

# Implementing the illicit financial flows agenda: Perspectives from developing countries

While once considered solely a concern of law enforcement agencies; money laundering, tax evasion and secrecy jurisdictions are now perceived as important obstacles to development. Dealing with illicit financial flows is an important aspect of the policy coherence agenda in international development, and developed country governments have made international commitments to tackle the problem.<sup>1</sup> Reforms and actions are necessary both in developed and developing countries, and this Brief looks at the experiences of some bilateral agencies that have begun to implement the illicit financial flows-agenda. Promising areas to engage in include support for improving tax systems and strengthening anti-money laundering programmes.

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*This Brief is based on a U4/OECD workshop in Paris on 14 May 2012, with participants from bilateral and multilateral agencies working on the IFF agenda. It reflects information shared during the workshop, and examples given are therefore illustrative rather than comprehensive. The workshop and the brief are both part of an ongoing process in the OECD Development Assistance Committee to inform the debate on the IFF agenda, with a specific focus on the role of development cooperation agencies.*

## The concept of Illicit financial flows

There are various definitions of illicit financial flows. The term includes not only clearly illegal actions but also borderline activities such as tax avoidance. Of particular interest for this brief are corruption and corporate tax evasion.

Figure 1 shows the different sources of IFF, the methods by which these flows are created or circulated, some of the tools available to address the problem, and the regulatory framework.

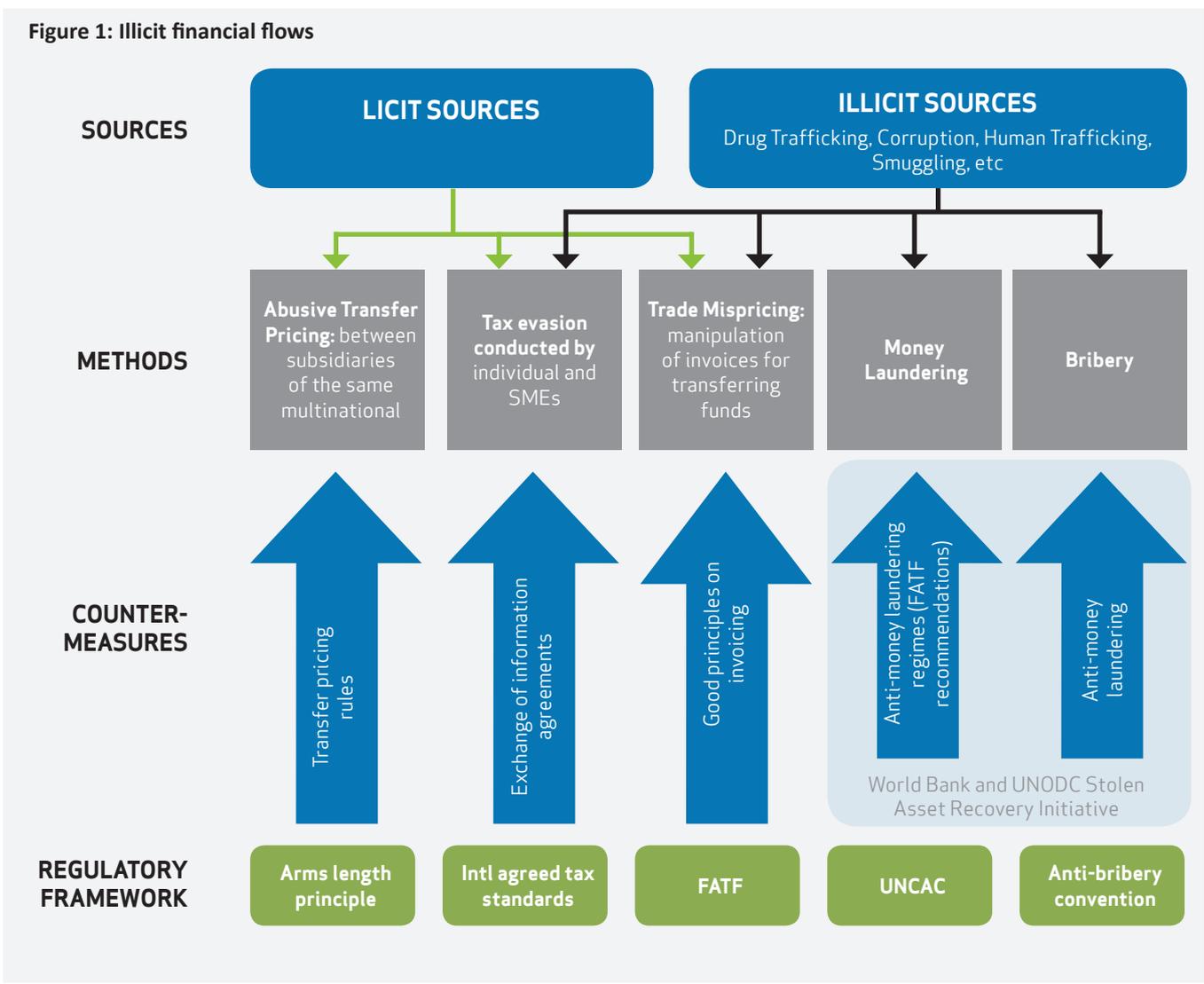
## Tax and anti-money laundering

Norad (the Norwegian Agency for Development Cooperation), DFID (the UK Department for International Development), and GIZ (the German Agency for International Cooperation) all have IFF related activities. Their efforts, carried out in partnership with multilateral agencies or drawing on the expertise of other government agencies in their home countries, suggest possible ways for bilateral donors to engage with IFF. Support for improving tax systems and strengthening anti-money laundering programmes are two promising areas.<sup>3</sup>

### Improving tax systems

The Norwegian Ministry of Foreign Affairs is engaged in partnerships with Zambia, Mozambique, and Tanzania to support capacity building for their tax authorities. In Zambia, the objectives include increased tax collection and greater accountability. Within this framework, Norway provides assistance to the mining unit of Zambia Revenue Authority's Large Taxpayer Office. Norway does so by drawing on own experiences with tax administration in the natural resource sector.

Bilateral aid agencies face challenges when integrating the illicit financial flows (IFF) agenda into their programming. In their cooperation with developing country partners, they need to convince ministries outside the development arena that engaging with the issue is in their own interest. They must improve standards that have not been designed with development objectives in mind, and address areas that require new technical expertise, e.g. against abusive transfer pricing.<sup>2</sup>



In Mozambique, the Norwegian Tax Administration (NTA) assists the tax authority in auditing international oil companies, while in Tanzania, the NTA has conducted workshops on transfer pricing. For this work it engages with different institutions such as the Norwegian Oil Taxation Office, the International Monetary Fund (IMF) and the African Tax Administration Forum. This helps to avoid overlap between the NTA's efforts and those of other agencies, and contributes to multilateral work in areas such as transfer pricing risk assessments and audit manuals. In addition, Norway is funding an in-depth study on IFF from Tanzania, conducted by the country's central bank.

*Strengthening anti-money laundering regimes and recovering proceeds of crime*

Two programmes led by DFID in Nigeria and GIZ in the Western Balkans have focused on money laundering. They have set anti-money laundering (AML) standards, supported mutual legal assistance in investigations of stolen assets, enhanced the competences of financial intelligence units/prosecutors/police, and supported work on asset recovery. DFID's efforts in Nigeria have been part of a larger five-year programme on access to justice, of which anti-corruption is an important pillar.

DFID has, for example, relied on international expertise on asset recovery, to train Nigerian counterparts on how to prepare mutual legal assistance requests and manage returned funds.

Through a European Union (EU) project, GIZ has supported prosecutors involved in cross-border investigations of organised crime and corruption in the Western Balkans. The objective was to help prosecutors use international cooperation instruments and mutual legal assistance within the region, as well as other structures like Eurojust (the EU's Judicial Cooperation Unit). Another component was to build the capacity of local prosecutors through secondment of EU member states' prosecutors to general prosecutor's offices and other specialised agencies in the targeted countries.

In a third programme – one with a multi-country scope – the Norwegian Ministry of Foreign Affairs supports the Corruption Hunters Network, which brings together investigators, prosecutors, and heads of anti-corruption agencies from developing countries. The network provides a platform where members can support each other by exchanging information.

## Lessons from bilateral experiences

The partner institutions of GIZ, Norad, and DFID in these programmes face challenges similar to those of other institutions supported by bilateral development agencies. Partners often lack adequate technical equipment and in some cases essential software. Police and tax auditors are poorly trained to deal with the increased work load created by AML regulations and financial investigations. Tax administrators need more quantitative and qualitative capacity to deal with complex cases and large taxpayers.

Most significantly, AML and measures to counter tax evasion are sensitive issues commonly resisted by those who benefit from the status quo. However, progress is possible despite these obstacles. Although experience is limited, there are clear lessons that may help other bilateral agencies initiate work in this area.

### *Determine whether IFFs pose significant risks*

Bilateral development agencies should avoid taking up this issue simply because it is trendy. Instead, they should investigate particular country contexts to verify that IFFs do in fact pose significant risks to development. New analytical tools are being developed to help donors conduct such assessments. These include the OECD's *International Drivers of Corruption: A Tool for Analysis*<sup>4</sup> which helps stakeholders determine whether and where major risks of international corruption, including IFF, may exist within a country. The OECD Centre for Tax Policy and Administration is also developing a transfer pricing risk assessment tool to help countries determine whether there is a risk from abusive transfer pricing in their economies. Risk assessments related to money laundering and counter-terrorist financing can build on findings from Financial Action Task Force (FATF) peer reviews, as well as from World Bank and IMF reports on the Observance of Standards and Codes (ROSCs) and Financial Sector Assessment Programmes.

### *Seek technical expertise*

The cases in this Brief exemplify needs for technical knowledge that is not commonly available within bilateral development agencies. Norad has drawn on expertise from officials in the Norwegian tax authority, while GIZ has turned to prosecutors' offices in EU member states. Development agencies need to work outside their comfort zone and coordinate with other agencies in their home countries, which may be challenging given the different agendas involved.<sup>5</sup> Alternatively, bilateral agencies can recruit staff with the required competencies or train existing employees.

### *Coordinate with other agencies*

Other international institutions (e.g. IMF/World Bank) may already be working in this area in particular countries. They will likely have the required expertise and may be open to joint programmes with bilateral development agencies. For instance, GIZ's programme to support the tax authority in Ghana is linked to an OECD initiative to build skills and promote legislation on transfer pricing.

In the USA, the Department of Justice has since 2001 led a "Kleptocracy Initiative" to investigate, prosecute,

and recover proceeds of crimes committed in the USA or abroad. The component of this programme implemented in developing countries (placement of US prosecutors in prosecuting authorities) is funded through the US Agency for International Development. This example shows how IFF initiatives can be coordinated with other agencies in the home country. Development aid funds can thus help leverage expertise in other agencies for the benefit of developing countries.

### *Expect resistance*

Any actor working on these sensitive questions, including donors, is likely to meet some resistance. This should not be a deterrent to action, but it is important to anticipate where obstacles may arise and to prepare for them. In Nigeria – where DFID supports anti-money laundering work – increasing control over financial transactions poses a threat to those who benefit from the existing lack of transparency. Beneficiaries of the status quo in many countries include members of the political elite who have significant influence over whether AML standards are applied to vulnerable sectors such as real estate. But they also include the domestic private sector and multinational enterprises, including those headquartered in developed countries and/or incorporated in other secrecy jurisdictions.

Some members of the Corruption Hunters Network – supported by Norway – have been subjected to harassment or removed from their jobs without due process. And banks in developed countries continue to willingly engage in business with politically exposed persons (PEPs) from around the world without identifying the source of their funds as required by international AML standards and national laws.<sup>6</sup> Hence, when commercial interests in developed as well as developing countries are at stake, it may be difficult – though not impossible – for bilateral agencies to advance their work on IFFs.

### *Consider actions at home and abroad*

For issues related to IFFs, action or inaction in the developed countries has a significant impact on developing countries. While this Brief focuses on activities in developing countries, bilateral donors also need to consider their role at home. For example, DFID has shown how a bilateral agency can include peer institutions at home in working for development purposes.<sup>7</sup> Bilateral development agencies should take the lead in working for more coherent policies on the part of their governments. Other important components for agency headquarters include establishing an agency policy on IFFs and building organisational capacities to set standards, develop guidelines, and train and support field staff.

Finally, bilateral development agencies should strive to influence international policy on IFFs. They can help define international standards that are appropriate for both developing and developed countries, and monitor implementation by developed countries. Bilateral donors also have a role to play in keeping IFFs and their development impacts on the international agenda in forums such as the G20.



U4 is a web-based resource centre for development practitioners who wish to effectively address corruption challenges in their work. The centre is operated by the Chr. Michelsen Institute – an independent centre for research on international development and policy – and is funded by AusAID (Australia), BTC and Ministry of Foreign Affairs (Belgium), CIDA (Canada), DFID (UK), GTZ/BMZ (Germany), Norad (Norway), Sida (Sweden) and The Ministry of Foreign Affairs of Finland. All views expressed in this brief are those of the author(s), and do not necessarily reflect the opinions of the U4 Partner Agencies or CMI/U4. (Copyright 2012 - CMI/U4)

## Thinking outside the development box

Although the areas of tax enforcement, criminal prosecution and asset recovery require technical expertise that may not currently be available to donors, these agencies do have a number of comparative advantages in taking action on the IFF agenda. These include an understanding of sensitive local political contexts and of the structural dynamics of the political economies of specific developing countries. Development staff in the field may be able to assist in identifying local counterparts who can champion this agenda and work with international technical teams that lack country-experience.

Bilateral development agencies also have experience in brokering contacts between international networks and counterparts in developing countries. The cases mentioned above (prosecutions in the Balkans and efforts to recover stolen Nigerian funds in London) show that staff working for tax, police, and prosecution authorities in developing countries need contacts in peer institutions in developed countries. They also need support to maintain their engagement in such international networks. Bilateral agencies, with contacts in both worlds, may open doors and otherwise support developing country participation in relevant international forums.

Work on the IFF agenda requires bilateral development agencies to think outside their usual “development box.” They must reach out to those involved in law enforcement and anti-corruption work beyond the borders of specific countries. This may require new forms of collaboration. But, as with corruption 20 years ago, illicit financial flows are too important to be left out of the portfolio of issues relevant for bilateral development aid.

### WHERE TO START?

A basic understanding of the IFF agenda can help bilateral development agency staff decide whether they should undertake such work in a particular developing country. Recommended initial steps:

- Read the basic literature on illicit financial flows. Material is available from several international NGOs and think tanks.<sup>8</sup>
- Approach officials dealing with these issues in the donor country, including the tax authorities, prosecutor’s office, or ministry of justice. These officials may already have some involvement with counterparts in developing countries and may be interested in exploring partnerships related to IFF.
- Conduct a risk assessment in the developing country to determine whether IFF is an issue that merits attention and resources. If so, determine what type of IFFs pose the greatest risks (e.g. corruption, smuggling, trade mispricing, tax evasion).
- Find out from headquarter staff whether programming guidelines exist in this area. If there are none, the interest expressed by field office staff may provide an incentive for developing such guidelines.

### Notes and further reading

1. The final declaration of the Fourth High Level Forum on Aid Effectiveness (2011) stated that representatives from developed and developing countries as well as aid agencies acknowledge the importance of IFFs as a development problem: [http://www.aideffectiveness.org/busanhlf4/images/stories/hlf4/OUTCOME\\_DOCUMENT\\_-\\_FINAL\\_EN.pdf](http://www.aideffectiveness.org/busanhlf4/images/stories/hlf4/OUTCOME_DOCUMENT_-_FINAL_EN.pdf)
  2. Transfer pricing refers to the price charged by one part of a company for products and services it provides to another part of the same company located in a different country. In order to be legal, such transactions should be consistent with the OECD “arm’s length principle”: the price charged in transactions between two related companies should be the same as the price that charged between two unrelated companies. Disrespecting this principle amounts to abusive transfer pricing – frequently used by companies trying to evade taxes.
  3. Another significant arena for the engagement of bilateral agencies is through global forums such as the G20, but that is beyond the scope of this brief.
  4. OECD (2011) International Drivers of Corruption: A Tool for Analysis. Paris: OECD. <http://www.oecd.org/dataoecd/54/1/49263997.pdf>
  5. DFID experienced difficulties convincing the British Home Office to use its own budget to focus on investigations of money laundering in the UK that involved senior political figures in developing countries, so it decided to use aid budgets to fund a unit within the London Metropolitan Police (Fontana 2011, see point 7 below).
  6. FSA (2011). Banks’ Management of High Money-Laundering Risk Situations: How Banks Deal with High-Risk Customers (Including Politically Exposed Persons), Correspondent Banking Relationships and Wire Transfers. [http://www.fsa.gov.uk/pubs/other/aml\\_final\\_report.pdf](http://www.fsa.gov.uk/pubs/other/aml_final_report.pdf)
  7. Fontana, A. (2011) Making Development Assistance Work at Home: DfID’s Approach to Clamping Down on International Bribery and Money Laundering in the UK. U4 Practice Insight 2011: 5. <http://www.u4.no/publications/making-development-assistance-work-at-home-dfid-s-approach-to-clamping-down-on-international-bribery-and-money-laundering-in-the-uk/>
  8. U4 Theme: International Drivers of Corruption – selected literature <http://www.u4.no/themes/international-drivers-of-corruption/>
- See also: Reed, Quentin, and Alessandra Fontana. 2011. Corruption and Illicit Financial Flows: The Limits and Possibilities of Current Approaches. U4 Issue Paper 2. Bergen, Norway: U4 Anti-Corruption Resource Centre. <http://www.u4.no/publications/corruption-and-illicit-financial-flows-the-limits-and-possibilities-of-current-approaches-2/>