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Item 7 (a) of the provisional agenda

**Financing the 2030 Agenda for Sustainable Development
in the Arab region**

**Domestic resource mobilization by curbing illicit financial
flows and trade misinvoicing**

(Panel discussion)

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I. BACKGROUND

1. Following the adoption of the 2030 Agenda on Sustainable Development, the international community began considering how to achieve the ambitious 17 Sustainable Development Goals (SDGs). Mobilizing financial resources and recalibrating how they were channeled became a key issue at the global and regional levels. Implementation of the 2030 Agenda is still in its early stages; however, some already foresee that the financing necessary to meet the SDGs far exceeds the scope and magnitude of the traditional levels available to developing countries over the past decade.
2. While views differ on the exact sum needed to achieve the SDGs, there is overwhelming consensus on the need to move from billions to trillions of dollars in investments of all kinds. The Third International Conference on Financing for Development (Addis Ababa, 13-16 July 2015) marked a turning point, whereby all available sources and means of financing are to be mobilized to implement the 2030 Agenda, including the costs associated with achieving the SDGs. The Conference succeeded in securing the political will to adopt the Addis Ababa Action Agenda and the new global financing for development framework, as principle means of implementation to turn SDG commitments into reality.
3. The new global financing framework marks a clear departure from the business-as-usual approach that had governed financing for development issues. It broadens the scope of financing sources and channels, with an emphasis on domestic resource mobilization. Against this backdrop, the Action Agenda recognizes domestic resource mobilization as the key channel for achieving sustainable development, and highlights specific actions to that end, including introducing progressive tax systems, improved tax policies and efficient tax collection mechanisms, administration and compliance; reducing subsidies; and curbing illicit financial flows, all of which have significant implications for the Arab region.
4. However, the successful mobilization of domestic resources remains highly dependent on creating an enabling socioeconomic environment, and requires new modes of economic governance at the national, regional and global levels. Systemic conditions that hinder a Government's ability to effectively utilize its own revenues for sustainable development need to be tackled with coherent actions. The commitment to curb and eventually eliminate illicit financial flows and other resource leakages has become fundamental to achieving sustainable development. The growing literature on the volume of illicit financial flows illustrates the magnitude of the damage being caused to developing countries. It is estimated that the developing world lost \$7.8 trillion in illicit financial flows between 2004 and 2013. Illicit financial outflows are increasing at an average rate of 6.5 per cent per year - nearly twice as fast as global gross domestic product. Since 2013, illicit financial outflows in the Arab region have outstripped the combined growth of official development assistance and foreign direct investment.¹
5. While illicit financial flows occur across many countries, their social and economic impact on the Arab region remains more severe, especially given the circumstances and challenges currently facing the region, including protracted conflicts and almost 60 years of Israeli occupation of Palestinian and other Arab land.
6. Illicit financial flows are adding to the aforementioned challenges, causing severe indirect drainage of foreign exchange reserves, eroding tax-bases and weakening investment. Illicit financial flows undermine the rule of law, stifle trade and worsen macroeconomic conditions, facilitated in part by international tax havens. It is in this context that illicit financial flows out of the Arab region are becoming a growing concern, and must be curbed.
7. Arab countries have subscribed to the commitment enshrined in the Action Agenda to substantially reduce illicit financial flows by 2030, with a view to eventually eliminating them. In this vein, the Economic and Social Commission for Western Asia (ESCWA) has taken the initiative to lead efforts to combat illicit

¹ http://www.gfintegrity.org/wp-content/uploads/2015/12/IFF-Update_2015-Final-1.pdf.

financial flows in the region, as requested in the Action Agenda for international institutions and regional organizations to measure the volume and composition of illicit financial flows. ESCWA is preparing a report on estimating illicit financial flows and trade misinvoicing in the Arab region, whose preliminary findings will be shared with member States at the eleventh session of the Committee.

II. OBJECTIVES

8. This panel will provide a platform for dialogue between decision-makers and experts regarding the effects of illicit financial flows on the mobilization of domestic resources to implement the 2030 Agenda in the Arab region. The main motives behind illicit financial flows in the Arab region will also be addressed, along with regional estimates of illicit financial flows and trade misinvoicing. The panel should aim to support member States' efforts in implementing their commitments under the Action Agenda to eliminate illicit financial flows by 2030. More specifically, the panel should build a foundation for developing a regional road map to tackle illicit financial flows and trade misinvoicing at the regional level, given that illicit financial flows require national and regional collaborative efforts.

III. TOPICS OF DISCUSSION

A. DEFINITION AND METHODOLOGY TO QUALIFY AND QUANTIFY ILLCIT FINANCIAL FLOWS

9. To date, there is no multilaterally agreed definition of illicit financial flows, or a standard methodology for their measurement. Institutional stakeholders use different methodologies and elements to measure illicit financial flows, thereby frustrating attempts to provide comparable global and regional assessments across time and space. Measuring and tracking progress in curbing illicit financial flows under such conditions becomes difficult, if not impossible. The illicit nature of these flows further frustrates attempts to systematically and accurately capture their magnitude, both in intra and inter-regional settings.

10. The above predicament underscores the need for agreement among experts and policymakers on a common working definition and methodology to qualify and quantify illicit financial flows and trade misinvoicing at the regional and international levels.

B. NATURE AND PATTERN OF ILLICIT FINANCIAL FLOWS IN THE ARAB REGION

11. Illicit financial flows in the Arab region take on many forms, including abusive transfer pricing by multinational corporations, trade mispricing, misinvoicing of services, bulk cash transfers, aggressive tax practices, and tax evasion and avoidance, all of which seek to hide wealth, avoid taxes and dodge customs duties/levies. Illicit financial flows also involve criminal activities such as the trafficking of people, drugs and arms, smuggling, financial fraud including unsecured loans and money laundering, and organized crime. According to a study on illicit financial flows conducted by the Washington-based think tank Global Financial Integrity, the fraudulent misinvoicing of trade transactions was identified as the largest component of illicit financial flows from developing countries.²

12. ESCWA findings reveal that trade misinvoicing is the primary measurable component of illicit financial flows. Another primary quantifiable component in the region is leakages from the balance of payments (net errors and omissions). However, inferences from unrecorded flows are complicated in some Arab countries by licit flows arising from and associated with sovereign wealth funds. The unrecorded data related to transfers of sovereign wealth funds can lead to large net errors and omissions in balance of payments, which do not necessarily constitute a source of illicit financial flows.

² Ibid.

13. *Hawala* transfers are not necessarily illicit. However, since they cannot be fully monitored, there might be a security or tax-based illicit component. Furthermore, when an imbalance arises between *Hawala* brokers in different countries, they need to find a way to settle accounts, which in some cases causes them to resort to trade misinvoicing to correct the imbalance. Illicit flows in the region are also taking place through bulk cash smuggling. This practice is not reflected in official statistics, so it is not quantitatively estimated. Nevertheless, such smuggling is a concern when cash-generating industries operate in the informal or underground economy of transnational crime, such as the global illicit trade in drugs, small arms and light weapons, cultural property, and crude oil theft.

C. DRIVERS OF ILLICIT FINANCIAL FLOWS IN THE ARAB REGION

14. ESCWA findings confirm that trade misinvoicing is the largest component of measurable illicit financial flows in the region. Quantitative examination by ESCWA of illicit financial flows is therefore based on estimating trade misinvoicing, similarly to other studies conducted on illicit financial flows at the global and regional levels, since combating trade misinvoicing can enhance domestic resource mobilization.

15. Trade misinvoicing can be divided into three types: macroeconomic, governance-related, and structural. There are variations between countries regarding the extent to which each of these drivers and their subtypes operate. Macroeconomic incentives for illicit trade flows can stem from exchange controls (including multiple exchange rate practices) and export proceeds subject to surrender requirements. Governance drivers include weak regulatory oversight (for example, limited customs enforcement), long judicial delays, and the prevalence of bribery and kickbacks. Structural incentives include a skewed distribution of income.

IV. DISCUSSION QUESTIONS

16. The following are suggested discussion questions:

- What do we know about illicit financial flows in the Arab region? What is the nature of these flows and what are their main drivers?
- In what way are illicit financial flows undermining the ability of Arab countries to mobilize domestic resources and achieve the SDGs?
- How can current regulatory measures combat illicit financial flows? How can they be enforced nationally/regionally?
- What new measures are needed? Is there a need to shift attention towards tackling sources of illicit financial flows or rather the illicit flows themselves?
- What role can civil society and non-financial stakeholders play in this regard?
- What global actionable recommendations for curbing illicit financial flows are relevant to the Arab region?

V. PARTICIPANTS

17. The panel discussion will bring together high-level representatives from member States, and international and regional experts concerned with illicit financial flows and trade misinvoicing. Representatives of international organizations, the private sector, civil society, academic institutions and United Nations entities might also be invited to provide an institutional and multi-stakeholder perspective on illicit financial flows and trade misinvoicing.

VI. LANGUAGES

18. The panel will be held in Arabic and English, with simultaneous interpretation.

VII. CONTACTS

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