

Illicit Financial Flows

Background Note

The Financing for Development outcomes all stress the importance of improving national tax systems and enhancing revenue. Both Monterrey and Doha address the question of return of stolen assets. Doha also notes that “it is vital to address the problem of illicit financial flows, especially money laundering.” The Addis Agenda takes this call a step further by outlining a range of actions and commitments in relation to illicit financial flows (IFFs), including a commitment to redouble efforts to substantially reduce IFFs by 2030, with a view to eventually eliminating them. The Addis Agenda also commits Member States to eliminate safe havens that create incentives for IFFs and for the transfer abroad of stolen assets. It invites international institutions to publish estimates of the volume and composition of illicit financial flows. The Inter-agency Task Force on Financing for Development is mandated to follow-up on these commitments, and is further mandated by General Assembly resolution A/RES/71/213 to analyse the issue.

In September 2016 members of the Inter-agency Task Force held a meeting to map out a way forward, with specific reference to estimation of the volume of IFFs. Despite the commitment to reducing and eventually eliminating illicit financial flows, there is as of yet no firm agreement on conceptual and definitional issues related to the term IFFs. There are, however, some parameters that members of the Task Force agreed on, namely: i) illicit financial flows constitute money that is illegally earned, transferred or used and ii) that crosses borders. Three types of flows are generally considered, which are not mutually exclusive or comprehensive: IFFs originating from criminal activity; corruption-related IFFs; and tax-related IFFs. However, within this definition differences remain, particularly on how to treat tax-related IFFs. Tax avoidance practices such as base erosion and profit shifting are often in grey areas between legality and illegality because of differences in legal standards across countries, weak legal systems in some countries, and different interpretations and acceptance of norms on international taxation.

The lack of an agreement on a definition makes developing methodologies for monitoring and assessment of progress difficult. There are also well-known disagreements and dissatisfaction with some of the methods currently utilized to estimate the volume of IFFs. In part, the problems stem from continued lack of conceptual clarity, but fundamentally, given the illicit nature of the flows, approaches to estimates will have problems in accurately capturing the phenomenon due to inadequate and incomplete sources of data.

Estimating flows – a component by component approach

At the IATF meeting, experts debated whether to aggregate different types of flows and activities into a single measure called IFFs. A majority of the participants were strongly against one single measure. Most participants supported work on improving measurement for separate components and activities. Participants felt that the different channels for IFFs are not comparable, that aggregation could result in double-counting, and that looking at channels separately would be more beneficial in determining and designing policy responses. However, some participants noted that a single headline number could be a powerful tool for garnering political attention and generating political will for policy changes.

Components of IFFs for which estimates have been made include: proceeds of crime, stolen assets, goods trade mis-invoicing, profit shifting & transfer mis-pricing, and undeclared or untaxed offshore wealth. However, there were disagreements at the Task Force meeting about the best estimation methodologies to use. The quality of the estimates and their comparability over time and across countries are variable, particularly because of the lack of robust data in most sectors. Goods trade mis-invoicing estimates are some of the most frequently cited, in part because they rely on relatively robust evidence from trade databases. This method was used for regional estimates of goods trade mis-invoicing in Africa, Latin America by UNECA (Mbeki panel report) and CEPAL, respectively. UN ESCAP is also launching a similar exercise. UNCTAD employs a related methodology to analyse mis-invoicing in primary commodities at the product level in a number of commodity dependent developing countries. However, trade mis-invoicing only covers one mechanism for transfer of illicit flows. Illicit flows can also flow through services, the capital account, or internal transactions of multinational enterprises.

At the IATF meeting, it was agreed that as a first step for broader estimation, the Task Force will map the different components and the current status of data and estimates, in order to begin building on the efforts and identify data gaps.

Policy responses and questions

Policy responses can focus on attacking IFFs at the source (where the money is earned), at the transfer (i.e. through trade, capital transactions, or transfer mis-pricing), or at the destination (where the money is used). Technical cooperation and capacity building for national action at the source is a critical component of any work. This includes better enforcement by tax administrations, more effective customs administrations, financial intelligence units, and prosecutions. There are important roles for ODA, South-South Cooperation, joint enforcement action, peer learning, and other types of capacity building. One key area for work raised at the IATF meeting was conducting risk and vulnerability assessments at country level based on size/volume of transactions that could pose IFF risk, and the risk arising from the counterparty to the transaction.

Policy responses in relation to the transfer are not always unique to each component of type of IFF. Some policy responses will improve data and enforcement across multiple different channels and against multiple motivations or IFFs. Others might focus on a single component, for example strengthening customs enforcement capacity could be targeted specifically at goods trade mis-invoicing. International cooperation is also important in the three main sectors of IFFs: transnational crime, corruption and tax. These are all addressed in other sections of the Addis Agenda, and there are extensive international processes underway.

One role for the Task Force may be to focus on measurement and better tracking of IFF. Progress can be made through better use of the data that will be generated by recently agreed changes in international norms, such as exchange of beneficial ownership information, automatic exchange of information in relation to financial accounts, and country-by-country reporting of multinational enterprise accounts. The IATF could also assess the implications of policy changes particularly for developing countries, including which countries might benefit the most.