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Addressing illicit financial flows for anti-corruption at country level

A primer for development practitioners

By Maria Helena Meyer Dolve and Saul Mullard

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Developing countries lose a massive volume of wealth through illicit financial flows (IFFs), presenting a major threat to their development. Initiatives to address IFFs exist at national, regional, and international levels but present several challenges. Collaboration is required across borders, to strengthen the integrity of the global financial system, encourage more transparency, and tackle international corruption and movement of illicit funds.

Main points

- IFFs have devastating consequences for developing countries as a vast volume of wealth is lost every year that could be used to fund sustainable development and provide public services.
- As well as significantly reducing IFFs, strengthening the rule of law and prosecuting offenders could increase citizens’ trust in state institutions and contribute to stability.
- Standard estimate methodologies cannot be relied upon to determine the true scale of IFFs; however, there is widespread agreement that it is huge and IFFs pose a major obstacle to development.
- The possibility of moving capital illicitly makes it easier to engage in corruption; yet many features of the global financial system facilitate IFFs.
- Measures to tackle IFFs differ depending on the country and the underlying activity, making it difficult for development practitioners to address the problem of IFFs in partner countries and regions.
- Although global attention on combating IFFs has increased, the scale of donor support is relatively modest. There is a need to strengthen existing regional networks and organisations through greater cross-border collaboration and political dialogue.
- The successful collaboration between enforcement, legal, and financial agencies has led to a coordinated policy response to IFFs. Future strategies should identify key points for engagement on the issue with local and national governments and agencies.

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Abbreviations

AEOI – Automatic exchange of information
AML – Anti-money laundering
ARA – Assets Recovery Agency
ATI – Addis Tax Initiative
BEPS – Base erosion and profit shifting
BMZ – German Federal Ministry for Economic Cooperation and Development
BO – Beneficial ownership
CBGA – Centre for Budget and Governance Accountability (India)
CSO – Civil Society Organisation

CTF – Counter terrorist financing
DAC – OECD Development Assistance Committee
DFAT – Australian Department of Foreign Affairs and Trade
DFID – UK Department for International Development
EITI – Extractive Industries Transparency Initiative
EU – European Union
FATF – Financial Action Task Force
FCO – Foreign and Commonwealth Office of the UK
FDI – Foreign direct investment
FIU – Financial intelligence unit
FRC – Financial Reporting Centre
FSRB – FATF-style regional bodies
FTC – Financial Transparency Coalition
GAFILAT – Grupo de Acción Financiera de Latinoamérica (Latin American FATF-style regional body)
GFI – Global Financial Integrity
GIZ – Deutsche Gesellschaft für Internationale Zusammenarbeit (German Development Agency)
ICIJ – International Consortium of Investigative Journalists
IFF – Illicit financial flows
IMF – International Monetary Fund
INL – US State Department Bureau of Narcotics and Law Enforcement Affairs
MENA – Middle East and North Africa
MNC – Multinational corporations
MoF – German Federal Ministry of Finance
ODA – Official development assistance
OECD – Organisation for Economic Co-operation and Development
PEP – Politically Exposed Person
SDC – Swiss Agency for Development and Cooperation
StAR – Stolen Assets Recovery Initiative
SDG – Sustainable Development Goals 2030
TI – Transparency International
UNCAC – United Nations Convention Against Corruption
UNECA – United Nations Economic Commission for Africa
UNODC – United Nations Office on Drugs and Crime

1. Introduction

Illicit financial flows (IFFs) are a major obstacle to development and have become an increasing source of concern for developing countries.[1] Every year, a massive volume of capital is illegally or illicitly transported out of developing countries and into tax havens and the financial centres of the world.[2] Simultaneously, large amounts of IFFs are transferred within the same country. IFFs drain capital and tax revenue from developing countries. Moving capital out of the country illicitly enables tax evaders, corrupt officials, businesspeople, and criminals to better protect their funds from seizure.

IFFs threaten fundamental aspects of development, such as the rule of law, the quality and accountability of democratic institutions and, some argue, affect broader social trust.[3] These illicit outflows largely exceed aid funds and a great proportion of the flows are likely to stem from corruption.[4] These funds could otherwise be used to finance education, infrastructure, health care, and other vital elements of sustainable development. By reducing IFFs, governments will have more public funds available to invest in the development of their countries. Strengthening the rule of law and effectively prosecuting offenders could, in addition to significantly reducing IFFs, increase citizens' trust in state institutions and, in turn, contribute to stability.

Combating IFFs is an important element of tackling the crime, corruption, and violent extremism that threaten stability and economic development.

In the last ten to fifteen years, governments and international organisations have paid increasing attention to IFFs.[5] More recently, the World Bank and

1. Massa 2014, 1.
2. Does de Willebois, et al. 2011.
3. Reuter 2017; SDC 2014; Fontana and Hearson 2012.
4. GFI 2017, 2.
5. World Bank 2017; Hearson 2014.

the International Monetary Fund (IMF) have placed increased emphasis on corruption and addressing tax havens.[6] Additionally, Goal 16 of the 2030 Sustainable Development Goals (SDGs) addresses corruption, and Target 16.4 specifically concerns IFFs: 'By 2030, significantly reduce illicit financial flows and arms flows, strengthen the recovery and return of stolen assets and combat all forms of organized crime.' Achieving the SDGs will require considerably more resources than can be afforded by public finance. By curbing IFFs and recovering stolen assets, governments have the opportunity to unlock much needed resources to close the financial gap to achieve the SDGs.[7] Moreover, combating IFFs is an important element of tackling the crime, corruption, and violent extremism that threaten stability and economic development. However, the scale of donor support for tackling IFFs is relatively modest.[8]

Development practitioners located in developing country offices and/or embassies of bilateral donors tend to be familiar with domestic anti-corruption structures and actors in the countries where they work. They are often less familiar with the dynamics of domestic corruption that create transnational dimensions and effects, and the importance of international bodies, processes, and assistance programmes that are seeking to address these aspects. In cases where these issues are understood, it is often difficult to see how to tie national-level anti-corruption efforts to internationalised corruption and the international mechanisms designed to counter it. This U4 Issue highlights important information regarding IFFs and the international bodies and processes designed to reduce them, and illustrates how development practitioners can make use of that information when addressing IFFs at country level. Moreover, this paper will provide an introduction to IFFs generally and address the relationship between corruption and IFFs specifically.

1.1 Methodology

We undertook a targeted literature review of the international dimensions of corruption and IFFs based on existing published research. This is presented throughout the paper and informs our analysis. In addition, we conducted semi-structured telephone interviews with development practitioners to

6. IMF 2018; World Bank 2017.
7. TI 2015.
8. OECD 2014.

identify how IFFs are addressed at country level. We chose this approach in order to evaluate the strengths and weaknesses of existing programmes and the usefulness of international legal, policy, and operational bodies, and the processes and initiatives which country-level practitioners might engage with.

As a case study throughout this paper, we have highlighted the German Development Agency's (GIZ) global programme 'Combating Illicit Financial Flows', which was implemented by GIZ in East Africa, South America, the Western Balkans, and Germany. There were several reasons for selecting this programme. First, it has a wide geographical spread, including an important component linked to financial hubs in Germany and the Global West, which indicates a growing realisation that IFFs are not purely a 'developing country problem' but an international one tied to challenges in the global financial system. Second, this programme sought to strengthen the links of Germany and partner countries with regional and international bodies and support their efforts to address the international effects of IFFs. Finally, while it has recently been extended for an additional three years, it has run for several years and programme managers have therefore had time to reflect on its strengths and weaknesses.

IFFs are not purely a 'developing country problem' but an international one tied to challenges in the global financial system.

2. Main issues to understand in IFFs

2.1. Definitions

In the literature on IFFs, there is no general agreement of a precise definition of the term. There are two main ways of defining IFFs. The first relies on the dictionary definition of 'illicit' as 'forbidden by law, rules or custom.' When illicit is defined in this way, IFFs include 'illegal' in addition to the 'socially unacceptable.' This definition poses several problems. For example, different political or financial actors may consider corporate tax

avoidance by multinationals corporations as either socially acceptable or unacceptable, whereas transfers of funds that come from crime such as corruption are clearly illegal. Determining whether or not an international transfer whose purpose is to minimise tax payments is 'illicit' is difficult. Most tax planning is legal and considered by many to be legitimate. Yet there is substantial disagreement at the point when aggressive corporate tax planning becomes tax avoidance and undermines the social responsibility of corporations to pay taxes.[9]

The second way of defining IFFs is to equate 'illicit' with 'illegal.' This is the most common definition, and is used by the World Bank and Global Financial Integrity (GFI): 'Funds illegally earned, transferred or utilised that cross borders.' Fontana and Hearson.[10] argue that IFFs can be illicit for two overlapping reasons. In the first case, the money involved comes from the proceeds of crime, such as corruption or drug smuggling, so the transfers of funds are clearly illegal. In the second case, it is the process of transferring the money that is illegal and illegitimate, even when the funds come from legal and legitimate sources. The latter is most often done to escape taxes. Aggressive tax planning often uses loopholes in countries' legal systems to hide away assets, hence defeating the legislative intent of the law without violating the law itself.[11] This type of aggressive tax planning poses a grey area between the legal and illegal, and the flow of money will be regarded as an IFF as per the dictionary definition,[12] but not when illicit is equated with illegal. Moreover, definitions of IFFs often include a third component that addresses funds which are utilised illegally or illicitly, thus including terrorist financing in the definition.[13]

Including such grey areas in the definition of IFFs is attractive for several reasons. For example, it allows an opening for an important debate on what constitutes the social responsibility of corporations. Nevertheless, it defies operationalisation. It is difficult to stop something that is not illegal *per se*. The operationalisation, upon which the literature on IFFs is built, relies on the illegal component of the definition: 'Funds *illegally* earned, transferred or utilised'.[14]

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9. Fontana and Hearson 2012, 1; CBGA 2015, 4.
10. 2002.
11. CBGA 2017, 4.
12. 'Illicit' as 'forbidden by law, rules or custom.'
13. Reuter 2017.
14. Reuter 2017.

Most of the definitions of IFFs refer to illicit funds that cross borders. However, some definitions also include funds that are illicitly earned, transferred, or used within the same country.[15] In their programme, 'Combating Illicit Financial Flows', GIZ argues that domestic IFFs are equally important to address in a development perspective. They define IFFs as '… all movements of capital or other assets which are illegal by virtue of their origin (e.g. criminal activity, tax evasion, corruption), the target/ purpose (e.g. terrorist financing), or due to the modalities of their transfer (e.g. violation of sanctions or avoidance of oversight mechanisms).' In order to tackle IFFs within and between states, both the measures at domestic level (to tackle purely domestic IFFs) and those at the international level (to tackle cross-border IFFs) must be applied.[16]

2.2. Scale

Research on IFFs poses methodological challenges because IFFs are hidden. Most of the existing estimates[17] are largely based on analysis of mismatches in official statistics. In other words, checking whether exports reported from country A to country B match reported imports. The IMF, which publishes some of the underlying macroeconomic statistics, specifically warns against using their data in this way, stating that the data cannot be used to estimate trade misinvoicing. There are two reasons why it is problematic to use the data in this way. First, not all trade misinvoicing shows up as mismatches in the trade data, and not all mismatches are evidence of trade misinvoicing. Second, large and seemingly detailed estimates may divert attention away from other areas of illicit flows, where such estimates do not exist. Relying on bad numbers debases the political debate and leads to weak policy analysis and ineffective action.[18]

Moreover, estimates of IFFs provide few details as to their composition or the factors affecting variations across countries and over time. In 2005, GFI estimated that approximately 5% of global IFFs came from corruption, and

15. See the U4 publication 'Improving coherence in the illicit financial flows agenda' (Erskine and Eriksson 2018) for a more detailed discussion on the definition, measurement, and the estimation of IFFs.
16. Source: GIZ review process.
17. The methods used, for example, by GFI to estimate IFFs and by a 2016 UNCTAD study to estimate trade misinvoicing relating to commodities from developing countries (Forstater 2017a; UNCTAD 2016).
18. Forstater 2017a; Forstater 2016.

most stemmed from commercial and criminal activities. The United Nations Economic Commission for Africa's (UNECA) High Level Panel on Illicit Financial Flows from Africa also estimated that 5% of African IFFs came from corruption, and most came from corporate activities.[19] Despite the critiques of the global estimates on IFFs, there is widespread consensus among scholars, politicians, and policymakers that their scale is huge, and that they pose a major obstacle to development.[20] Estimates on how much developing countries lose through IFFs on an annual basis are important for raising the issue up the political agenda. No matter how the numbers are estimated, they are severe. We will never have accurate data on IFFs, just as we will never have entirely accurate data on corruption, drug trade, or human trafficking. Nevertheless, it is vital that IFFs are addressed and reduced.[21]

Regardless of the methodological challenges in measuring the scale of IFFs, all existing estimates on the volume indicate that IFFs are a massive phenomenon in both developing and developed countries. In a 2017 report on IFFs[22] to and from developing countries between 2005 and 2014, GFI finds that IFFs likely accounted for between 14.1% and 24.0% of total developing country trade, on average, in this period. In the most conservative calculations, GFI estimates that illicit outflows from developing countries ranged from USD 620 billion to USD 970 billion in 2014.[23] By comparison, the total official development assistance (ODA) from the OECD's Development Assistance Committee (DAC) member countries totalled USD 137.2 billion that same year.[24] Hence, even the most conservative estimates on the volume of IFFs largely exceed the amount of DAC aid that developing countries receive. Moreover, the GFI estimates are based on data on trade misinvoicing[25] and therefore do not count all types of IFFs. The GFI estimates do not include cash movements, most criminal activities, misinvoicing of intangibles and services for which there are no

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19. Reuter 2017.
20. Fjeldstad, et al. 2017; GFI 2017; World Bank 2017; UNECA 2015; Massa 2014.
21. Baker 2017.
22. In the report, GFI defines IFFs as 'illegal movements of money or capital from one country to another.'
23. GFI 2017.
24. OECD 2018a.
25. Trade misinvoicing is a method of moving money illicitly across borders which involves deliberate falsification of the value of volume of an international commercial transaction of goods or services by at least one party to the transaction. According to GFI, trade misinvoicing is the largest component of IFFs (GFI 2018).

data, and certain other invisible forms of trade anomalies. If these data were available, the estimates would be considerably higher.[26]

IFFs are damaging to all countries. However, they have more damaging consequences in developing countries because of their limited resource base and their smaller and less stable markets.

IFFs into developing countries are also huge. GFI estimates that the total inflows range between USD 1.4 trillion and 2.6 trillion in 2014,[27] making them much higher than the total outflows. GFI President Raymond Baker[28] argues that the difference in numbers suggest that the outflows may well be understated. According to several customs officials in African countries: 'No one in the business sector brings illicit money in without a parallel means of taking it out'.[29]

Measured against the level of trade, Africa ranked the highest in illicit outflows, ranging from 5.3% to 9.9% in 2014, while Asia ranked the lowest of the major regions, ranking from 3.9% to 5.6% of total trade in 2014.[30] IFFs are damaging to all countries. However, they have more damaging consequences in developing countries because of their limited resource base and their smaller and less stable markets. UNECA's High Level Panel on Illicit Financial Flows has estimated that IFFs from Africa could amount to USD 50 billion per year.[31]

2.3. Impact on developing countries

'The poor of the world cannot wait for perfection of the data' – Tom Cardamone before a World Bank audience.[32]

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26. Baker 2017, 57.
27. GFI 2017, 8.
28. 2017, 57.
29. Baker 2017.
30. GFI 2017, 5–7.
31. OECD 2018b, 13.
32. Baker 2017, 58.

Every year, developing countries lose a massive volume of wealth to corruption, tax evasion, and money laundering enabled by IFFs.

Every year, developing countries lose a massive volume of wealth to corruption, tax evasion, and money laundering enabled by IFFs. These funds could help to fill the gap for funding sustainable development. The consequences of IFFs can be devastating for several reasons. IFFs enable corrupt politicians, public officials, and economic elites to hide their proceeds of corruption. When IFFs are sent overseas, they are likely to reduce the elites' support for the development of the state because less of their wealth is dependent upon the domestic economy.[33]

Further, reduced tax earnings have a direct negative effect on public and private investment as well as the provision of public services. The result is fewer schools, hospitals, jobs, and infrastructure projects, and weaker social protection for the citizens in these countries. IFFs place skewed tax burdens on poor citizens and honest businesses.[34] Many of the effects of IFFs are circular. For example, if money laundering enables corrupt politicians to safely hide the proceeds of corruption, this will help them to retain power by shielding them from proper accountability, which may further enable them to corrupt the institutions responsible for detecting money laundering and crime.[35] When weaknesses in the financial system are not regulated effectively, organised crime and illegal economies can thrive.

When weaknesses in the financial system are not regulated effectively, organised crime and illegal economies can thrive.

IFFs do not have only economic consequences; they can also affect other fundamental aspects of development that cannot be captured solely by

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33. Lain, et al. 2017.
34. TI 2015.
35. Reed and Fontana 2011, 10.

numbers. First, the rule of law is partly dependent on the support of economic and political elites. If elites can shelter much of their wealth outside the country, they have a lesser stake in the development of, for example, property rights, which is an important aspect of the rule of law. IFFs, can therefore have a negative effect on good governance. Second, IFFs can have a negative effect on broader social trust in a society and trust in the government.[36] Bo Rothstein[37] argues that the elites' use of secrecy jurisdictions to hide away their wealth and avoid taxes can have serious consequences for citizens' trust in institutions:

'If the political, economic, social and maybe also the artistic elites behave in the way we have now seen in the Panama money laundering scandal, people will not only lose trust in these elites and the institutions they represent. There is also an additional cost to society that in the long run may have even graver consequences, namely that the basic fabric of social trust is eroded. And trust is a delicate thing, because once lost it is hard to regain. The implication is that we have to account for the existence of a double negative effect from scandals like this'.[38]

2.4. IFFs and corruption

There is a close relationship between IFFs and corruption since the former is often a result of the latter. The literature on IFFs and corruption tends to show that there is a reciprocal causality between IFFs and corruption. Corruption is a source of IFFs and an enabler of money laundering, and money laundering allows for the proceeds of corruption to be hidden away and used. The possibility of moving capital illicitly makes corruption easier to engage in. Moreover, IFFs disproportionally damage state institutions in developing countries, by limiting the provision of public goods and undermining the stability and legitimacy of institutions.[39]

Corruption and IFFs can be linked in several ways. Corruption can be the source of funds (bribes) that constitute illicit funds to be laundered. Illicit funds from corruption can be channelled to a bank account in a foreign country, typically to secrecy jurisdictions, and laundered abroad. Tackling

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36. Reuter 2017.
37. 2016.
38. Rothstein 2016.
39. Wickberg 2013, 2.

IFFs has the potential to deal with high-level corruption of this kind. Moreover, corruption can be the means of facilitating the creation of IFFs, for example through corrupt tax administrators who ignore illegal tax evasion and other financial obligations. Examples of such corruption can be tax officials who make 'favourable' interpretations of tax regulations to lower a company's tax burden, or tax officials turning a blind eye to tax evasion. Further, corruption can be a means for enabling an IFF via corruption in the institutions with obligations to report on IFFs. For example, when a bank official does not notify suspicious transactions to the relevant authorities because they have received a bribe.[40]

Secrecy jurisdictions

Secrecy jurisdictions facilitate IFFs, harmful tax competition, money laundering, grand corruption, and economic crime.

Secrecy jurisdictions,[41] including but not limited to tax havens, facilitate IFFs, harmful tax competition, money laundering, grand corruption, and economic crime. Tax havens are jurisdictions that offer low tax rates for foreign individuals and companies, (non-resident) limited regulations, and extreme secrecy about the ownership of registered corporations and individuals. The secrecy is a result of national laws that prevent the sharing, or even the collection, of information regarding the ultimate beneficial owner of bank accounts, legal persons, or other corporate vehicles.

Hiding away wealth, income, and company ownership in secret bank accounts and shell companies[42] encourages individuals and enterprises to evade tax. As such, the secrecy industry represents the supply side of corruption, while corrupt individuals and enterprises represent the demand

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40. Reed and Fontana 2011, 19–20.
41. We have decided to use the term 'secrecy jurisdictions' because it is a standard term used to describe such territories. See Tax Justice Network, Transparency International, Fjeldstad et.al2016, Forstater 2018, and European Parliamentary Research Service 2018.
42. Shell companies exist on paper and have no office and no employees, but may have bank accounts or be the holder of assets.

side.[43] Secrecy jurisdictions are especially damaging to developing countries where financial regulation is weak, as they undermine rule of law in the countries of origins of the non-residents, and where money from taxpayers is desperately needed. An estimated USD 21 trillion to USD 32 trillion of private financial wealth is located in secrecy jurisdictions around the world.[44] As much as 2.7% of global GDP is laundered worldwide in connection with criminal activities, and according to the World Bank, over 70% of large-scale corruption cases involve anonymous companies.[45]

One of the most damaging aspects of secrecy jurisdictions is that they hide public money stolen by corrupt government officials from other countries. There are countless cases of politicians moving public money out of the country and into private accounts and shell companies in tax havens. However, only a handful of corrupt leaders have ever been held accountable for their actions, and seen their stolen assets returned.[46]

Box 1: The Panama and Paradise Papers

The Panama Papers and the Paradise Papers are two of the biggest leaks of financial documents that revealed the offshore links of some of the world's most powerful people and companies. The Panama Papers refers to the leak of 11.5 million documents from the law firm and corporate service provider company Mossack Fonseca in Panama in 2016. The leak included nearly 40 years of data from the firm, which is one of the world's top creators of shell companies and corporate structures that can be used to hide away ownership of assets, and revealed information on more than 214,000 offshore companies connected to people in over 200 countries and territories. The documents show how Mossack Fonseca helped clients launder money, evade sanctions, and avoid paying taxes through the use of tax havens or secrecy jurisdictions. In 2017, the Paradise Papers were leaked, disclosing 13.4 million files from a combination of offshore service providers. Similar to the Panama Papers, the Paradise Papers' files expose the offshore holdings of political leaders, billionaires, celebrities, and household-name companies.

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43. Fjeldstad, et al. 2017, 19, 42, 79–80.
44. FSI 2018.
45. CBGA 2015.
46. Fjeldstad, et al. 2017, 51.

The use of aggressive tax planning and hiding of income and wealth is nothing new. What is new about the Panama Papers, and later the Paradise Papers, is that the leaks shed light on practices that many thought had been largely eliminated by initiatives for transparency in recent years. The Panama and Paradise Papers are the result of investigative journalism led by the International Consortium of Investigative Journalists (ICIJ).

See also: Schjeldrup and Pires (2017); OECD (2018); ICIJ (2018a) and (2018b).

3. Assessment of existing responses

3.1 Existing policies and the international architecture for tackling IFFs

Policies aimed at tackling IFFs are more useful to prevent grand corruption where relatively large amounts of money are involved. Petty bribery is much less likely to be detectable as IFFs, unless, for example, a politician receives many smaller bribes that need to be laundered. This is because policies designed to tackle IFFs have to target transactions of a certain size. Smaller bribes are more likely to be given and received in the form of cash outside the formal banking system.[47]

Efforts to address IFFs differ depending on the country context and the underlying activities that result in their outflows. A number of policies have been introduced at national, regional, and international levels to prevent IFFs within and from developing countries. At national level, the main focus is on curbing corruption as a source of IFFs as well as on tackling money laundering related to different kinds of crime, including corruption. At international level, the initiatives aim at strengthening the integrity of the global financial system, a higher level of transparency, and addressing international corruption as well as the cross-border movement of illicit funds and recovering stolen assets.[48]

47. Reed and Fontana 2011.
48. Massa 2014.

National efforts are important to curb IFFs, but on their own, they are not sufficient because of the global nature of the problem. The case of tax havens illustrates this very well. Offshore financial activity is a result of other states offering tax breaks to attract business into their jurisdictions and, as such, it is impossible to prevent this without an agreement on tax regimes.[49] Moreover, national efforts to hinder domestic corruption must address IFFs in order to be successful. As such, any counter-IFF measures depend on both intra-state and inter-state cooperation.[50]

Box 2: UN Convention against Corruption

The United Nations Convention Against Corruption (UNCAC) is an international anti-corruption treaty adopted by the UN General Assembly in October 2003. The convention represents a global response to a global problem. With 186 countries bound by the UNCAC so far (as of 9 May 2019), it is unique not only in its worldwide coverage but also in the extent of its provisions, recognising the importance of both preventive and punitive measures. States Parties are obliged to adopt coordinated policies that prevent corruption and designate a 'body or bodies' to coordinate and oversee their implementation.

International cooperation

States Parties are obliged to assist each other in cross-border criminal matters (mutual legal assistance). This includes, for example, gathering and transferring evidence of corruption for use in court (Article 46).

Chapter V: Asset recovery

A 'fundamental principle' of the Convention, and one of its many innovations, is the right to recovery of stolen assets. According to many observers, Chapter V is the main 'selling point' of the Convention, and the reason why so many developing countries have ratified it. The UNCAC provisions lay a framework for countries to adapt both their civil and criminal law in order to facilitate tracing, freezing, forfeiting, and returning funds obtained through corrupt activities.

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49. Becket and Dewey 2018.
50. CBGA 2015.

How can the UNCAC be used by embassy and donor agency staff?

The UNCAC lays down internationally agreed standards; however, it should not be confused with a blueprint for reform. It is the leadership in each country that determines their priorities and the appropriate sequencing of steps towards implementation. The biggest challenge for donors is to mainstream the Convention into political dialogue and technical assistance with partner governments and other relevant stakeholders, to pursue reforms on the basis of country-owned plans and priorities, and to effectively coordinate around that.

The UNCAC is well suited to address the global nature of corruption-related illicit financial flows. However, for this potential to be fully achieved, donor countries also need to act on the home front. Additionally, donor agencies should lead by example, in order to engage in a credible dialogue on corruption with partner governments. At a local level, donor staff should ensure that their agency practices are consistent with the Convention's standards. In addition, it is important that donor countries address international drivers of corruption by prosecuting cross-border bribery and limiting bank secrecy, and provide technical expertise, especially on the international aspects of mutual legal assistance, such as recovery of assets claims.

Sources: UCAC in a nutshell version 2019 and version 2017.

General restrictions on capital flows

IFFs can occur through black markets and illegal cash transfers. However, the mainstream financial system is where the majority of IFFs take place. The main objective of, for example, money laundering is to enable the funds involved to move into the financial system without raising suspicion. The system has several features that enable and even encourage IFFs, particularly where funds can be moved across borders anonymously and legally, quickly, and with few bureaucratic restrictions.[51]

51. Reed and Fontana 2011, Massa 2014.

Many features of the global financial system, such as banking secrecy, secrecy jurisdictions, and financial innovation, may also facilitate IFFs.

Massa[52] argues that the domestic financial system in many African countries is characterised by a number of features that may facilitate IFFs. These characteristics are related to 'the structure and functioning of the financial sector, the scope and effectiveness of financial regulation and supervision, the linkages between the domestic financial system and global financial system, as well as to progress in financial innovation.' Moreover, many features of the global financial system, such as banking secrecy, secrecy jurisdictions, and financial innovation (for example, new payment methods, virtual assets, and speedy transactions), may also facilitate IFFs. General restrictions on and greater transparency in financial markets are two ways of reducing the space for IFFs.

Good governance and strong institutions

In general terms, strong, capable, and well-respected government institutions create a hostile environment for IFFs. Such government institutions are more effective in combating IFFs, and a well-respected and legitimate system fosters a culture which discourages some illegal activities.[53] Rigorous tax authorities are critical in this regard. Ineffective tax authorities are one of the main constraints on the ability of states to collect revenue in general, and can enable tax evasion.

Good governance beyond government institutions is also important. A strong civil society and independent media are key to holding elected leaders and government institutions to account.[54] Donor support to civil society and media can help national actors to investigate illegal activities and advocate reforms. Moreover, legal professionals and accountants are also explicit in facilitating IFFs, as seen in the Panama Papers and Paradise Papers. In the ongoing GIZ global programme, 'Combating Illicit Financial Flows', the Germans work with civil society in the Western Balkans to raise public awareness on the money laundering and IFF risks that are specific to

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52. 2014.
53. OECD-PCD 2015.
54. OECD-PCD 2015.

the area; assist investigative journalists in the MENA region in financial investigations; and provide support to tax authorities with regard to politically exposed persons (PEPs).

Anti-money laundering measures and financial intelligence units

Efforts to combat money laundering are essential to tackling IFFs. Anti-money laundering laws and programmes attempt to prevent offenders from turning illegally earned money into legal funds that can be used for investment or consumption. Moreover, they aim at apprehending and punishing offenders, including those professionals who help primary offenders move, conceal, or transform proceeds of crime.[55] All countries should comply with the Financial Action Task Force (FATF) recommendations to combat money laundering and terrorist financing. Stopping money laundering comes down to prevention and law enforcement. If countries do not possess the necessary legal framework and are not enforcing the laws and regulations already in place, it is not possible to stop money laundering.[56] This is why FATF introduced the concept of effectiveness of AML/CTF regimes, in addition to technical requirements, in its revised standards of 2012.[57]

Box 3: Financial Action Task Force

The Financial Action Task Force (FATF), constitutes an important instrument in curbing IFFs. FATF is a Paris-based inter-governmental organisation established in 1989 by the G7 summit in Paris. It consists mostly of developed countries; however, several developing countries are now included. As of June 2018, FATF comprises 36 member jurisdictions and a strong global network of nine FATF-style regional bodies, covering a total of 190 countries worldwide. FATF's objective is to set standards and promote effective implementation of legal, regularity, and operational measures to combat money laundering, terrorist financing, and other threats to the international financial system.

Their most important is the 40 FATF recommendations (The Forty Recommendations) on anti-money laundering (AML) and counter

55. Reuter 2017.
56. GFI 2017.
57. FATF 2012 (2018).

terrorist financing (CTF). The FATF standards are used as a basis for conducting peer reviews, called 'mutual evaluations', of each member country's AML/CTF regime. The mutual evaluations help member countries to identify where money laundering and terrorist financing risks are high, thereby assisting them to prioritise intervention and allocate resources effectively. Donors can use the evaluations to get an overview of a country's development over time and to gain an understanding of the country's political will to counter money laundering and corruption (FATF 2012 (2018), Borlini 2015).

GIZ Programme: 'Combating Illicit Financial Flows in Latin America'

In Peru, the GIZ programme 'Combating Illicit Financial Flows' focuses on the implementation of international standards against money laundering – most notably, the implementation of the FATF standards, through close cooperation with the FATF-style regional body in Latin America, GAFILAT.[58] Peru faces many obstacles in curbing IFFs, and these include limited effectiveness in the investigation of money laundering, gaps in the criminal law, weak institutions, and lack of statistical information. The system to monitor compliance with AML recommendations is not a strong one, and the strategies to coordinate actors between relevant entities are missing (Interviews with GIZ staff).

Financial intelligence units (FIUs) are central bodies for receiving and analysing reports from the financial sector, as well as the non-financial sector, regarding activities that are suspected of constituting money laundering, and for distributing the results to the relevant authorities. FIUs can play a leading role in preventing institutional corruption and IFFs. When money is involved in crime, countries need institutions capable of investigation.[59] Establishing FIUs and equipping them with the necessary capacities is required by the FATF standards,[60] and is mentioned in the subsections of the other FATF recommendations.[61] Most countries establish FIUs in compliance with the FATF recommendations.

58. The Latin Americal Financial Action Task Force. In Spanish: *Comisión Ejecutiva Multisectorial contra el Lavado de Activos y Financiamiento del Terrorismo* (Multisectorial Executive Commission against Money Laundering and Financing Terrorism).
59. Fontana and Hearson 2012; OECD-PCD 2015.
60. FATF recommendation 29.
61. FATF 2012 (2018).

Asset recovery

Gaps in the legal frameworks create opportunities for criminals.

Stolen assets are the proceeds of corruption, such as money, properties, or other assets, amassed through corrupt acts.[62] The process of identifying, restraining, seizing, and repatriating stolen assets hidden abroad is a crucial part of curbing IFFs, and one of the greatest challenges for the global anti-corruption movement.[63] Countries around the world face legal constraints when dealing with stolen assets, especially developing countries that lack the resources needed to match the skills and creativity of criminals. Finding and holding stolen assets is a lengthy process full of legal and practical constraints because stolen assets are often held in secret corporate structures in multiple jurisdictions.[64] Gaps in the legal frameworks create opportunities for criminals. At the same time, globalisation, digital communication tools, and easy mobility of assets and funds allow individuals to transfer illegal funds with ease, making it very difficult to trace and recover funds and other property.[65] Up until today, only a small fraction of stolen assets have been returned to the country of origin.[66]

Box 4: Stolen Asset Recovery Initiative

The Stolen Asset Recovery Initiative (StAR), is a partnership between the World Bank Group and the United Nations Office on Drugs and Crime (UNODC) which supports international efforts to end safe havens for corrupt funds. StAR works with both developing countries and financial centres to prevent laundering of the proceeds of corruption and to facilitate more systematic and timely return of stolen assets (StAR 2014). The partnership provides a platform for collaboration and dialogue, and enables contact among different

62. OECD 2018c.
63. See Article 57 – 'Return and disposal of assets' in the UNCAC for legal framework on asset recovery. (Zinkernagel, Pereira and Simone 2014, 2).
64. StAR 2017.
65. Knowtzl and Marsch 2012.
66. StAR 2019.

jurisdictions involved in asset recovery. Moreover, StAR can assist countries in developing legal frameworks, institutional expertise, and the skills necessary to trace and return stolen assets.

StAR cooperates with a number of international institutions, such as the Conference of State Parties to the UNCAC, G8, G20, OECD, and FATF, and it is supported by 8 donors (StAR 2018).*

* *Australian Department of Foreign Affairs (DFAT), the Government of Belgium, the Government of Luxemburg, Norwegian Ministry of Foreign Affairs, Swiss Agency for Development and Cooperation (SDC), the UK Department for International Development (DFID), Foreign and Commonwealth Office of the UK (FCO), and the US State Department Bureau of Narcotics and Law Enforcement Affairs (INL).*

Addis Tax Initiative

The Addis Tax Initiative (ATI) is a non-binding agreement reached in 2015 to address IFFs. The ATI is important for practitioners because it is relevant in some of the countries in which they work. The ATI emerged from the government negotiations in Addis Ababa on how to finance the SDGs. The initiative directly links IFFs to domestic resource mobilisation and, in turn, to sustainable development.

The initiative was set up with the support of 40 countries and organisations. The participants pledged to collectively double their technical cooperation in the area of domestic revenue mobilisation and taxation by 2020. Tanzania, Ethiopia, the Philippines, and Indonesia are among the developing countries that have signed the agreement and have said that they will strive to curb their losses in revenue due to IFFs.[67] One of ATI's aims is to facilitate donor coordination and share information. International organisations and 'lead' donors active in partner countries are encouraged to use the ATI network to seek the participation of other donors for elements of domestic resource mobilisation programmes.[68]

Exchange of information in tax matters

To tackle the negative consequences of tax havens and find out where residents are hiding their money, authorities in one country need to obtain

67. GFI 2017; Fjeldstad, et al. 2017, 126–127; Coplin 2018.
68. ATI 2018.

information from financial institutions or commercial registers in other countries. However, tax authorities cannot simply request information from these institutions in another country. A legal framework for the exchange of information must be in place. There are three methods for exchange of information.[69]

1. **Upon request:** Under this standard, a jurisdiction must first make a formal and specific request to receive information from a state abroad. Because it is very easy for tax evaders to hide their assets and identity in tax havens, it can be time- and resource-demanding for the requestor to collect the necessary information about the taxpayer being investigated before the request can be made. Furthermore, after that information is gathered by the jurisdiction, the state can still reject the request, if it does not meet the criteria of the applicable agreement. Even when the information is exchanged, by the time the jurisdiction received the evidence, the individual may already have moved the assets.
2. **Spontaneous:** This standard allows jurisdictions to exchange information with each other whenever they come into possession of any data which may be relevant for the other jurisdictions.
3. **Automatic Exchange of Information (AEOI):** This standard supposes the periodic exchange of information without the need to request it.

AEOI is the preferred way of exchanging information between jurisdictions. The OECD regards cooperation between tax authorities through AEOI as crucial in bringing national tax administration in line with a globalised economy. Over the past 20 years, the OECD has designed and updated standards for exchange of information and, in 2014, released the Common Reporting Standards for AEOI. They also developed the OECD Automatic Exchange Portal for the implementation of AEOI in tax matters. This online support contains information about AEOI and an overview of all bilateral relationships that are currently in place for AEOI under the OECD framework and other bilateral agreements.[70] Moreover, it is important to mention the Global Forum on Transparency and Exchange of Information for Tax Purposes, which offers technical assistance activities to support its member jurisdictions in effectively implementing the international standards

69. CBGA 2015.
70. OECD 2018d.

on transparency and exchange of information, and ensuring that exchanges between members' tax authorities are efficient and of high quality.[71]

Base erosion and profit shifting, and country-by-country reporting

Base erosion and profit shifting (BEPS) refers to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low- or non-tax locations. The BEPS initiative seeks to address these international tax standards that have become open to exploitation by multinational firms. The OECD has, together with the BEPS Associates in its Inclusive Framework on BEPS Format, initiated an implementation package under Action 13 of the BEPS project on transfer pricing documentation and country-by-country reporting. Country-by-country reporting requires certain multinational companies to report to the tax authorities for risk assessment purposes their revenues, profits before income tax, tax paid and accrued, numbers of employees, stated capital, retained earnings and tangible assets in each tax jurisdiction, and staff levels on a country-by-country basis. This can be used to detect and deter abusive tax avoidance practices. The implementation strategy foresees that tax authorities will automatically exchange these key indicators of multinational enterprises with each other, thereby allowing tax authorities to make risk assessments as to the transfer pricing arrangements and BEPSrelated risks, which may then serve as a basis for initiating tax audits.[72]

Beneficial ownership transparency

Beneficial owners (BO) are the true human owner(s) of a company or other legal entities. BO secrecy helps to feed corruption and tax evasion, as it enables criminals and corrupt individuals to hide their assets in secrecy jurisdictions by a chain of unaccountable corporate entities. Publishing the real owners of companies can help ensure that there is a level playing field for all companies to know who they are doing business with, and for law enforcement and tax authorities to find the companies that are related to a specific individual.

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71. OECD 2019.
72. Fjeldstad, et al. 2017; OECD 2018e; OECD 2018f.

Beneficial ownership transparency can improve investment climate, reduce reputational and financial risks, prevent corruption, strengthen the rule of law, increase trust and accountability, and enhance revenue collection.

The benefits of BO transparency are numerous. It can help improve investment climate, reduce reputational and financial risks, prevent corruption and IFFs, strengthen the rule of law, increase trust and accountability, and enhance revenue collection. Since 2013, the fight against secret company ownership has gained great momentum. The G8 and G20 have made BO transparency one of their priorities, and the European Union (EU) has required member states to establish registers. In addition, several countries have passed national legislation and are working towards public registers. However, as it is a relatively recent development, there is little BO information available to date.[73]

The Extractive Industries Transparency Initiative (EITI), which works on greater transparency in the extractive industries, is one of the few organisations that have delivered practical results through annual collection and publication of BO information in EITI Reports. By early 2017, 45 EITI countries have published BO roadmaps which outline how they are going to reach public BO goals.[74]

Box 5: The Egmont Group of Financial Intelligence Units

The Egmont Group is a united body of 159 FIUs,* which provides a platform for secure exchange of expertise and financial intelligence to combat money laundering and terrorist financing. The Egmont Group supports the efforts of its international partners and stakeholders to give effect to the resolutions and statements of the UN Security Council, the G20 Finance Ministers, and FATF. Moreover, they can add value to the work of member FIUs by improving the understanding of

73. EITI 2019.
74. GFI 2017; Fjeldstad, et al. 2017.

money laundering and terrorist financing risks amongst its stakeholders (Egmont Group 2018)

** As of October 2018.*

3.2 Engaging with IFFs at country and regional level: Lessons from GIZ's global programme

One of the key challenges for development practitioners is how to address the problem of IFFs in partner countries and regions. Particularly, how to relate to the international frameworks discussed above. In this section we present an overview of our findings focusing on the example of the German global programme, 'Combating Illicit Financial Flows', implemented by GIZ on behalf of the Federal Ministry for Economic Cooperation and Development (BMZ). Specific insights related to the GIZ global programme can be found in this section. Whereas generalanalysis of this and other policies and practices can be found in section 3.3 below and recommendations for donors and practitioners wishing to engage in addressing IFFs appear in section 4.

GIZ global programme: 'Combating Illicit Financial Flows'

This global programme was initiated in May 2015 and aims to improve the inter-sectorial, inter-state, and inter-regional fight against IFFs.At the end of 2018, it was recommissioned for another three years. The objective for the new period is to strengthen 'the system used in the cross-sectorial fight against illicit financial flows at national, regional and international level', and the current programme has four fields of intervention:

1. The prevention of IFFs
2. Cross-institutional investigations
3. Asset recovery
4. Inter-ministerial cooperation

The project is implemented in four hubs: Latin America (Peru), Eastern Africa (Kenya),[75] the Western Balkans (Macedonia), and global

75. In the 2019–2022 period of the programme, the regional focus is expanded to other regions of Africa and MENA.

(headquarter level in Germany). In Latin America, the main emphasis of the programme is on the implementation of international standards against money laundering and the financing of terrorism. More specifically, it focuses on implementing the FATF standards through a close cooperation with national authorities, mainly in Peru, as well as with the FATF-style regional body GAFILAT. The programme seeks to link national-level efforts to regional and global processes against IFFs. In Kenya, the aim of the project is to reduce the volume of IFFs transferred into, through, and out of Kenya. At micro level, the Kenya programme focuses on human capacity development; at meso level, the intervention aims to develop key institutional players combating IFFs;[76] and, at the regional macro level, it focuses on networking and knowledge-sharing in the areas of asset tracing, recovery, and mutual legal assistance.[77] The regional cooperation is centred upon FSRBSAAMLG.[78] In the Western Balkans, the project aims to reduce the volume of IFFs which are transferred into, out of, and through the region. As of November 2017, the project implemented in Macedonia has centred on developing capacities in techniques to investigate IFFs tailored to the specific needs of the region. To this end, the programme has been working with public prosecutors on the necessary techniques and standards to combat money laundering and transnational bribery.

Box 6: Is cash still king?

Despite increasing interest in virtual currencies and online transaction methods, cash remains an important means of settlement for billions of people across the globe, and is still widely used in the criminal economy (FATF and MENAFATF 2015). Information from law enforcement investigations indicates that cash remains the choice for criminal payments and money laundering activities (Europol 2015). Findings from the 2015 FATF report 'Money laundering through the physical transportation of cash' imply that the increasing robustness of anti-money laundering regimes in the financial sector has led to the increased prevalence of physical transportation of cash, in order to keep funds out of the traditional financial system. (FATF and MENAFATF 2015, 3, 6).

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76. Such as the Asset Recovery Agency (ARA) and the Financial Reporting Centre (FRC).
77. Between members of the Asset Recovery Inter-Agency Network for Eastern Africa (ARIN-EA) and East African Association of Anti-Corruption Authorities (EAAACA).
78. The FSRB-ESAAMLG is the Eastern and Southern Africa Anti-Money Laundering Group.

'Combating illicit financial flows' in the Western Balkans

In its global programme, GIZ addresses the problem of illegal cross-border cash flows in the Western Balkans. The region is a long-existing transit route between Europe, the Middle East, and East Asia. As a result, the transnational aspects of organised crime are highly developed. These well-organised criminal groups stand in contrast to the shortcomings of the law enforcement agencies, as well as the agencies' national, regional, and international cooperation. This has resulted in considerable IFFs in the region, originating from drugs, arms, and human trafficking, as well as from widespread corruption and money laundering (Kovachich and Lammers 2018).

The programme in the Western Balkans focuses on improving financial investigations by building capacities within relevant government agencies. The programme has recently piloted a project to support law enforcement in Macedonia in order to enhance the inter-agency cooperation and information exchanges, to contribute to the active involvement of Macedonian law enforcement to address the illegal transport of cash, and to improve financial and money laundering investigations. In 2017, GIZ established a working group on cash smuggling with the law enforcement authorities, equipping the Police K9 Unit with training on tracing hidden banknotes, and donating two dogs. In France, such dogs annually detect EUR 20 million of hidden banknotes, and since 2010, they have uncovered EUR 200 million in cash (GIZ video).

Sources:

https://www.youtube.com/watch?v=LsFVI9MOMDs

https://www.europol.europa.eu/publications-documents/why-cash-still-king-strategic-report-use-of-cash-criminal-groups-facilitator-for-money-laundering

http://www.fatf-gafi.org/media/fatf/documents/reports/money-laundering-through-transportation-cash.pdf

The programme in the Western Balkans collaborates with other countries in the region, such as institutions in Kosovo, Serbia, and Montenegro. The relationship with these countries is not as developed as in Latin America

and Eastern Africa; however, it addresses the aspect of inter-agency cooperation in the whole region.

At headquarter level in Germany, GIZ supports the inter-ministerial coordination on IFFs among BMZ, the Federal Ministry of Finance (MoF), the Federal Ministry of Interior including the Federal Police Office, the Federal Ministry of Justice, the Federal Ministry of Economic Affairs and Energy, and the Federal Foreign Office. This coordination is of utmost importance to ensure that Germany adopts a uniform position in the international processes and partnerships set up to combat IFFs. Furthermore, the involvement of these bodies opens up additional channels for efficient cooperation of the global programme with international organisations such as FATF, OECD, the UN-System, and the World Bank.[79]

A third advantage is the fact that the programme can advise the German ministries on the effect of their policies in developing countries . One example of this is the case of FATF. Money laundering in general and FATF in particular are often not looked at primarily from a development perspective. However, in Germany the MoF heads the German delegation to FATF – and not BMZ.[80] The MoF's decision-making focuses on the effects of FATF processes in Germany and on the global AML system, even though their institutional setup is not designed to automatically look at the effects in developing countries. As such, the programme assesses the (potential) effects of decisions made by FATF on the unique situation of developing countries and translates it into advice for BMZ and German practitioners. This ensures that the development perspective is considered in the process and reflected in Germany's positioning on FATF matters.[81]

Key insights from the programme

The GIZ global programme follows a holistic approach that comprises the entire value chain to combat IFFs: from prevention through detection and investigation to asset recovery and mutual legal assistance. Project activities are tailored to the specific national or regional context, and target necessities regarding human capacities, organisational development, cooperation systems, and regulatory frameworks. Those activities are then based on

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79. (Klemme 2017) (GIZ 2018) (Klemme, Barron and Lammers 2018) (Osore 2018) (Kovachich and Lammers 2018).
80. BMZ is the German Federal Ministry for Economic Cooperation and Development, and GIZ's main commissioning body.
81. Source: Correspondence with GIZ staff.

country priorities stipulated in national policies and strategies, identified in national and sectorial risk analyses, and highlighted by international assessments such as the FATF mutual evaluations.

A country's desire to attain a high level of FATF compliance can provide a good entry point for building partnership agreements that address IFFs and financial crime.

Our interviews identified FATF compliance as a key entry point for reform at national level. Many of those interviewed expressed their surprise that there was not more interest from donors to support FATF compliance, despite a strong desire from partner countries to meet FATF standards. Our contact from GIZ headquarters remarked that countries have a national interest to meet FATF standards. This is because FATF compliance is taken into consideration when ranking a country's credit-worthiness, and that country's risk according to FATF mutual evaluations has implications for foreign direct investment (FDI). A country's desire to attain a high level of FATF compliance can provide a good entry point for building partnership agreements that address IFFs and financial crime.

In Macedonia it was discovered that while criminal investigations tended to be well run, authorities neglected financial investigations, which which led to fewer prosecutions relating to financial crime. The focus of GIZ's activities in the country was to strengthen the ability of its authorities to conduct financial investigations. The programme identified several capacity gaps, such as the inability to tackle illegal cash movements and process them with financial investigations.

Another structural weakness leading to the neglect of financial investigations was the failure of different government agencies to share information. GIZ established a multiagency working group which included members from customs authorities, financial police, FIU, and public prosecution, and engaged with individuals at different levels of those agencies in order to ensure a wider buy-in to the idea of joint investigations and information and data sharing.

The FATF standards recommend that countries develop a risk-based strategy to tackle money laundering and the financing of terrorism. That is why GIZ supported Peru in analysing money laundering and terrorism financing risks in important sectors such as the financial, mining, fisheries, and timber sectors.[82] Moreover the programme advised Peru on the development of the long-term policy and the medium-term national plan to combat these crimes.[83]

In addition to this in-country work, the global programme also strengthened existing regional networks and organisations. For example, the hubs in Africa and Latin America support the regional asset recovery inter-agency networks as well as the FATF-style regional bodies (FSRB).

It was noted that some standard anti-corruption measures can actually weaken the effectiveness of programmes aimed at reinforcing financial investigations. For example, in Peru there is an anti-corruption measure that requires all police personnel to rotate positions every three years. This led to significant difficulties in creating a cadre of staff specialised in financial investigations.

One of the key insights from our research was that, while it had a global approach, the programme paid a lot of attention to the local context. For example, in Peru the National Risk Analysis regarding money laundering assumed that IFFs would be a major issue in the timber sector, as it is in neighbouring Brazil. However, after examining that sector the programme realised that, despite the high extent of illegal activities, there were no signs of major IFFs. Similarly, in the Balkans it was assumed that electronic transfers of IFFs would have been a significant issue; yet after assessing the situation it was realised that illegal cash transfers were also an issue and they adapted the programme accordingly.

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82. Sectorial Assessments of Exposure to Money Laundering and Terrorist Financing Risks.
83. National Policy and Plan against ML / FT.

3.3. Evaluation of existing policy responses

In many developing countries, there is very low compliance with FATF standards and there are very few cases of successful asset recovery.

Despite the many initiatives to curb IFFs, the existing initiatives and policy responses face several challenges. In many developing countries, there is very low compliance with FATF standards and there are very few cases of successful asset recovery.[84]

There are a number of possible explanations for the ongoing challenges in preventing IFFs in developing countries. First, there is a lack of political will. In many cases, corrupt officials tend to protect their own interests by remaining passive to the mechanisms that are essential to combat IFFs and to promote asset recovery. In cases where the necessary initiatives have been adapted, there is often a lack of implementation of laws and policies. This may be due to lack of will, resources, or expertise.

Second, the existing international initiatives present a number of weaknesses. Many of the most important initiatives have not been integrated into developing countries' legal frameworks. Few developing and emerging countries have been actively part of the development of such initiatives. The FATF recommendations, for example, to some degree fail to take into account specific characteristics of developing countries, such as the economy being largely cash based, the lack of financial inclusion that leads to the dependence on informal banking systems, and the use of informal value transfer methods. Another weakness with many international standards[85] is that they lack a legal enforcement mechanism because they are soft laws. As a result, the initiatives can easily be watered-down at national level.[86]

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84. Chêne 2017; FATF 2019.
85. Excluding the UNCAC.
86. Massa 2014.

Third, the existence of regulatory loopholes and weak governance in many developing countries, together with a low level of expertise and knowledge, constrains effective implementation of international standards. In the case of asset recovery, a country requesting the recovery of assets can be perceived as being highly corrupt, and the country receiving the request may refuse to participate in repatriation, due to the risk of the assets entering into dark channels again.

Fourth, tackling IFFs requires inter-institutional collaboration at the national level and across borders. For example, FIUs, prosecutors, and the judiciary have to work together effectively to tackle money laundering. However, there is often a lack of collaboration between authorities, locally as well as internationally, which limits the effectiveness of investigations of IFFs.[87]

There are examples of successful cooperation and the return of stolen assets. In 2005, following a decision by the Federal Supreme Court of Switzerland, the governments of Nigeria and Switzerland agreed on a process to return USD 458 million stolen by the late military dictator General Abacha. The repatriation of these funds was one of the first cases of looted funds being returned.[88] Moreover, in April 2019, ICIJ, the investigative journalists behind the Panama Papers, reported that more than USD1.2 billion has been publicly collected by governments after the 2016 investigation.[89]

The Financial Transparency Coalition (FTC[90]) questions the role of financial institutions in curbing IFFs. Conventional thinking holds that it is the country's head of state, minister of finance, and other elected officials who set the rules of its financial system. However, this is not always the case. There are many international institutions that establish the standards and rules of financial systems. In many cases, elected officials have little or no say in these standards, but are obliged to follow them. Some of these institutions, mentioned by the FTC, are FATF, the Bank for International Settlements,[91] the Basel Committee on Banking Supervision,[92] the Financial

87. Ajayi and Ndikumana 2014, 229.
88. World Bank 2005.
89. ICIJ 2019.
90. FTC 2016.
91. Today a multifunctional player in the financial area, it operated in the private market as an assets manager and lender. The Bank of International Settlements is often referred to as 'the bank of central banks'. As of 2015 it had 60 members, where only 21 came from the Global South.
92. Offers regulatory guidelines that assess banking risks and bank capital requirements. The guidelines have no legal force and are considered soft law. However, these are often

Stability Board,[93] International Accounting Standards Board,[94] and the International Organization for Securities Commissions.[95]

FTC criticises these institutions for having significant influence, without enough transparency and accountability in how they operate. Moreover, these institutions may not be inclusive enough to address global IFFs, as the membership is often small and there are usually few seats at the table for developing countries. Many of their non-binding norms and standards are being implemented in developing countries in a one-size-fits-all approach without properly questioning their suitability at the local level.[96] FTC recommends that these institutions should increase their transparency and include non-government stakeholders in their processes to ensure accountability; that their decisions should be subject to healthy scrutiny; and that the membership needs to be globally representative and include middle- and low-income countries.[97]

Assessing the GIZ global programme

The programme is a well-developed one in that it recognises the fact that tangible activities, beyond data gathering and research activities, to address the problem of IFFs can be initiated at country, regional, and global levels. This is perhaps its biggest success given that much of the literature suggests that, in order to address the problem of IFFs, it is first necessary to document evidence and collect data. Certainly, as GIZ staff have acknowledged, data sharing is crucial to the success of the programme, but it also demonstrates that key activities which build institutional capacity to investigate and prosecute financial crime can be achievable at country level.

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translated into actual law at the national level. The Basel Institute on Governance has expressed concerns that the principles and regulations only consider the European and US contexts, and can potentially be damaging to developing countries.

93. Was given the mandate to develop and coordinate global financial regulation in the aftermath of the 2008 financial crisis. Its recommendations cover a broad range of issues; they have far-reaching impact and developing countries are often the first to implement them.

94. Based in London, it has evolved from setting basic accounting standards to developing global norms on financial reporting. Despite having a role as a gatekeeper in global accounting standards, it is not a public institution and is financed by voluntary contributions from various private firms and government agencies. The funding model has been criticised for potential conflicts of interest.

95. The international body that convenes global security regulations and is recognised as the global standard setter for the security sector. The body is responsible for regulating more than 95% of the world's security markets.

96. Massa 2014, FTC 2016.

97. FTC 2016.

It identifies a number of entry points for engaging development partners with the IFF agenda at country level – in particular, highlighting the relationship between FATF compliance and favourable credit and country-risk ratings. The legal and institutional reform needed at country level to meet FATF standards thus becomes an issue tied to national interests.

Box 7: South-to-South IFFs

While traditionally one may associate IFFs with transfers from developing to developed nations, increasingly IFFs often involve two or more south–south exchanges. This can lead to complex money laundering schemes that involve the transfer of funds obtained from corruption to a second country. There, the illicit funds are used to establish a legitimate private enterprise. That enterprise then invests the funds back either into the source country or a third country.

(Source: informant interview)

What is also promising about this programme is that it makes use of a broad definition of IFFs which is not limited to international flows but includes illegal domestic flows of capital. Its level of sophistication, particularly in how it coordinates activities at national, regional, and international levels and advances inter-regional cooperation, is to be celebrated. It was acknowledged that key regional locations, both in the Gulf and on the African continent, facilitate transnational money laundering. This illustrates the need to engage actors outside of the traditional framework of development assistance i.e. Gulf nations and sultanates.

That being said, any programme designed to address the issue of IFFs will be judged on its ability to produce tangible results beyond the activity level. Ultimately, its success will be dependent upon either a reduction in the levels of IFFs or a corresponding increase in the number of public prosecutions for financial crime related to illegal transfers, money laundering etc. At present, those types of figures, as GIZ staff have acknowledged, are not yet available. As a result, this programme, although extremely promising in its design and activities, is susceptible to the problems plaguing other types of anti-corruption reforms that see the problem of corruption in terms of institutional or capacity weakness, or as a deviation from law-abiding behaviour. Corrupt practices also need to be

understood in relation to the structure of social relations within wider society, prevalent social behaviour and norms, and social status incentives tied to the accumulation of wealth. When IFFs are viewed as a technical problem, the solution to that problem also appears technical. Yet the mixed success of other anti-corruption initiatives necessitates an approach that also addresses the non-technical, social issues that enable corruption.

4. Recommendations for development practitioners and donors

The principal aim of this paper is to offer operationally useful policy guidance to country-level development practitioners on how they might consider transnational corruption, specifically IFFs, as part of their strategic approach to in-country anti-corruption measures. We began this paper with a guide to the key issues needed to understand what IFFs are, how they relate to a country's development, and the relationship between corruption and IFFs. This was followed by a survey of international instruments, agreements, and processes designed to address the problem of IFFs, including an assessment of existing policies. Assessment of those policies has been hampered by a lack of consistent and concrete evidence of their potential impact. In order to evaluate existing practice, we included an assessment of a GIZ global programme designed to link country-level activities to regional and international bodies. To conclude, we present both general and practical in-country recommendations based on the research. While the emphasis of these recommendations remains at the country level, we also include more general recommendations given the need for wider regional and international support to address the global dimensions of IFFs.

The general recommendations are largely at the national government level, illustrating how governments and donors can leverage their influence for change in existing laws, address the problem that tax havens pose, encourage transparent beneficial ownership, and press for domestic and international regulation of financial sectors. A key issue relevant to these recommendations is the role that supporting sectors play in enabling IFFs – particularly the role of accountancy firms, lawyers, notaries and so forth. This is especially important as often these sectors also play conflicting roles in the discovery of corruption. These issues point to the very general recommendation of encouraging greater transparency within the economy as

a whole. Since the economic crisis of 2008, increased scrutiny of the financial sector has risen up the policy agenda and, subsequently, economic transparency has been embraced by the World Economic Forum and others. Registers of beneficial ownership are one such tool to increase the transparency of this sector. We also recommend that resources should be used to foster greater collaboration and inter-ministerial dialogue. These general recommendations help to build a wider approach towards controlling illicit flows.

4.1 General recommendations

Legal changes and improved regulation

Donors should use their influence to:

- Push for changes in existing laws in order to close current loopholes (for example, improving money laundering legislation to include the mainstream financial system),
- Urge governments both in home and host countries to regulate and control tax havens within their jurisdiction,
- Encourage beneficial ownership transparency (this can, for example, be achieved by compliance with FATF or EITI standards for beneficial ownership),
- Increase regulation and supervision of the financial as well as the non-financial sector (especially notaries, lawyers, accountants, luxury traders, and casinos), with new regulations to focus on how the domestic financial sector links with the wider global financial system, and
- Change legislation to encourage greater transparency within the economy.

Programme recommendations

- Donors should consider programmes that tie together activities at national, regional, and international (including home countries) levels.
- Governments should consider using their development aid budgets to support inter-ministerial dialogue on IFFs in their own countries. This approach is already in operation in the UK and Germany, and is being discussed in Switzerland.

4.2 Practical recommendations for the country level

Working at the country level poses several challenges and requires a thorough understanding of the local political and social contexts to assess which sectors are high risk for illicit flows. The following recommendations propose a number of approaches towards addressing in-country illicit flows as well as identifying key entry points for engagement on this issue with local and national governments and agencies. For example, many countries have a strong desire to meet FATF standards as compliance with them is a factor which influences their credit rating. Putting aside the question of how reliable those credit ratings actually are, the fact that they are often taken into consideration in relation to FDI decisions is a strong incentive towards FATF compliance.

Successful collaboration between enforcement, legal, and financial agencies has led to a coordinated policy response to IFFs.

Coordination is an important area both between donors but also at inter-ministerial and agency levels. By highlighting the GIZ programme, we have shown that successful collaboration between enforcement, legal, and financial agencies has led to a coordinated policy response to IFFs. Supporting civil society as partners can aid this approach – particularly when civil society organisations can present evidence to legal authorities to support those agencies' work in detecting and prosecuting money laundering and corruption offences.

Strategy and entry points

- Follow a value chain approach from prevention through detection and investigation to asset recovery and sanctions.
- Prioritise activities according to national policies and strategies, national and sectorial risk analyses, and international assessments such as the FATF mutual evaluations.
- Use the strong desire of countries to meet FATF standards as an entry point for reform. Countries have a national interest to meet these

standards as FATF compliance is taken into consideration when assigning a country's credit rating, which has implications for FDI.

- Conduct national and sectorial risk analyses to identify areas or sectors most prone to IFFs. For example, training of border and customs officials to detect cash transfers was more important in Macedonia than initially thought.

Collaboration, coordination, and support

- Link with core in-country authorities and establish good relationships both between the donor agencies and the authorities but also among domestic authorities. The latter can be achieved by establishing joint working groups and providing platforms for dialogue and information sharing.

Creating inter-institutional cooperation is a challenge but it is necessary to overcome institutional silos in order to effectively tackle the problem of IFFs, which naturally cut across competences of different institutions.

- Use existing structures to create dialogue within the country, region, and among international development partners.
- Develop inter-regional cooperation and facilitation of information sharing.
- Have in mind the wider donor community in order to create strategic links with other donors and increase coordination towards strengthening the capacities of authorities to cope with increased demand for activities. Establish donor coordination committees to meet regularly every quarter to share information on their anti-IFF activities.
- Make use of FATF regional bodies and regional asset-recovery networks when developing interventions at country level. Building regional support through these bodies can strengthen their work as well as the impact of in-country activities.

Working with civil society

- Avoid the exclusion of civil society in donor-led programmes. Often the vital role that civil society can play is neglected in such programmes, yet its activities have had a significant impact on uncovering the size and scope of IFFs. For example, the Panama and Paradise Papers were brought to light by investigative journalists and Civil Society

Organisations (CSOs).

- Work with journalists and non-governmental organisations to strengthen programmes focusing on institutions. For example, journalists can help government agencies in their investigations of illegal activities by providing much needed data.
- Donors should use existing contacts with CSOs from programmes engaged in social accountability work. This can help in creating advocacy platforms to push for legal and other reforms.
- Train investigative journalists on the topic of IFFs.

Donor flexibility

- Donors need to be aware that addressing the issue of IFFs takes time and needs to be reflected in project cycles, and monitoring, evaluation, and learning approaches.
- Donors should consider integrating IFF programmes into longer-term strategic plans for addressing in-country corruption.
- The donor community needs to be flexible in their programmes so that they are needs-driven and avoid replication of activities.

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