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Combating illicit financial flows: The role of the international community

Query

What is the role of G20 / OECD DAC countries in combating illicit financial flows from developing countries at the international level and on the ground?

Purpose

Provide support to donor activities in this area.

Content

Summary

Illicit financial flows have pervasive effects on developing countries' social and economic development. In many countries the volume of financial outflows exceeds the inflows of aid and foreign direct investment due to corruption, money laundering, tax evasion and avoidance.

The international community and particularly countries that are members of the G20 and the OECD Development Assistance Committee (DAC) have an important role to play. At the international level, global standards to identify and prevent cases of money laundering need to be strengthened and enforced, including rules to identify politically exposed persons and beneficial owners. The international community can also advance international standards related to tax evasion and avoidance, such as rules requiring multinational companies to report on their country of operation and tax authorities to automatically exchange information, while maintaining policy coherence. Increased enforcement of foreign bribery infractions and the freezing and repatriation of stolen assets may also help to send the message that corruption is not tolerated.

At the domestic level, donors can provide technical assistance and capacity building to developing countries. They are also in a good position to support civic organisations that hold governments to account and can fund further research on illicit financial flows in specific countries to help target their development assistance.

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1 Illicit financial flows: Introduction

Illicit financial flows are the movement of illegally acquired, transferred or spent funds across borders (Fontana & Hansen-Shino 2012; Transparency International 2014). This definition includes relatively simple activities, such as transferring funds abroad without paying taxes, as well as complex schemes involving sophisticated corporate structures and organised criminal groups (OECD Bank 2014a).

Measuring the amount of illicit financial flows is a great challenge. It is estimated that in 2011 a total of US$946.7 billion in illicit outflows was lost – a significant increase compared to the US$270.3 billion lost in 2002 (Global Financial Integrity 2013). According to Global Financial Integrity, developing countries have lost a total of US$5.9 trillion over the last 10 years.

In many developing countries these outflows may greatly exceed the inflows of aid and net foreign direct investment (FDI) (Reed and Fontana 2011). In Africa, for instance, between 1980 and 2009, US$1.2 to 1.3 trillion left the continent, with an average annual outflow of US$50 billion. At the same time, foreign direct investment flows in 2008 were US$38 billion and US$68 billion in 2009 (African Development Bank and Global Financial Integrity 2013).

It is however important to bear in mind that the methodology behind such estimates, often produced by reputable NGOs, has been questioned by academics and practitioners. In general, they may provide little more than a hint of the magnitude of the problem.

The sources of funds for these cross-border transfers usually involve corruption, such as bribery and embezzlement by government officials, money laundering associated with criminal activities such as drug and human trafficking, and tax-related illicit financial flows, such as tax evasion and transfer mispricing (Transparency International 2014).

Studies have shown that corruption accounts for approximately three percent of illicit financial flows from developing countries. Criminal activities by organised criminal groups amounts to approximately 35 percent of the outflows, and tax evasion and avoidance, particularly through transfer mispricing, account for 60 to 65 percent of the flows (Global Financial Integrity 2013).

While only a small percentage of the financial outflows are directly connected to embezzlement and bribery, corruption is inextricably linked to all the other issues that generate illicit financial flows. Corruption is often used as a means to ensure companies, individuals and criminal organisations can evade taxes or launder the proceeds of criminal activities and avoid punishment (Reed and Fontana 2011).

Illicit financial flows adversely affect both developed and developing countries. The impact in developing countries however is particularly pervasive as they have smaller resource bases and markets (World Bank 2014a). Illicit financial flows hamper economic and social development and they directly affect the ability of public institutions to access resources and provide goods and services.

The international community and particularly countries that are members of the G20 and of the OECD Development Assistance Committee (DAC)[1] have a dual role to play in this area. As major destinations for illicit financial flows from developing countries, they have the responsibility to build strong domestic and international frameworks against illicit financial flows. As donors, they can help developing countries build the relevant capacities on the ground to fight illicit flows (OECD 2014a; 2014b; Action Aid at al 2013). Policy coherence, that is, the way in which these two roles are reconciled and made consistent, should be the key objective for OECD and G20 members.

2 The role of G20 / OECD DAC countries in combating illicit financial flows from developing countries

As many of the G20 / OECD DAC countries are also the main destination for illicit financial flows from developing countries, they must ensure they have the necessary safeguards in place to prevent illicit funds from coming in and to freeze, seize, and return stolen assets. (OECD 2014a).

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[1] The OECD DAC currently has 29 members, including the European Union, while the World Bank, the IMF and UNDO participate as observers. G20 countries that are also part of the OECD DAC include: Australia, Canada, France, Germany, Italy, Japan, the United States, the United Kingdom and the Republic of Korea.

Within the G20 platform, member countries aim to lead by example by achieving individual and collective progress on their anti-corruption and tax-related commitments (G20 2013). The G20 also has considerable influence over international standards on issues relating to illicit financial flows that are put in place by the OECD and other international organisations. Moreover, as part of the OECD DAC, these countries play an instrumental role in guaranteeing policy coherence and supporting the economic and social development of low and medium income countries.

Against this backdrop, the international community plays an important role in ensuring that rules regarding money laundering are effectively implemented and enforced, clear rules on tax evasion and avoidance are set and implemented, secrecy jurisdictions are limited, anti-bribery conventions are effectively enforced, and stolen assets are effectively confiscated and repatriated.

This section analyses the role of G20 / OECD DAC countries in the above mentioned areas.

Money laundering

Overview

Money laundering allows corrupt public officials and other criminals around the world to "re-integrate stolen assets into the global financial network in a manner that does not raise suspicion" (FATF 2011). Within this framework, the fight against corruption and the fight against money laundering are intertwined.

Western banks and non-financial institutions in G20 / OECD DAC countries are to a great extent responsible for receiving, transferring and managing illicit funds from developing countries. For instance, in the case of Theodor Obiang, President of Equatorial Guinea, a US investigation concluded that an American financial institution had failed to comply with anti-money laundering rules by allowing embezzled money from Equatorial Guinea to pass through the country (Basel Institute on Governance 2011). More recently, HSBC was also involved in a scandal where the bank allegedly laundered proceeds of criminal activity in Mexico and Colombia (Financial Times 2012).

The Financial Action Task Force (FATF) provides specific recommendations for tackling money laundering and while G20 / OECD DAC countries are members of the FATF Global Network, compliance with these recommendations in such countries is still not a given (OECD 2014a).

The analyses of the inventory of grand corruption cases compiled by the FATF in 2011 shows that in 27 of the 32 grand corruption cases analysed[2], the authorities involved made use of foreign accounts to hide the proceeds of corruption. In most cases, the assets were hidden in more than one foreign jurisdiction, including secret jurisdictions such as the United States (19 cases), the United Kingdom (13 cases), Switzerland (15 cases), as well as the Cayman Islands, Singapore, Hong Kong, Jersey, Bahamas and others.

According to the FATF recommendations, financial institutions are required to know their customers, understand their risk profiles, their source of wealth and monitor their transactions. Proper due diligence requires financial institutions to identify the beneficial owner in cases where the client is a corporate body or trust. Financial institutions should also be extra careful in cases involving politically exposed persons (PEPs). These two issues are instrumental for effectively fighting money laundering and corruption and ultimately reducing the amount of illicit flows from developing countries.

PEPs

PEPs are understood as individuals who currently hold (or held in the recent past) public positions and those closely linked to these individuals. Due to their position and potential influence, PEPs, their close family members or business associates generally present a higher risk for potential involvement in corruption. Financial institutions should consequently perform enhanced due diligence and monitoring of accounts that fall within this category (Transparency International 2014).

However, developed countries consistently fail to comply with these recommendations. For instance, an analysis carried out by the OECD based on FATF assessments of compliance shows that none of the OECD countries are fully compliant with recommendations related to PEPs, meaning that they

[2] The grand corruption cases inventory is part of the report *Laundering the Proceeds of Corruption* published by FATF in 2011. The inventory represents a summary of 32 corruption cases which the project team used to draw conclusions regarding the nature of money laundering and corruption.

all fail to identify whether or not the customer is a PEP (OECD 2014a). Investigations conducted by the UK Financial Service Authority in 2011 also show that more than one third of the banks in the UK ignored PEP due diligence requirements, even in cases when there was enough information available to identify a client as a PEP (OECD 2014a).

What is the role of G20 / OECD DAC countries?

Within this framework, G20 countries should seek to strengthen supervision of financial institutions to guarantee that the necessary attention is paid in cases where PEPs are involved. Banks, other financial institutions and real state agencies failing to comply with this requirement should receive an adequate and dissuasive sanction.

However, one of the problems related to the due diligence process to uncover PEPs lies on the fact that there is no comprehensive public database available to financial institutions and the public at large. There are several commercial providers of PEP databases currently available which license their data to banks under a proprietary model. Nevertheless, these databases cannot be viewed, validated or discussed by external stakeholders, limiting their scope as effective anti-money laundering tools. G20/ OECD DAC donors can support the establishment of an open database on PEPs that could be accessed by financial institutions, law enforcement officials and the public.

Beneficial ownership

A beneficial owner is the natural person who ultimately owns, controls, or benefits from a company or trust and the income it generates (Global Witness 2014; Transparency International 2014).

The FATF recommendations stipulate that the identity of the actual beneficial owner of a company should be available to the authorities in an adequate, accurate and timely manner (FATF 2012). The majority of countries seek to comply with this recommendation by requiring banks, company formation agents, and other financial professionals and intermediaries to assess who is the beneficial owner of corporate clients.

Most countries fail to meet FATF recommendations in this area, which are easy to circumvent (Global Witness 2014). Only nine percent of OECD countries comply with the FATF recommendation regarding disclosure of the beneficial owners of legal persons. Compliance with the recommendation to disclose beneficial ownership in other legal arrangements (i.e. trusts) is even worse. None of the OECD countries fully comply and only 12 percent are largely compliant (OECD 2014a).

At the same time, research shows that beneficial ownership is frequently used by corrupt individuals to hide their assets. The analysis of the inventory of grand corruption cases compiled by the Financial Action Task Force (FATF) in 2011 shows that politicians and public officials often abuse loopholes or lack of enforcement to hide stolen assets. In 28 out of the 32 cases analysed, the authorities involved (or their families) made use of corporate vehicles to hide the actual beneficiaries. “Gatekeepers” such as lawyers or accountants were used in 14 cases (FATF 2011). The Star Initiative review of 150 grand corruption cases also shows that corporate vehicles were used to hide allegedly illicit money in almost all cases (Star Initiative 2011).

What is the role of G20 / OECD DAC countries?

Ensuring timely access to accurate beneficial ownership information is crucial in the fight against corruption. Each G20 country should take concrete steps towards tackling secrecy and publicly commit to establishing public registers of beneficial ownership information for companies and trusts as a new global standard (Global Witness 2014).

Clear timelines for the adoption of these public registers should be established. It is also critical that the information is made available to the public for free and in machine-readable format (i.e. transferrable to electronic formats) (Global Witness 2014; Transparency International 2013).

In addition, G20 countries should also pressure secrecy jurisdictions to adopt similar standards (Global Witness 2014).

A study commissioned by Global Witness in 2013 shows that putting beneficial information into the public domain is relatively cheap and much more cost effective than the ad hoc system countries currently have in place. According to the study, a UK register detailing beneficial ownership information that can be searched and updated as ownership changes would cost £11 million (US$16.7 million) a year for the government and approximately £4 million (US$6.1 million) a year for the private sector, with an initial investment of £24 million (US$36.5 million) (Howell and Co 2013).

Public registers will make the process more transparent, resulting in fewer opportunities to circumvent FATF recommendations. In addition, such registers can also facilitate investigations by law enforcement agencies and allow civil society, academics, journalists and ordinary citizens to scrutinise who owns companies and other legal structures, as well as to identify false or incomplete information and detect crime and corruption.

What has been done?

In 2013, the G8 adopted an action plan based on principles to prevent the misuse of companies and legal arrangements. The action plan was accompanied by individual plans for each of the G8 countries (Star Initiative no year), and led to the UK officially confirming the intention to adopt legal requirements for companies to register beneficial owners in a central, publically accessible register. The rule however would not cover trusts.

A new money laundering directive is currently being discussed by the European Parliament. If the draft directive is approved, ultimate owners of companies and trusts will have to be listed in public registers in EU countries (European Parliament 2014).

In the US, two pieces of relevant legislation have been introduced in Congress, but have not yet been approved. One is aimed at holding to account top executives at financial institutions who are responsible for overseeing anti-money laundering compliance at their bank, and the other requires firms incorporated in the US to disclose their beneficial owners in a central registry that is accessible to law enforcement officials (Wayne 2014).

Tax evasion and avoidance

Overview

As mentioned, a great deal of illicit financial flows from developing countries seems to be related to tax evasion and tax avoidance practices. Companies and individuals have been using foreign accounts, preferably in secrecy jurisdictions, to place their money without complying with tax laws.

Likewise, multinational companies have been exploiting legal loopholes to avoid paying taxes in developing countries. Christian Aid estimates that developing countries lose approximately US$160 billion annually due to tax avoidance and tax evasion (Eurodad 2008).

Issues such as a lack of transparency in corporate reporting, the use of secrecy jurisdictions to evade taxes, and transfer mispricing (which is the manipulation of import and export prices utilised by companies with subsidiaries in different countries with the aim of reducing their tax burden by avoiding the payment of taxes where the income is generated) have serious negative consequences for developing countries (Hearson, 2014; Action Aid et al 2013).

Considering that policy-making in many tax-related areas is heavily influenced by international standards, G20 countries play a key role in closing loopholes that allow tax evasion and avoidance. Action is needed at both the international and domestic levels if the international community is serious about supporting resource mobilisation in developing countries.

For instance, more transparency about multinational companies' operations, including a requirement to publish data on every country where they do business (country-by-country reporting) may help developing countries, civil society and the media determine how much the company is contributing to the country's budget and spot potential irregularities (Reed & Fontana 2011). At the moment, regulations for the majority of sectors do not require multinationals to report on their profits, assets, taxes and number of employees on a country-by-country basis. A study conducted by Transparency International in 2012 shows that only four percent of the 105 multinational companies assessed produce country-by-country reports (Transparency International 2012).

What has been done?

In 2012, G20 countries requested the OECD to carry out more in-depth analysis of the issue of tax-base erosion and profit shifting (BEPS) to address issues such as trade mispricing. This culminated in the BEPS Action Plan published in 2013, which presents 15 actions to establish fairer international tax standards, with deadlines for implementation throughout 2014 and 2015 (OECD 2013). The plan aims to involve developing countries in the process, but it remains to be seen how this will develop in practice. Some experts have pointed out that two years may be too short a timeframe for such a complex reform (Hearson 2014).

In addition, all G20 countries are now signatories to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, and the global standard on Automatic Exchange of Information (AEOI) was endorsed in February 2014 (G20 website).

What is the role of G20 / OECD DAC countries?

There is broad consensus among researchers that G20 / OECD DAC countries can play an important role in:

Requiring multinational companies to improve tax transparency and compliance in developing countries in which they operate

As G20 / OECD DAC countries also host the majority of multinational companies operating in developing countries, they can play a key role in ensuring compliance with international standards. They can also certify that domestic rules are applied and that transfer pricing practices do not result in tax avoidance (IMF et al 2011).

Ensuring developing countries are consulted, represented and engaged in setting international tax standards

As the OECD is the main body setting the standards in key international tax policies that affect developing countries (Hearson 2014), it is important that OECD members support broader participation of developing countries in the discussions (Action Aid 2013).

Pushing for the inclusion of country-by-country reporting as an international standard for multinational corporations

G20 countries can also ensure that such international standards guarantee the necessary level of detail and frequency of reporting and that the information is disclosed to the public. Some G20 members have made important steps by requiring country-by-country reporting in certain sectors (e.g. the Dodd Frank Act in the US, and the EU's 2013 decision to implement similar requirements in the extractives sector). Other countries should follow these examples and expand such requirements to companies operating in different sectors (Transparency International 2013a).

Supporting spontaneous information sharing in international tax fraud cases (IMF et al 2011) Automatic information exchange has been endorsed by the G20 as the new global standard. According to non-governmental organisations advocating for more transparency in tax issues, the G20 should establish a multilateral platform allowing for the implementation of the new standard and ensure that developing countries are included in the process (Action Aid et al 2013). In addition, G20 / OECD countries have to fully implement the agreed upon international standards and expand exchange of information agreements with developing countries (OECD 2014a).

Encouraging policy coherence between tax rules and development aid activities

Considering that many of the G20 / OECD DAC countries are home to companies involved in tax evasion and avoidance while also providing aid to developing countries, they should ensure their tax policies do not negatively affect developing countries. (Action Aid et al 2013; Hearson, 2014). Therefore, the International Monetary Fund (IMF) and G20 countries should conduct "spill over" analyses of the impact of their tax system on those of developing countries (IMF et al 2011; Hearson, 2014).

Encouraging international organisations and donors to broaden and strengthen their assistance programmes to cover tax administration capacity development

During 2010/2011, only 0.08 percent of official development assistance (ODA) to developing countries supported issues related to tax administration and customs, despite how important such measures are for enhancing domestic resource mobilisation (OECD 2014a; 2014b). Donors however can provide more targeted assistance to strengthen developing countries' tax administration, reduce corruption and prevent illicit flows (OECD 2014a; Fontana and Hansen-Shino 2012).

Making transparent their exemptions on ODA funded goods and services and encouraging other development agencies to do the same

Tax exemptions on transactions involving foreign development assistance and for donor-funded projects have distorting effects and have contributed to the erosion of tax bases in developing countries. Governments receiving foreign aid could also consider imposing taxes on imported goods and services for bilaterally and multilaterally funded projects (CMI 2005; IMF et al 2011).

Asset recovery

Asset recovery refers to "the legal process of a country, government and/or its citizens to recover state resources stolen through corruption by current and past regimes, their families and political allies, or foreign actors" (Transparency International 2009). The recovery and repatriation of stolen assets is instrumental in the fight against illicit financial flows. It not only provides additional financial support to developing countries but also acts as a deterrent by showing that corrupt officials cannot easily hide the proceeds of corruption and go unpunished (OECD 2014b).

G20 / OECD DAC countries have made commitments to strengthen national and international policies, legal frameworks and institutional arrangements to facilitate the tracing, freezing and recovery of illegal assets (G20 2013; OECD 2011), and several of them have even made asset recovery a political priority (OECD 2014a).

However, progress in repatriating stolen assets has been very limited. For instance, a survey conducted by the Star Initiative shows that between 2010 and 2012 Switzerland froze US$786 million in stolen assets (58 percent of the total volume of assets frozen in OECD countries in that period), but only US$20 million were repatriated in the same period (OECD 2014a).

What has been done?

In 2012, the G20 launched an asset tracing country profile, containing information on how to find information about a natural person or legal person's assets. In addition, the group also published a step-by-step guide that provides states seeking mutual legal assistance from G20 countries with an overview of the requisite procedures in these countries to ensure requests are received and processed as efficiently as possible (Requesting Mutual Legal Assistance in Criminal Matters from G20 Countries).

What is the role of G20 / OECD DAC countries?

There is broad consensus among researchers that G20 / OECD DAC countries can support asset recovery by:

Implementing the United Nations Convention against Corruption (UNCAC)

The UNCAC[3] requires state parties to establish "the widest measure of cooperation and assistance" relating to the return of assets acquired through criminal offences covered by the convention. This includes setting clear rules on mutual legal assistance. National authorities play an important role in facilitating this process by deciding how the principles of proportionality, dual criminality and reciprocity will be applied, for example. At the same time, the international community can support these efforts by developing international standards, promoting appropriate avenues for formal cooperation, and developing guidelines on the use of alternative legal instruments (Star Initiative 2011).

Following international best practices for tracing, freezing and returning assets

Countries should facilitate the process of tracing, freezing and returning assets by allowing non-conviction based asset confiscation, permitting authorities to freeze funds based on requests from a foreign jurisdiction, allowing foreign countries to initiate civil actions in their courts, and enabling courts to order compensation, restitution, or damages to the benefit of a foreign jurisdiction. This also includes establishing mechanisms for the systematic exchange of information to ensure that law enforcement authorities in other countries also have access to information on ongoing asset recovery cases (UNCAC Coalition 2013).

Denying safe haven to proceeds of corruption

The UNCAC Coalition calls on signatory countries to introduce legal frameworks that enable them to take legal action against money launderers even in the absence of a request from another country (UNCAC Coalition 2013).

Allowing citizens and civil society organisations to seek redress in cases where public prosecutions do not take place

Article 35 of the UNCAC requires state parties to: take all measures as may be necessary, in accordance with principles of its domestic law, to ensure that entities or persons who have suffered damage as a result of an act of corruption have the right to initiate legal proceedings against those responsible for that damage in order to obtain compensation.

Foreign bribery

As mentioned, corruption is extremely interlinked with illicit financial flows. Fighting corruption "reduces the opportunities for financial gains and thus illicit financial flows" (OECD 2014a). Bribes paid by companies from G20 / OECD DAC countries in developing countries in order to be awarded a public contract, a concession or tax benefits have pervasive social, economic and political effects. While some of these acts do not necessarily involve the transfer of money abroad, the illicit gains obtained through corruption will however translate into outflows (OECD 2014a).

[3] Germany and Japan are the only G20 / OECD DAC countries that have not yet ratified the UNCAC.

OECD DAC members are all signatory parties of the OECD Anti-Bribery Convention and therefore required to criminalise bribery of foreign officials and act to ensure that individuals or companies engaging in such behaviour are punished. Nevertheless, implementation of the convention and the actual prosecution of foreign bribery cases in particular vary significantly among DAC countries. According to a study conducted by Transparency International, very few countries effectively prosecute foreign bribery cases. The US has the most developed legal and enforcement regime, followed by the UK and Germany (Transparency International 2013). Most other OECD DAC countries however have failed to prosecute any foreign bribery cases (Transparency International 2013, please see table 1 for an overview of the number of cases under investigation / commenced).

What is the role of G20 countries?

Members of the G20 and the OECD DAC can support the fight against corruption affecting developing countries by:

Criminalising foreign bribery

All countries should criminalise foreign bribery, in accordance to the OECD Anti-Bribery Convention and publicly report on their implementation and enforcement efforts.

Increasing enforcement of foreign bribery legislation

Adequate funding and staffing should be given to law enforcement agencies charged with investigating and prosecuting cases of foreign bribery (Barrington 2013). G20 / OECD DAC countries could consider setting up a specialised body to deal with foreign bribery, which can independently and autonomously investigate foreign corruption cases (Transparency International 2013).

Creating a level playing field

G20 / OECD DAC countries should call on countries signatory to the Anti-Bribery Convention to actively enforce the convention. In addition, they should encourage signatory countries to close existing loopholes and exemptions in their legal frameworks, such as those relating to facilitation payments (Barrington 2013).

Providing protection to whistleblowers

G20 / OECD DAC countries should adopt effective whistleblower protection rules and also commit to protecting whistleblowers in transnational corruption cases, in order to guarantee that victims of corruption will support investigations (Transparency International 2013).

Establishing dissuasive sanctions

Sanctions in cases of foreign bribery should be proportionate and dissuasive, including fines and imprisonment, and be applicable to both individuals and companies. There is currently a large disparity in the level of sanctions applied by different countries. The G20 could work with the OECD Working Group on Bribery in International Business Transactions on a review of sentencing practices in order to identify cases where sanctions do not adequately deter companies from engaging in corruption (Transparency International 2013). In addition, special attention should be taken in settlements in cases where companies voluntarily self-report corruption. G20 countries can play a role in ensuring that settlements are fair and credible by, for example, requiring prior court approval and publishing their terms (Transparency International 2013).

Improving statistical data collection and access to information

G20 / OECD DAC countries could push for more data on foreign corruption cases, which in turn would allow for more informed policy-making. Civil society organisations have been calling on signatory countries to produce reports on the numbers of investigations, convictions and acquittals, and for these to be shared proactively or upon request by authorities (Transparency International 2013).

What has been done?

The G20 published a series of guidelines regarding foreign bribery, including the Guiding Principles on Enforcement of the Foreign Bribery Offence (2013) and the Guiding Principles to Combat Solicitation (2013).

3 The role of development agencies in combating illicit financial flows from aid recipient countries

In addition to their role at the international level, G20 / OECD DAC countries can, through their development agencies, play a key role in combating illicit financial flows in recipient countries. Donor support in the areas of corruption, money laundering and tax evasion and avoidance is still relatively small. Besides providing technical assistance and capacity building to aid recipient countries, donors are also well positioned to help civil society organisations hold governments to account and fund further research into illicit financial flows in specific countries to help target their development assistance (OECD 2014a).

This section analyses what development agencies can do to combat illicit financial flows from developing countries, with a focus on the areas of money laundering, tax evasion and avoidance, as well as asset recovery. As corruption acts as an enabler of the above mentioned illicit activities, to effectively reduce illicit financial flows, donor activities should be combined with broader anti-corruption reforms and support for key institutions and organisations such as the judiciary, parliament and civil society (OECD 2011).

Money laundering

Given the transnational nature of money laundering, a great part of the literature focuses on combating money laundering through the adoption of international standards and on what developed countries can do to address this issue. Nevertheless, a series of reforms/interventions in developing countries are also necessary to efficiently combat money laundering and prevent money outflow.

Within this framework, international donors can support developing countries by designing and implementing anti-money laundering systems, as well as providing technical capacity and advisory services to strengthen developing countries' anti-corruption mechanisms and law enforcement systems.

This section analyses some of the activities international donors can support in this area, including:

Improving the legal framework

Donors can help developing countries adopt coherent laws to prevent and punish money laundering. An efficient anti-money laundering legal framework should cover a broad range of predicate offences, including the crimes of corruption and tax evasion. A predicate offence is a criminal activity from which the proceeds of a crime are derived. As money laundering is a derivative crime, and its status as a crime depends on the origin of the funds involved, it is extremely important that crimes such as corruption and tax evasion are included in the legal framework (Basel Institute on Governance 2011).

Moreover, in order to facilitate the detection of illicit enrichment, developing countries should pass asset declaration rules and establish disclosure requirements for PEPs as well as their spouses and close relatives. Disclosure should take place at regular intervals and cover a wide range of key information, such as assets, liabilities, income from all sources, gifts, and potential conflict of interests. There should also be an effective system for monitoring and enforcing the rules, and declarations should be made available so that members of the public, the media and even financial institutions can monitor officials' wealth variation overtime (Messick 2009). In addition, donors could support the establishment of national public registers to publish information on politically exposed persons. This could facilitate and strengthen due diligence processes (UNCAC Coalition 2013).

Building technical capacity

The complexity of money laundering requires a great degree of specialisation on the part of officials responsible for identifying and investigating suspicious transactions. Such capacity is often lacking in developing countries. Donors can help to develop this capacity in a wide variety of ways, such as by providing training and capacity building workshops, funding specialised staff to support the work of law enforcement authorities, prosecutors and judges for a set period of time, or through the secondment of professionals working for their own governments. For instance, on several occasions, USAID placed US prosecutors in developing countries to support domestic prosecutors and improve their skills (OECD 2014a). Areas where the development of capacity is particularly needed include multi-jurisdiction investigations and the process of responding to and formulating mutual legal assistance requests.

Prosecutors and judges also lack knowledge and understanding of existing rules and consequently do not make use of the full range of tools and sanctions available. For instance, in many developing countries the confiscation of criminal proceeds is rarely used as a punishment, which hampers the recovery of illegally acquired assets (Fontana and Pereira 2012).

In 2011, development agencies and international organisations arranged a series of training sessions with a variety of individuals considered key to curbing money laundering in Zambia, including law enforcement officials, judges and supervisory authorities, among others. The training focused on anti-money laundering principles with hands-on case studies (Goredema 2011).

Moreover, donors can also help to address developing countries' lack of necessary technical equipment to conduct complex investigations, such as wiretapping or electronic databases (e.g. property registries, asset declarations, etc.).

Strengthening supervisory institutions

The responsibility of different institutions regarding their role in monitoring compliance with anti-money laundering standards should be clearly defined by law. In many developing countries this responsibility is spread across different institutions which operate separately without any kind of coordination (e.g. central banks, financial intelligence units). Donors can support the adoption of a coherent framework to avoid duplication of structures and facilitate coordination among different institutions (Fontana and Pereira 2012).

The establishment of an effective mechanism for monitoring and oversight, such as financial intelligence units (FIU) or financial integrity authorities, is important for preventing and identifying suspicious transactions and is also considered a good practice. FIUs should be independent, well resourced, and operated in a transparent and accountable manner (Reed & Fontana 2009). Development agencies have helped developing countries establish such units and have provided technical expertise and built up the capacity of local officials. For instance, the Australian Financial Intelligence Unit provided several training courses in developing countries on how to establish FIUs, and the Norwegian Agency for Development Cooperation (NORAD) supported the establishment of a financial unit in Zambia (Goredema 2011).

Improving identification systems

Several developing countries still lack a proper identification system for their citizens and a functional physical address system, making it difficult to conduct proper due diligence procedures (Fontana and Pereira 2012).

Supporting the collection of data

Donors can support the establishment of a system to collect data, which can significantly help to anticipate criminal behaviour, identify trends, allocate resources to areas that are more vulnerable, and target auditing and enforcement efforts (Fontana and Pereira 2012).

Building the capacity of CSOs and the media

CSOs and the media play a key role in informing, advocating for reforms, investigating and publicising cases of corruption and money laundering. Supporting their work can help to build the necessary support and create an environment conducive to government action (Fontana and Pereira 2012; OECD 2011).

Tax evasion and avoidance

"Taxes are crucial for mobilising revenue to fund services, infrastructure and other development needs" and taxes are also crucial "for building the accountability of states to their citizens, and reduce inequality by redistributing wealth" (Tax Justice Network and Christian Aid 2014).

Developing countries often lack the necessary capacity to effectively regulate and administer the collection of taxes. In addition, the tax administration and law enforcement institutions in these countries often suffer from high-levels of corruption, making it easier for companies and individuals to evade and/or avoid taxes, which consequently increases the amount of financial flows leaving developing countries.

What is the role of development agencies?

Besides influencing and setting international tax standards, G20 / OECD DAC countries[4] can also play a key role in helping developing countries to better manage their expenditures and improve tax collection. Donors' activities in the area of tax and development tend to focus on domestic resource mobilisation, where the primary objective is to maximise public revenue. Donors can however coordinate their efforts to also provide more targeted assistance for combating illicit financial flows, which is essential to fully achieve sustainable domestic resource mobilisation. Ultimately, these two tax agendas are closely interconnected and should be addressed as such (Hearson, 2014).

Research shows that development assistance aimed at improving developing countries' tax systems can yield good results. According to the OECD, "each dollar

[4] The IMF is the leading organisation supporting developing countries on tax-related issues; G20 countries can also exercise pressure to ensure that reforms adopted by the IMF at the country level address issues that cause financial outflows from developing countries.

spent on tax systems can generate several dollars in tax collected" (OECD 2014b). For instance, the UK's Department for International Development (DFID) provided support to the Rwanda Revenue Authority, which significantly improved the country's tax collection. At one point, the tax revenues received every three weeks were equal to the amount Rwanda was receiving in aid (GBP 24 million, US$36.5 million) (OECD 2014b). In El Salvador, between 2004 and 2010 USAID provided more than US$5 million to improve tax collection. As a result, El Salvador increased its annual tax revenue by US$350 million (OECD 2014a).

Within this framework, G20 / OECD DAC countries can support international cooperation, provide technical assistance to developing countries in the areas of tax policy-making, administration and enforcement, as well as invest in measures aimed at curbing corruption and enhancing transparency and accountability in both tax revenue and public expenditure. Interventions aimed at strengthening the judiciary and law enforcement institutions are also necessary to put an end to a culture of impunity and build tax morale. Examples of possible interventions include activities aimed at:

Supporting the simplification and standardisation of tax rules and procedures

Donors can support measures to simplify tax rules and procedures. Such measures will reduce tax officials' discretionary power and potential abuse of tax laws, while making it easier for companies and individuals to comply with requirements (Rahman 2009). The establishment of automated systems may also help to reduce the discretionary power of tax officials and reduce opportunities for corruption. Donors have played an important role in supporting the adoption of electronic tax systems in several developing countries.

Supporting the regulation and enforcement of transfer pricing

Transfer mispricing negatively affects domestic revenue mobilisation as companies operating in developing countries use legal loopholes to avoid paying income taxes. For instance, an analysis of mining companies operating in Sierra Leone shows that as of 2011 only one of the major mining firms was paying corporate tax. None of the top five were reporting profits despite the rapid growth of mineral exports (Tax Justice Network Africa and Christian Aid 2014).

Donors can help developing countries work out which regulations are required to prevent transfer mispricing and support the development of legislation and guidance in this area. In addition, donors can help to build tax administration expertise and experience in transfer pricing that will enable tax officials to carry out effective audits and enforce the rules (IMF et al 2011). For instance, the Norwegian development agency has financed the audits of three mining companies operating in Zambia to assess whether their transfer pricing policies are in accordance with international standards (OECD 2014a).

Moreover, in many developing countries it is difficult to obtain information regarding the prices or profit margin of other companies conducting similar transactions, which is used to determine the amount of tax to be paid when companies undertake intra-group transactions (arm's length principle). Donors can support the adoption of administrative provisions to facilitate access to such information (IMF et al 2011).

Development assistance can also focus on supporting the operation of adequate dispute resolution mechanisms to ensure that issues related to transfer pricing are dealt with in a fair and timely manner.

Supporting human resources management reforms

Support can be provided to ensure an effective recruitment and advancement system conducive to attracting, retaining and motivating highly qualified staff. Improved salaries, retirement benefits and physical working conditions should also be part of the reform efforts (CMI 2005).

Supporting enforcement

Support can be provided to establish and strengthen revenue administration bodies. For instance, the Canadian Development Agency (CIDA) – backed by the expertise of the Canadian Revenue Agency – provided assistance to establish a specialised unit responsible for collecting and managing taxes in several developing countries (Goredema 2011).

Technical auditing expertise is also essential. Several donors have provided auditing training and also seconded experienced auditors to work with agencies in developing countries.

In 2014, the project "Tax Inspectors without Borders" will be launched by the OECD. The project aims to improve the quality and consistency of audits in developing countries by deploying experienced auditors from OECD tax administrations to work with auditors in developing countries for a certain period of time (OECD 2014b).

Enhancing transparency and accountability

Transparency and accountability are key to helping limit illicit financial flows and boosting confidence in the public administration, which in turn encourages compliance with the law and helps to broaden the country's tax base (OECD 2014b).

Donors can provide support to strengthen developing countries' public financial management systems, and help them adopt measures to increase transparency and public accountability throughout the budget process and in public procurement. Measures to enhance civic participation and monitoring should also be adopted. GIZ (Deustche Gesellschaft für Internationale Zusammenarbeit), for instance, has adopted an approach that "integrates the technical dimensions of public finance reforms with elements of good governance, such as transparency, participation, responsiveness, oversight, accountability, and predictability" (Hearson 2014).

In resource-rich countries, support can be provided for the implementation of the Extractive Industries Transparency Initiative (EITI), which aims to improve governance through the verification and full publication of company payments and government revenues from oil, gas and mining.

In addition, developing countries can be assisted to implement commitments under initiatives such as the Open Contracting, which, for instance, includes among its principles the requirement for companies seeking a contract from public authorities to provide information on their real beneficial owner (Open Contracting no year). Similar requirements could be adopted by developing countries in all procurement processes, as well as in granting concessions and licenses, in order to reduce corruption opportunities.

Supporting international cooperation

Donors can also help developing countries to build the necessary capacity to exchange information, and enter multilateral/bilateral agreements with relevant countries. In addition, assistance could be provided so that developing countries can also enter the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (Hearson 2014).

Asset recovery

Recovering the proceeds of corruption also depends on the timely and effective intervention of law enforcement agencies and the judiciary in the developing countries where the assets originated from. This requires an independent judicial system that has the technical capacity and resources necessary to conduct investigations (and the ability to support investigations conducted in other jurisdictions), as well as to prosecute corrupt individuals. This would also require a legal framework that does not allow corrupt persons to avoid prosecution due to immunities, legal privileges or short statute of limitations.

In addition, an adequate system to manage repatriated funds should be put in place to ensure that such funds are used to benefit the population.

What is the role of development agencies?

On the ground, international donors can provide support by:

Providing technical assistance and capacity building to help developing countries engage in asset recovery

There is a lack of skilled practitioners who understand international conventions, existing bilateral agreements and standards to submit substantiated requests for mutual legal assistance (Stephenson et al 2011). In addition, very few countries have established specialised investigative units that focus on stolen asset recovery cases. Assistance can also be provided regarding the costs of investigating asset recovery cases.

Supporting the administration of repatriated funds

Considering that "asset recovery can serve as an important source of financing for development," donors can also provide assistance to ensure that returned funds are managed in a transparent and accountable manner (UNCAC Coalition 2013).

Adopting clear legislation regarding the key issues of asset recovery

In many jurisdictions a lack of clear asset recovery policy (e.g. dual criminality rule) means prosecutors are able to choose whether or not to get involved in high-profile corruption cases and/or provide support to another jurisdiction investigating corruption. In many instances, prosecutors may opt to work on smaller and domestic cases that require less time and resources (Stephenson et al 2011). Broad rules relating to immunity can also hamper prosecutions. The legal framework should thus provide effective safeguards to avoid immunities being used to protect individuals from being held accountable for corruption (UNCAC Coalition 2013). Donors can contribute to the process by helping developing countries exercise good practice in these areas and adopt clear rules and guidelines on asset recovery that are suitable for the country's specific circumstances.

Supporting broader anti-corruption reforms

Success stories in the area of repatriation show that effective asset recovery is usually followed by the establishment of anti-corruption strategies and the creation of investigative and oversight agencies. Therefore domestic reforms, including judicial reforms, are key to ensuring domestic asset recovery and/or providing foreign investigators with the necessary information to instigate the repatriation process (Star Initiative 2007). Donors can support anti-corruption reforms as well as reforms aimed at enhancing the integrity and efficiency of judicial institutions[5].

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[5] For more information on interventions in the judiciary, please refer to a previous Helpdesk Answer: "Innovative Anti-Corruption Reforms in the Judiciary" available at:
http://www.transparency.org/whatwedo/answer/innovative_anti_corruption_reforms_in_the_judiciary

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5 Annex

Aid Watch and Concord published a study on Global Financial Flows, Aid, and Development (2013), which sets out all the financial resources potentially available for development, examines their key characteristics, and discusses their impact on poverty and sustainable development as well as the implications for aid. The table below is a summary of the scale of the resources analysed. The figures are net flows (inflows minus outflows) and are grouped in order of magnitude and under 'inflows' if the inflows exceed the outflows and vice versa. Figures are given in comparison to GDP, as this is the best yardstick to measure scale. For more information, you can view the study here.

Table: Summary of resource flows compared to domestic resources

Resource (year)	*% GDP*[2]	*%GDP LICs*	*Trends, volatility and other features*
DOMESTIC RESOURCES			
Public revenues (2008)	30*	17	Rising over past decade. Predictable, not highly volatile.
Private investment (2010)	28	23	Increased over past decade, particularly in LICs. Not highly volatile.
RESOURCES WHICH ARE NET INFLOWS			
Private borrowing (2010)	1.8		Volatile and pro-cyclical. Loans have to be repaid – costs vary.
Remittances (2009)	1.5	4.9	Steadily rising. In 22 developing countries equivalent to over 10% GDP. Concentrated in certain countries.
FDI (2011)	1.3	1.6	Rising until sharp drop in 2008-9; now rising again. Less volatile than other private flows, but pro-cyclical. Overestimate due to double counting with other flows.
Government borrowing (2010)	0.7		Until 2007 an outflow as governments paid off the IMF. Now a rising inflow as governments borrow, mainly from IFIs, but also from domestic markets.
ODA (2011)	0.6	10	Steadily rising until 2011. Not pro-cyclical overall, but unpredictable at country level. In 37 countries equivalent to over 10% of GDP. Aidwatch analysis suggests this figure is inflated
Portfolio equity (2010)	0.6	-11	Highly volatile and pro-cyclical.
Philanthropy (2010)	0.2		Increasing rapidly.
RESOURCES WHICH ARE NET OUTFLOWS			
Illicit flows (2009)	-4.3	-3	Increasing rapidly but dipped after 2008. Significant underestimate as hard to measure.
Government lending (2010)	-4.7		Mostly from middle-income countries. Sharp increase in recent years due to reserves increasing to protect against heightened risks.

*Figure for upper-middle income countries only: combined figure for all developing countries not available.