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Coherent policies for combatting Illicit Financial Flows

United Nations Office on Drugs and Crime (UNODC)
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United Nations Office on Drugs and Crime (UNODC)/ Organisation for Economic Co-operation and Development (OECD)

Commitments – Addis Ababa Action Agenda: *We commit to pursuing policy coherence and an enabling environment for sustainable development at all levels and by all actors and to reinvigorating the global partnership for sustainable development (para 9). We recognize the importance of policy coherence for sustainable development and we call upon countries to assess the impact of their policies on sustainable development. (para 103). Regulatory gaps and misaligned incentives continue to pose risks to financial stability, including risks of spillover effects of financial crises to developing countries, which suggests a need to pursue further reforms of the international financial and monetary system. We will continue to strengthen international coordination and policy coherence to enhance global financial and macroeconomic stability. (para 105). Building on the vision of the* ***Monterrey Consensus****, we resolve to strengthen the coherence and consistency of multilateral financial, investment, trade and development policy and environment institutions and platforms and increase cooperation between major international institutions, while respecting mandates and governance structures. We commit to taking better advantage of relevant United Nations forums for promoting universal and holistic coherence and international commitments to sustainable development (para 113). We underline the need to promote peaceful and inclusive societies for achieving sustainable development and to build effective, accountable and inclusive institutions at all levels. Good governance, the rule of law, human rights, fundamental freedoms, equal access to fair justice systems and measures to combat corruption and curb illicit financial flows will be integral to our efforts (para 18). We will redouble efforts to substantially reduce illicit financial flows by 2030, with a view to eventually eliminating them, including by combating tax evasion and corruption through strengthened national regulation and increased international cooperation (para 23). We urge all countries that have not yet done so to ratify and accede to the* ***United Nations Convention against Corruption****, and encourage parties to review its implementation. We commit to making the Convention an effective instrument to deter, detect, prevent and counter corruption and bribery, prosecute those involved in corrupt activities and recover and return stolen assets to their country of origin. We encourage the international community to develop good practices on asset return. We support the* ***Stolen Asset Recovery Initiative*** *of the United Nations and the World Bank and other international initiatives that support the recovery of stolen assets. We further urge that regional conventions against corruption be updated and ratified. We will strive to eliminate safe havens that create incentives for transfer abroad of stolen assets and illicit financial flows. We will work to strengthen regulatory frameworks at all levels to further increase transparency and accountability of financial institutions and the corporate sector, as well as public administrations. We will strengthen international cooperation and national institutions to combat money-laundering and financing of terrorism (para 25). We will effectively strengthen national institutions to combat* *money-laundering, corruption and the financing of terrorism, which have serious implications for economic development and social cohesion. We will enhance international cooperation for capacity-building in these areas at all levels, in particular in developing countries. We commit to ensuring the effective implementation of the* ***United Nations Convention against Transnational Organized Crime*** *(para 112).*

Commitments – 2030 Agenda for Sustainable Development: *Sustainable development cannot be realized without peace and security; and peace and security will be at risk without sustainable development. The new Agenda recognizes the need to build peaceful, just and inclusive societies that provide equal access to justice and that are based on respect for human rights (including the right to development), on effective rule of law and good governance at all levels and on transparent, effective and accountable institutions. Factors which give rise to violence, insecurity and injustice, such as inequality, corruption, poor governance and illicit financial and arms flows, are addressed in the 2030 Agenda (para 35). We commit to pursuing policy coherence and an enabling environment for sustainable development at all levels and by all actors (para 63).*

Monitoring implementation - Sustainable Development Goals: ***16.4*** *By 2030, significantly reduce illicit financial and arms flows, strengthen the recovery and return of stolen assets and combat all forms of organized crime;* ***16.5*** *Substantially reduce corruption and bribery in all their forms;* ***16.6*** *Develop effective, accountable and transparent institutions at all levels;* ***17.1*** *Strengthen domestic resource mobilization, including through international support to developing countries, to improve domestic capacity for tax and other revenue collection;* ***17.13*** *Enhance global macroeconomic stability, including through policy coordination and policy coherence;* ***17.14*** *Enhance policy coherence for sustainable development;* ***17.15*** *Respect each country's policy space and leadership to establish and implement policies for poverty eradication and sustainable development.*

1. Introduction

This is a joint Issues Brief by the OECD and UNODC. It draws almost entirely on the OECD's *Framework for Policy Coherence for Sustainable Development: Thematic Module on Illicit Financial Flows* [SG/PCD(2016)3], to be published in July 2016 in the annual OECD publication, *Better Policies for Sustainable Development 2016* (http://www.oecd.org/development/pcd/).

One of many lessons that the Millennium Development Decade taught all stakeholders is that sustainable development requires looking at entire systems of economic and governance related enablers and disablers of growth and domestic resource mobilisation. The innovation of the Sustainable Development Agenda (as composed of Agenda 2030 and the Addis Ababa Action Agenda for Financing for Development) is the emphasis on universality and the need to take what is essentially a systems approach to development policy – in other words to consider those factors which enable and disenable sustainable outcomes in economic growth, governance and security, politically commit to pursuing the enablers and preventing the disablers, and implementing a policy framework with will increase the effectiveness of implementation.

Illicit financial flows (IFFs) constitute a major disabler to sustainable development. They can have a direct impact on a country's ability to raise, retain and mobilise its own resources to finance sustainable development. International commitments to urgently address IFFs have accelerated in recent years: the *Addis Ababa Action Agenda* (AAAA) urge all countries to ratify and accede to the *United Nations Convention against Corruption*; to support the *Stolen Asset Recovery Initiative*; to combat money laundering and terrorism financing; and to ensure effective implementation of the *United Nations Convention against Transnational Organized Crime*. Similarly, the *2030 Agenda for Sustainable Development* and the *Sustainable Development Goals* call on countries to significantly reduce illicit financial and arms flows by 2030 (SDG target 16.4); to substantially reduce corruption and bribery in all their forms (16.5); to develop effective, accountable and transparent institutions (16.6); to strengthen domestic resource mobilization, including through international support to developing countries (17.1); and to enhance global macroeconomic stability (17.13). The 2030 Agenda also calls on countries to enhance policy coherence for sustainable development (17.14); and to respect each countries policy space and leadership to establish and implement policies for poverty eradication and sustainable development (17.15)

2. Stocktaking (progress and implementation gaps)

Although a precise definition of illicit financial flows is lacking[1], some efforts have been made to measure how well countries are performing in their fight against them. Much of these efforts will continue to be discussed, not least in the context of the UN Statistical Commission's work on improving indicators for SDGs.

UNODC is actively involved in working with a variety of stakeholders to improve methodologies to measure IFFs – including Member States, multilateral organisations, non-governmental organisations academia and other stakeholders. UNODC's long-term work in assisting Member States to developing data, trend analysis and data collection capacity on crime notably through surveys and mandated questionnaires will continue to inform this discussion.[2] UNODC also undertakes a wide range of research and analysis on value chains and trends of crimes related

[1] The term "illicit financial flows" (IFFs) is not defined in the international normative framework. For the purposes of this paper, IFFs are defined broadly as all cross-border financial transfers, which contravene national or international laws. This wide category encompasses several different types of financial transfers, made for different reasons, including: funds with criminal origin, such as the proceeds of crime (for example tax evasion, money laundering, fraud and corruption); funds with a criminal destination, such as bribery, terrorist financing or conflict financing; transfers to, by, or for, entities subject to financial sanctions under UN Security Council Resolutions such as 1267 (1999) and its successor resolutions (e.g. Al Qaida and other terrorist organisations); and transfers that seek to evade anti-money laundering/counter-terrorist financing measures or other legal requirements (such as transparency or capital controls).

[2] UNODC, E/CN.15/2016/10, *Commission on Crime Prevention and Criminal Justice, World crime trends and emerging issues and responses in the field of crime prevention and criminal justice, Note by the Secretariat*, 29 March 2016.

to trafficking and corruption which will continue to inform this discussion.[3] It can be envisaged that by considering each type of illicit financial flows separately, it is possible to develop specific methods to compile global and regional estimates. Such a process can build on available experience at the national and international levels.[4]

The OECD report *Measuring OECD Responses to Illicit Financial Flows from Developing* Countries[5] shows that progress has been made in recent years, but that we need to continue to rally international support to tackle existing performance gaps and shortfalls. Key findings include:

- 27 out of 34 OECD countries store or require some beneficial ownership information for legal persons, but no country is fully compliant with the beneficial ownership requirement for legal arrangements.
- Across all OECD countries as of 2012, only 221 individuals and 90 companies have sanctioned for foreign bribery, around half of all OECD countries have yet to see a single prosecution.
- Between 2010 and 2012, OECD countries have returned USD 147 million and frozen almost USD 1.4 billion assets.
- 30 out of 34 OECD countries do not properly regulate and supervise designated non-financial professions and businesses which may pose money laundering risks.
- Since 2000, OECD countries have signed roughly 1300 bilateral exchange of information agreements with developing countries.

Two years down the road, work on identifying an appropriate methodology for measuring progress in combatting IFFs – particularly in relation to developing a meaningful indicator for SDG target 16.4 – is accelerating.

3. Policy options and recommendations for corrective action

The policy considerations below are taken from *The Framework for Policy Coherence for Sustainable Development: Thematic Module on IFFs.* This module is intended to be used as a tool for policy makers and for the stakeholders with whom they engage in dialogue or for policy and capacity development assistance. The intention of this tool is to demonstrate how a policy coherence approach improves the effectiveness of efforts to combat illicit financial flows.

Combating IFFs involves multiple policy areas. From crime control to regulations in the financial sector, and tax regimes, its implications require cross-sectoral and cross-national responses. It requires a wide range of actors (Figure 1) to design and implement different (albeit mutually reinforcing) policies and actions at different levels of government. Law enforcement and customs authorities need to increase awareness and the financial sector and

[3] https://www.unodc.org/unodc/en/data-and-analysis/index.html?ref=menuside

[4] See, for example, Eurostat, Illegal Activities in National Accounts, 2013, Eurostat/C3/GNIC/230 ; UNODC, Drug Money: the Illicit Proceeds of Opiates Trafficked on the Balkan Route (Vienna, 2015).

[5] OECD (2014), *Illicit Financial Flows from Developing Countries: Measuring OECD Responses*, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/9789264203501-en

vulnerable professions need to take preventive measures. Transparency in corporate structures is essential and steps must be taken to promote public sector integrity and support asset recovery. Policy coherence for sustainable development will be instrumental for achieving SDG target 16.4 to reduce illicit financial and arms flows, with inter-agency and international co-operation at the heart of the solution.

Figure 1: Key actors involved in combating IFFs

The cross-cutting nature of IFFs, and the multi-faceted normative framework which can be implemented to prevent them, requires policymakers and other stakeholders to have a more strategic overview of IFFs. They must assess the potential trade-offs and synergies in an inter-disciplinary manner, better inform policy making upstream, and help government actors to take more effective action. Effective policy, therefore, will necessarily be based on ***an approach which emphasises coherence*** – including through:

- Identifying and raising awareness of the types, magnitudes and risks of IFFs (particularly at the political and policy making level).
- Considering the contextual factors that allow IFFs to thrive.
- Supporting coherence within and between national and international normative frameworks (vertical coherence).
- Identifying critical, prioritised interactions across economic, social and environmental areas to address IFFs (horizontal coherence).

Under the international normative framework of rules and standards, countries have a great deal of flexibility about how intensively they apply measures to combat illicit financing. Decisions on the priority given to fighting IFFs, or on whether to apply additional measures, should be based on ***an understanding of the risks*** – which vary considerably from country to country.

Policy effectiveness can be supported by ***aligning national efforts with international initiatives*** and standards and strengthening international co-operation. The policy dialogue surrounding the need to effectively prevent IFFs has accelerated enormously in the past two decades – concurrent to which a multifaceted international normative framework has been developed (e.g. by the UN, OECD, FATF, World Bank). This international normative framework is generally considered as coherent and the multitude of agreements and treaties refer to (and build on) each other.

Nonetheless, considerable scope for improved policy coherence remains at the interface between this multi-facetted framework and the different nation states. There is ***uneven progress*** across OECD countries in curbing IFFs, and developing countries are particularly dependent on coherent international action to tackle the links in the IFFs chain that are beyond the scope of their national policy making.

To improve coherence and ensure coordinated action, it is essential to: engage with international norms and standards, including peer review mechanisms, multilateral co-operation initiatives, and information exchange mechanisms; establish bilateral co-operation, in particular with countries which are key sources and destinations for IFFs; and identify how development assistance policies can support measures to combat IFFs.

Political commitment and leadership is also vital. All policy issues that cut across traditional policy-making boundaries cannot be addressed effectively by a single policy unit located within a policy silo at a lower level of the administration. Instead, support from the highest level and whole-of-government approaches are instrumental for a successful strategy to counter IFFs.

Policy makers need to consider ***strengthening national inter-agency co-ordination mechanisms*** to combat IFFs. The complexity of IFFs is mirrored by the variety of actors that are involved in combatting these flows. In order to ensure an effective response, governments need to build institutional mechanisms that assign clear responsibilities and facilitate straight-forward co-ordination and collaboration between the different agencies both on the level of policy design and implementation.

In addition, it is important that the government reach out to ***non-state actors*** and incorporate them into the effort to stem IFFs. This includes the financial sector as well as regulated professions, such as lawyers and accountants since they are in charge of implementing a substantial share of the preventive measures devised by policy makers. Private companies, too, have a role to play in the process and their participation could provide valuable feedback about the direct impact of new policies, and help to ensure better coherence. In general, feedback mechanisms and statistical tools are essential to avoid or address unintended consequences and incoherent outcomes.

To sum up, the interconnectedness among 17 SDGs and 169 targets implies that in order to make progress on IFFs, policy makers will need to ***consider inter-linkages and critical interactions*** between target 16.4 and all other goals. Against this background, the *Framework for Policy Coherence for Sustainable Development: Thematic Module on Illicit Financial Flows* has been developed to support governments in their efforts to map out potential frictions and incompatibilities so to exploit synergies and avoid unintended consequences in the fight against IFFs.

Table 1: Identifying critical interactions to improve coherence and reduce IFFs

SDG	***Summary of Target***	***Relevance to IFFs***
Enablers and Disablers: Factors which make an essential contribution to combating illicit financial flows, e.g. as a precondition for certain measures, or as structural factors which could undermine the effectiveness of anti-IFF measures.		
10.5	Regulation of Financial markets	Some measures to counter IFFs rely on requiring preventive measures by financial institutions, supported by supervision.
16.3	Rule of Law	An essential precondition for anti-IFF measures
16.5	*Reduce corruption*	Corruption of key institutions can undermine anti-IFF measures
16.6	Sound institutions	An essential precondition for anti-IFF measures
16.9	Identity documentation	Required for many anti-IFF preventive measures
16.10	*Public access to information*	Transparency to relevant government authorities can discourage crime and enhance anti-IFF measures
16.a	Institutions to combat crime	An essential precondition for anti-IFF measures
Potential Trade-offs and Policy Conflicts: Areas where there is a risk that excessively strict, or poorly targeted anti-IFF measures could undermine implementation of other SDG targets.		
8.3	*SME development*	Longer company registration process, with additional information requirements.
8.10	Access to financial services	Financial inclusion issues – e.g. with poor people who lack good identity documentation
10.c	Cheaper remittances	De-risking means money remitters lack access to financial system… potential to drive remitters underground (with cost to recipients). Also cost of compliance may make remittances more expensive…
16.10	*Public access to information*	Data protection rules, business secrecy, and censorship may conflict with measures to counter IFFs.
Synergies: SDG targets on which progress could be mutually reinforcing with efforts to curb IFFs.		
2.3	Agricultural productivity/incomes	Drug production is a major source of illicit funds. Measures promoting agricultural productivity and rural incomes can reduce pressure on farmers to grow narcotics.
16.5	*Reduce corruption*	Corruption is a major source of illicit funds.
17.1	Strengthen domestic resource mobilisation	Tax evasion is a major source of illicit funds, which weakens the capacity of countries to fund their own development through domestic resource mobilisation.
3.a	Tobacco control	Illicit trade in tobacco products generates illicit funds
5.2	Violence against women	Human trafficking generates illicit funds
10.5	Regulation of Financial markets	Poorly-supervised financial institutions are important facilitators of tax evasion and other sources of illicit funds
10.7	Safe migration	Smuggling migrants generates illicit funds
12.7	Public Procurement	Public procurement, public works and construction, are at high risk of corruption, and major sources of funds
12, 14, 15	Sustainable use of oceans and terrestrial ecosystems	Exploitation of natural resources is a driver of corruption and source of illicit funds. This includes forestry and fisheries, as well as extractive industries.