007). Indeed, corruption can distort the very composition of government revenue; cross-national studies have found that countries with higher incidences of corruption generally increase taxes on international trade rather than domestic taxes (Hwang 2002).

As well as public sector corruption being strongly detrimental to cross-border trade, other forms of corruption facilitate illicit behaviour on the part of private sector enterprises, which may seek to avoid legitimate taxation in their countries of operation (Sahadat 2015). In recent years, increasing attention has been paid to illicit financial flows (IFFs) (World Bank 2016), defined by the OECD as "resources generated by methods, practices and crimes aiming to transfer financial capital out of a country in contravention of national or international laws" (OECD 2014b).

Although only a small percentage of IFFs are believed to be directly linked to embezzlement and bribery (Schneider 2010), corruption is closely linked to many practices that facilitate these flows: it helps companies, individuals and criminal organisations to evade taxes or launder the proceeds of criminal activities and avoid punitive measures (Chêne 2011). According to Global Financial Integrity, every percentile increase in the corruption control indicator showed a decrease in illicit financial flows (Kar & LeBlanc 2013). Developing and emerging economies with high

[2] BEPS, or base erosion and profit-shifting refers to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations.

incidences of corruption are therefore particularly at risk: one estimate states that between 2003 and 2013, these countries lost US$6.6 trillion to illicit financial flows (Kar & Spanjer 2014).

Implications for the UK

While this transfer of wealth from low-income countries to developed economies may not appear to be particularly damaging to the recipient states, in developing countries illicit flows reduce public income, crippling long-term growth, leading to high inequality and larger fiscal deficits (De La Croix & Delavallada 2009; Depken & Lafountain 2006). In turn, this drastically lowers demand for industrial goods or services provided by advanced economies (Global Financial Integrity 2015).

Moreover, “transfer pricing” arrangements between entities in the same supply chain may also operate to the detriment of revenue collection in developed countries, as taxable income is also minimised in these jurisdictions (Hearson 2014). In 2009, investigative journalists from The Guardian revealed how some firms had established themselves as a UK company tax-resident abroad with brands owned in a third country (The Guardian 2009). Other companies were found to deliberately accrue enormous debts in its UK operations to minimise taxable profits (Ritter 2015).

Efforts to tackle the enabling ecosystem of illicit financial flows have great potential to protect tax bases both in the UK and in overseas countries where UK businesses operate. Any measures seeking to tackle IFFs must nevertheless build upon the effective implementation of national anti-corruption policies such as those on anti-money laundering. Several studies have shown that addressing problems like tax evasion and IFFs in isolation is ill-advised and ineffective, and that comprehensive anti-corruption measures are a key ingredient to success (African Union Commission 2012; Rangazas, Moumouras & Ivanyna 2010).

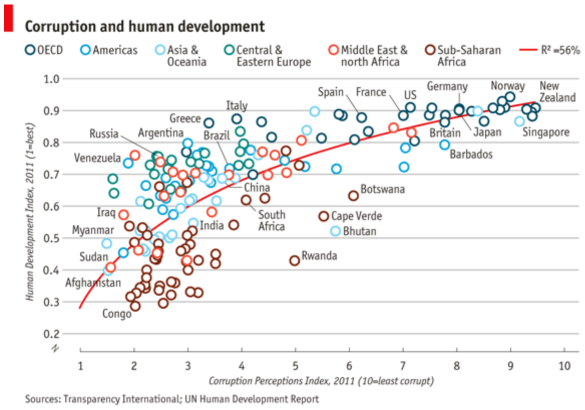
A U4 brief on tax-motivated IFFs recommends looking at tax issues through an “anti-corruption lens” focused on building integrity and transparency of governance institutions, increasing financial transparency in areas such as tax havens and beneficial ownership provisions and enhancing international cooperation in enforcement (Hearson 2014).

Finally, there is also the question of reputational risk. In its evidence to Parliament’s International Development Committee in 2012, DFID noted that the UK is a common staging-post or destination for many of the proceeds of illicit financial flows due to its position as a leading global centre of financial and legal services (DFID 2012). Indeed, the UK’s position as a target for attempts to launder ill-gotten gains and its perceived inaction over tax havens is a challenge to the UK government’s efforts to coordinate international action against global corruption (Sachs 2016; Oxfam 2016).

2. Development cooperation

There is substantial evidence for a strong, positive correlation between control of corruption and human development. Plotting Transparency International’s Corruption Perceptions Index against the United Nation’s Human Development Index (a combination of health, wealth and education indicators) clearly demonstrates this trend (Kaplan 2012).

Figure 3: Corruption and human development



Source: Kaplan 2012

The relationship between these two indicators is confirmed by regional studies, which demonstrate that in both the Asia Pacific (Rajasa 2014), and sub-Saharan Africa (Nguemegne 2011), corruption adversely affects human development once other variables like growth, welfare expenditures and political system have been controlled for. Other analyses at both cross-regional (Akçay 2006) and national level produce similar results (UNDP 2003).

Corruption is particularly damaging for human development as it retards income growth and denies lower-income groups access to basic health care (Ortega, Casquero & Sanjuan 2016). An IMF working paper found that a one standard deviation point increase in corruption resulted in an income reduction for the poor of 7.8 percentage points a year (Gupta, Davoodi & Alonso-Terme 1998).

While the nature of the relationship between trade liberalisation and human development is hotly contested (Malhotra 2004; Hamid & Amin 2013), better outcomes in health, education and poverty reduction have the potential to spur greater market participation and generate increased demand for goods and services in emerging economies (UNDP 2006). A number of studies have pointed to the existence of a virtuous cycle between human development and trade (Ranis & Steward 2006; Davies & Quinlivan 2006; Rui 2013; Banik no date).

Moreover, relationships between donor and recipient countries can also entail spillover into commercial relations: a recent study found that each dollar of German overseas development assistance was associated with an average increase of $0.83 of German goods exports, and that these aid-induced gains could be associated with the gross employment of over 200,000 German workers (Martinez-Zarzoso et al. 2016).

Aid therefore contributes powerfully to economic growth, trading relations and human development in developing countries (Kosack & Tobin 2006). Anti-corruption policies play a central role in both improving development outcomes and ensuring value for money of development assistance programmes. Donor agencies are uniquely placed to support these kinds of anti-corruption interventions abroad.

The role of donor agencies

The position of development agencies as contact points between developing and developed countries make them the perfect partners to provide support to anti-corruption work, which can be programmatic or case-based in nature.

The majority of donor agencies' anti-corruption work is likely to be programmatic. Anti-corruption interventions can target the demand side (related to improving the quality of public institutions), the supply side (working with civil society and the private sector to improve accountability), or a combination of the two. The UK is a leader in the field, using overseas development assistance for a variety of innovative anti-corruption programmes designed to reduce corruption in countries such as Nigeria, Uganda and Ghana (DFID 2016; Chr. Michelsen Institute 2016).

Donor agencies are also well-placed to support investigations into foreign bribery. Given that such investigations require close interaction and communication between different types of institutions in the donors' home and host countries, donor agencies can also act as bridges and mediators between governments and domestic companies (De Simone and Zagaris 2014). Cased-based approaches to anti-corruption, such as asset recovery, can be very fruitful. One OECD estimate is that for each $1 spent on investigating the proceeds of corruption originating from the developing world and transferred to OECD countries, up to $20 has been tracked and frozen, a significant proportion of which was repatriated to the country of origin (OECD 2014b).

Implications for the UK

According to OECD Development Assistance Committee statistics (2016b), over a third of UK aid flows to the least developed countries in the world, including Ethiopia, Bangladesh, South Sudan, the Democratic Republic of the Congo, Afghanistan, Sierra Leone and Tanzania, all of which rank poorly in governance indicators (Transparency International 2015).

Anti-corruption integrity measures within development programmes are therefore crucial to ensure that taxpayers' money is being spent effectively and not contributing to underlying corruption in the country of operation.

3. Security and crime

Security

Threats to global security range from pandemics and climate change to cybercrime and terrorism. Effective responses to such challenges require stable governments committed to combatting threats as they emerge. Corruption is a crucial consideration in these discussions for a number of reasons. Firstly, corruption is both a product and a driver of instability and conflict as it undermines the rule of law and faith in public institutions (Rodrik, Subramanian & Trebbi 2004). Corruption thus cripples the ability of governments in fragile or conflict-ridden states to tackle security threats.

Second, corruption is a crucial enabling mechanism for organised criminality and terrorism. Where corruption is widespread, it can stymie regulatory and governance systems. This allows criminals to cleanse and launder profits from illicit black markets in human beings, weapons, drugs, conflict diamonds, poached ivory, illegally harvested timber and oil from terrorist-controlled territories.

The criminal underworld and authoritarian regimes alike rely on corruption to siphon off their ill-gotten gains, fund their illegal activities or even finance terrorist organisations abroad. Failing regimes with weak and unstable institutions provide the perfect breeding ground for a multitude of security threats.

Third, corruption can prevent effective responses from the security services, allowing criminals to escape investigation and prosecution. This is covered in a previous Helpdesk answer on corruption in security services.

Prioritising anti-corruption efforts should be seen as one way to help strengthen security; anti-money laundering provisions can thwart terrorist organisations, while tackling corruption in developing countries can reduce incentives to emigrate and mitigate the destabilising effects of grand corruption and state capture.

Fragile states and conflict

Corruption exacerbates conflict in three significant ways: it creates conditions in which conflict is likely to occur, fuels and maintains existing armed struggles (O'Donnell 2006), and weakens peace-building and peace-keeping efforts (Le Billon 2008; World Bank 2011). In this way, corruption helps to generate and prolong conflict and forces people to leave the afflicted areas (North, Wallis & Weingast 2013; Chayes 2015).

The fragility of a state is not only shaped by the forces that attempt to undermine or confront it, but also by its ability to provide essential goods and services for its citizens. Failure to do so can result in grievances, and ultimately the rejection of dysfunctional official institutions can play into the hands of extremist and criminal organisations able to offer surrogate structures (Dix, Hussmann & Walton 2012).

Corruption is therefore a driver of diminished security; a 2010 study found that economic downturns caused by corrupt flows out of the country were prime triggers for conflict when a certain party did not benefit from corrupt resources themselves (Andvig 2010).

A good example of this is Yemen, which was the fifth largest source of illicit capital from the developing world between 1990 and 2008, during which time about US$12 billion was looted from the country (Hill et al. 2013). Constant capital flight from the country, both from public funds and through tax evasion, contributed to the years of economic stagnation that culminated in the 2011 uprising against the government. Since then, instability and fragility have led to an increase in capital flight, lowering the country's tax base and public resources, and creating a vicious cycle of conflict and economic disparity (Midgley et al. 2014).

Corruption also plays a large role in facilitating cross-border smuggling of weapons and insurgents. Whether to maintain followers or to purchase weapons and supplies, large sums of capital are essential. Conflicting parties generally want to keep the amounts and sources of this capital secret as it may derive from illegal activities, external sources (which may prompt other states to financially assist opposing parties), or from the state itself – as is the case with bribery or embezzlement (Ralston 2014).

Corruption can also keep conflict going, even if the state is subjected to arms or trade embargos. Schneider (2010) notes that both states and arms dealers use illicit flows to keep conflicts funded and supplied by using hard-cash transfers or letters of credit issued by banks to exchange commodities for supplies. Private sector companies, often headquartered in developed countries, can also be implicated in such systems; some timber companies in Africa have been found to be acting as middlemen between armed rebels and financial institutions, purchasing arms and materials, trafficking weapons and selling timber in exchange for part of the profits extracted from forestry (African Union Commission 2012).

Implications for the UK

According to the World Economic Forum's Global Competitiveness Report, the cost of terrorism to the UK not only increased between 2014 and 2015, but is higher than in most EU countries. In this particular indicator, the UK ranks 82/144 countries (World Economic Forum 2016). Reducing terrorism abroad is therefore one way to reduce costs for UK businesses and make them more competitive.

Corrupt practices offer an ideal channel for terrorists, particularly those of the state-funded variety (Zdanowicz 2009). Many terrorist organisations, like the FARC forces of Colombia, illegally extract minerals, such as gold or tungsten, and sell them to large multinational companies to finance their activities (Bargent 2013; Gomez 2012). Similarly, transnational terrorist organisations, like Hezbollah, the Islamic State, Al Qaeda and Hamas, have developed extensive multinational networks to finance themselves with the use of secret jurisdictions and offshore banks (Baker & Joly 2008). Such mechanisms directly affect organisations' ability to carry out terrorist attacks against the UK, its allies and its interests.

International crime

Transnational criminal organisations capitalise on corruption in the financial system to cover up the origin and use of profits derived from criminal activities. They tend to shift profits abroad to avoid domestic law enforcement from detecting, seizing or freezing these funds (Shelley 2005). Indeed, profits from crime or generated by criminal organisations constitute the largest component of illicit financial flows in the world (30% to 35%), ahead of transfer mispricing, tax evasion or outright corruption (Baker & Joly 2008).

Much of the financial, drug trafficking and organised crime of the type which directly affects the UK depends on these kinds of mechanisms. Measures to prevent such criminal activity depend on detecting, investigating and prosecuting corruption occurring at the interface between domestic and international markets.

DFID-funded anti-corruption investigation teams, such as the Proceeds of Corruption Unit and the Overseas Anti-Corruption Unit, have enjoyed some successes in this field; by their own calculation investigating over 150 cases of overseas bribery, successfully prosecuting 27 individuals and recovering £200 million of stolen assets (DFID 2015). The recent formation of a dedicated International Corruption Unit at the UK National Crime Agency (NCA) with a clear remit to investigate international corruption cases with a bearing on the UK is encouraging.
There are, however, concerns that neither complex commercial fraud nor international corruption cases are NCA priorities (The Wall Street Journal 2016), and ongoing uncertainty about the future role of the Serious Fraud Office, which, unlike the NCA, is a non-ministerial independent body (Transparency International 2014).

Implications for the UK

Future steps to tackle international criminality in the UK could involve greater efforts to investigate the inflow of "dirty money" into the UK, notably into the property market (Simmon & Simmons 2016). Deeper cooperation with authorities in other jurisdictions, particularly the United States and Switzerland, could also be helpful in this regard (Covington 2015).

Other initiatives also have the potential to aid UK authorities' attempts to clamp down on illicit behaviours. Two notable examples would be the reform of the Suspicious Activity Reporting mechanism (which only led to the blocking of seven transactions in 2014), and the introduction of Unexplained Wealth Orders as in Iceland and Australia (Simmon & Simmons 2016). A previous Helpdesk response on unexplained wealth orders as an anti-corruption tool may be of interest here.

Migration

There is evidence of a clear but nuanced correlation between higher levels of corruption and increased motivation for migration. The literature surrounding migration and its causes identifies a lack of economic opportunities and a lack of security as two key drivers of legal and illegal migration (Poprawe 2015). As described above, there is ample evidence that corruption has an impact on economic opportunities and security, and thus operates as an indirect driver of migration (Wheatland 2016).

Studies also find that corruption in its own right can act as an incentive for migration out of corrupt countries and towards countries with lower levels of corruption (Poprawe 2015; Cooray & Schneider 2014). Schneider (2015) argues that as well as retarding economic growth, corruption can lead to a situation in which jobs are no longer distributed fairly, leading to workers seeking to migrate for job opportunities.

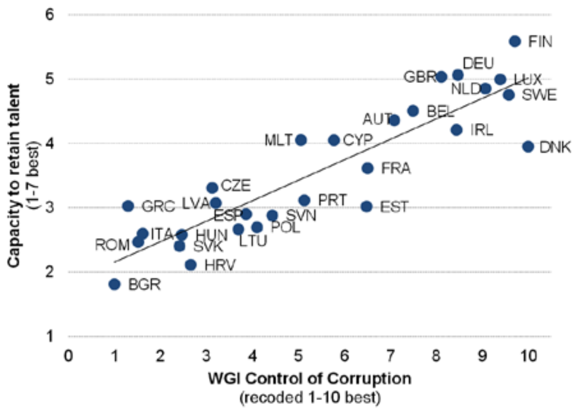
Corruption affects migration in two particularly salient ways: brain drain and illegal migration.

Brain drain

Recent research has investigated the role corruption plays in exacerbating "brain drain" from low-income countries (Dimant, Krieger & Meierrieks 2013). Notably, corruption is a determinant of *who* becomes a migrant. While emigration increases across the board with higher levels of corruption, once a certain threshold of corruption is surpassed, it is generally the affluent and educated who emigrate.

Studies suggest this is because corruption is naturally accompanied by increasing levels of both income inequality and liquidity constraints, which in turn disproportionately impairs the ability of low- and middle-skilled inhabitants to emigrate (Cooray & Schneider 2014). Tackling corruption in countries of origin is believed by some academics to be a means of reducing levels of brain drain (Dimant, Krieger & Meierrieks 2013).

Figure 4: Brain drain and the control of corruption in the EU



Source: Mungiu-Pippidi 2016

Illegal migration and human trafficking

Corruption both facilitates trafficking and magnifies illegal migratory flows by destabilising democracies, weakening rule of law and development. At the same time, trafficking, which can involve global or regional networks, contributes to a country's corruption as it relies on pay-offs to police, judges and ministers at all levels (Transparency International 2011b).

As increasing numbers of displaced people seek safe refuge in Europe, people smuggling has become increasingly lucrative and ruthless. Corruption is central to the modus operandi of people smugglers and human traffickers, enabling them to circumvent law enforcement, border protection and immigration controls (Rusev 2013). Officials are bribed to obtain or overlook migrants' documents, or waive controls or regulations (OECD 2015). Refugees and illegal migrants can be a lucrative source of additional income to border officials and organised criminal gangs (Koser 2008). A 2015 investigation found that illegal immigrants smuggled to the UK from Afghanistan and Pakistan found that, on average, smugglers' fees were around 250% of a household's annual income (Al Jazeera 2015).

Corruption is therefore a major obstacle to the prevention, detection and control of people smuggling. Moreover, illegal migration is closely linked to illicit financial flows: money laundering is a central component of concealing the origins of the proceeds from people smuggling (OECD 2015).

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