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The Arab Financing for Development Scorecard**Domestic public resources****Summary**

Efforts to enhance domestic public resource mobilization are a major pillar of the new global financing for development framework, namely the Addis Ababa Action Agenda. Illicit financial flows have been recognized as a major impediment to sustainable development. Combating illicit financial flows is grounded in the Addis Ababa Action Agenda, under which the international community has renewed its commitment to substantially reducing and eventually eliminating illicit financial flows by 2030, including by combating trade-based money laundering, tax evasion, safe havens and corruption. The commitment to combat illicit financial flows is also captured in the Sustainable Development Goals (SDG), particularly SDG16.

Illicit financial flows account for substantial financial leakages in the Arab region. They undermine the rule of law, challenge tax administration, distort the gains from multilateral and preferential trade, and worsen macroeconomic and governance conditions.

ESCWA work on illicit financial flows has culminated in the first report on illicit financial flows and trade misinvoicing in the Arab region. The present document sets out key findings and conclusions of the report. It also highlights the implications of illicit financial flows on the enforcement of regional trade agreements (intra and extraregional), and on the establishment of an Arab customs union by 2021.

Representatives of ESCWA member States are invited to review the report's findings and comment thereon.

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Introduction

1. The Third International Conference on Financing for Development ushered in a new era of cooperation and global action to support the implementation of the 2030 Agenda for Sustainable Development and its Sustainable Development Goals (SDGs). The Addis Ababa Action Agenda offers a viable global framework to contextualize and mobilize all sources and means of financing to implement the 2030 Agenda. Efforts to enhance domestic public resource mobilization are a major pillar of the new global financing for development framework.

2. Curbing illicit financial flows and other resource leakages remains fundamental to the effective mobilization of domestic resources, and to the advancement of the financing for development agenda. The adverse effects associated with illicit financial flows have been highlighted by many international institutions, notably the Washington-based Global Financial Integrity through its flagship publication entitled *Illicit Financial Flows from Developing Countries: 2004-2013*, which revealed that for every dollar of official development assistance the developing world received, \$10 flowed out illicitly.¹ The Organization of Economic Cooperation and Development (OECD) has also estimated the negative impact of illicit financial flows, establishing that for every dollar granted to developing countries in official development assistance, 3 dollars are left in the form of illicit financial outflows.² Irrespective of the methodologies employed, the implications are dire and point to the same outcome: it is impossible to adequately raise domestic resources if no international and regional action is taken to combat illicit financial flows.

I. GLOBAL ACTION ON ILLICIT FINANCIAL FLOWS

A. NORMATIVE INTERNATIONAL AND REGIONAL MANDATES ON ILLICIT FINANCIAL FLOWS

3. The Action Agenda presents a range of actions and commitments on illicit financial flows, including a normative commitment to substantially reduce them with a view to eventually eliminating them by 2030. Other actions highlighted in this area include combating tax evasion, safe havens and corruption through strengthened national regulations and international collaborative action. The Action Agenda also mandates international institutions and regional organizations to publish estimates of the volume and composition of illicit financial flows, so as to provide targeted recommendations that take into account asymmetries in regional contexts and levels of development.

4. Commitment to combating illicit financial flows is also captured in the SDGs. SDG16 stresses the need to combat corruption and bribery, and to address illicit financial flows and the recovery of stolen assets, all of which are considered critical to promoting economic growth and investment. The United Nations Inter-Agency Task Force on Financing for Development recognizes the adverse socioeconomic and governance related implications arising from illicit financial flows, particularly as they continue to cause substantial resource leakages in developing countries. Those leakages occur through several channels of delivery that, directly and indirectly, affect a country's ability to increase and mobilize its domestic resources.

5. At its seventy-first session, the United Nations General Assembly adopted resolution [A/RES/71/213](#) on the promotion of international cooperation to combat illicit financial flows to foster sustainable development. The resolution expresses deep concern about the impact of illicit financial flows, in particular those caused by tax evasion and corruption, on the economic, social and political stability and development of societies. It also notes the ongoing efforts by regional organizations to strengthen cooperation in combating illicit financial flows. The General Assembly decided to give consideration to illicit financial flows in the follow-up and review framework of the 2030 Agenda, and in the follow-up process of the Action Agenda.

¹ <http://www.gfintegrity.org/report/illicit-financial-flows-from-developing-countries-2004-2013/>.

² https://www.2030spotlight.org/sites/default/files/contentpix/spotlight/Agenda-2030-en_web_accessible.pdf.

6. At its ninth session, the Committee emphasized the need to address illicit financial flows, as they continue to undermine domestic resource mobilization efforts and the attainment of the 2030 Agenda. At the third session of the ESCWA Executive Committee (Rabat, 6-7 May 2017), high-level officials from member States were informed of the initiative to prepare the first report on illicit financial flows and trade misinvoicing in the Arab region, and the steps taken to that effect. There is an evident need to provide detailed understanding of the motives and drivers of illicit financial flows and their patterns, and to estimate their magnitude in the Arab region to better formulate appropriate regional recommendations in that regard.

B. MULTIDIMENSIONAL COMPLEXITIES ASSOCIATED WITH ILLICIT FINANCIAL FLOWS

7. Since the adoption of the Action Agenda in 2015, the multifaceted implications of illicit financial flows have been recognized. They undermine the rule of law, effective tax administration and revenue collection (tax evasion); distort trade figures and gains from multilateral and preferential trade (trade misinvoicing); and worsen macroeconomic and security conditions (terrorist or conflict financing). However, to date, there is no multilaterally agreed definition of illicit financial flows or an agreed methodology for their measurement. To frustrate matters further, the term “illicit financial flows” is not defined in the Action Agenda or in the 2030 Agenda. Institutional stakeholders therefore resort to various methodologies, and factor different elements and components in their measures of illicit financial flows. This impedes attempts to provide comparable global and regional assessments, or a clear picture of illicit financial flows across time and space.

8. Under such conditions, measuring and tracking progress made in curbing illicit financial flows is complex, if not impossible. The illicit nature of those financial flows further hampers attempts to systematically and accurately capture their magnitude, both in intra and inter-regional settings. General Assembly resolution A/RES/71/213 calls upon the United Nations system to ensure that no one is left behind in combating international financial flows.

9. The Inter-Agency Task Force on Financing for Development held a meeting to discuss definitional and methodological issues related to the measurement, tracking and monitoring of illicit financial flows.³ Participants agreed that illicit financial flows should cover cross-border movement of illicit funds and assets undertaken in contravention to national laws and international conventions on tax evasion, international trade fraud (including misinvoicing), criminal activity (including money laundering, and smuggling and trafficking in drugs, cultural objects, medicines, persons and natural resources), financing of organized crime and terrorism, and corruption.

10. Disagreements over whether tax avoidance (including aggressive tax planning and optimization, and transfer pricing) should be considered as illicit financial flows remained unresolved. Those flows might not necessarily be considered 'illicit' in nature, as they exploit loopholes in national and international regulatory frameworks.⁴ There was agreement however over two conceptual underpinnings associated with illicit financial flows, namely that they constitute resources/money that is illegally earned, transferred or used; and that they entail the crossing of international borders. As such, the following three types of flows were identified as illicit financial flows: those originating from criminal activity, corruption-related illicit financial flows, and trade/tax-related illicit financial flows.

11. With respect to the development of a single estimate for illicit financial flows, there was strong support for keeping efforts disaggregated, and working on improving measurement for the separate components of illicit financial flows and modes of transfer. However, it was also recognized that a single aggregate number would provide a powerful tool for effecting policy changes. Furthermore, trade misinvoicing was perceived as

³ The expert group meeting was held on 22 September 2016 at United Nations Headquarters in New York. ESCWA participated in this meeting via video conference to reflect the regional context and realities associated with illicit financial flows.

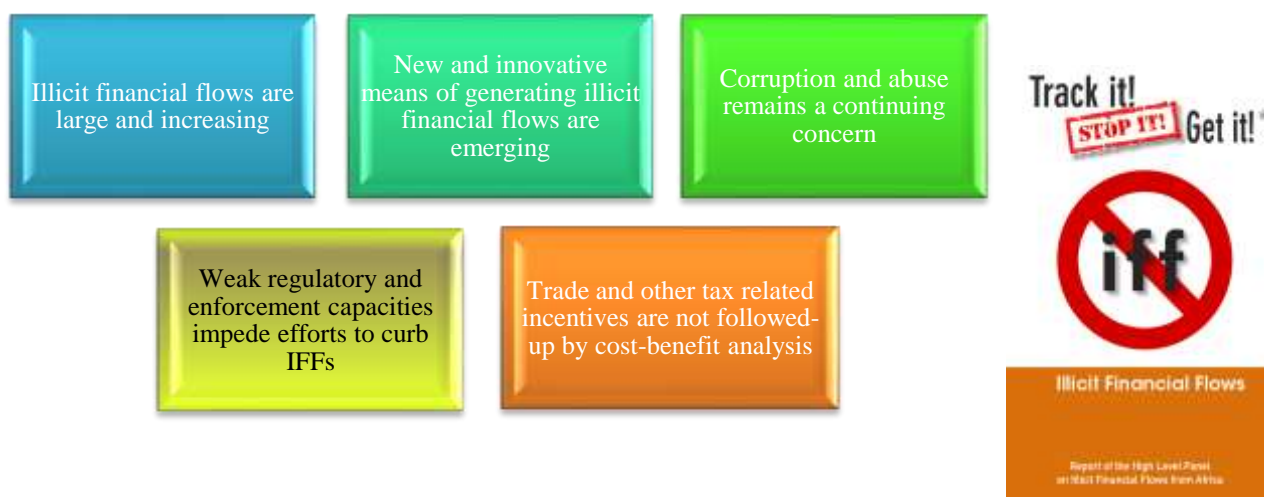
⁴ The World Bank, for example, does not perceive aggressive tax planning and profit shifting practices as illicit financial flows.

a principal detectable source of illicit financial flows. The Inter-Agency Task Force agreed that as a first step to developing uniform broad-based estimations, it was critical to map the different components and current status of data to identify data gaps.

C. CHALLENGES AND MEASURES OF ILLICIT FINANCIAL FLOWS AND TRADE MISINVOICING

12. Trade misinvoicing remains the dominant method for quantifying the trade-based components of illicit financial flows. Several international agencies and United Nations regional commissions have published estimations of trade-misinvoicing over the past few years. The Economic Commission for Africa provided estimates of trade misinvoicing for a number of African countries, reaching \$50 billion in average annual losses from illicit financial flows. The same conclusions were reached from a review of other related work undertaken by Global Financial Integrity, the African Development Bank and the United Nations Development Programme. In 2015, the High Level Panel on Illicit Financial Flows from Africa provided some significant findings in this area (figure 1). In 2016, the Economic Commission for Latin America and the Caribbean followed suit and dedicated an entire chapter of its annual economic survey to estimating illicit financial flows in Latin America and the Caribbean.⁵

Figure 1. Findings of the High Level Panel on Illicit Financial Flows from Africa



Source: https://www.uneca.org/sites/default/files/PublicationFiles/iff_main_report_26feb_en.pdf.

13. In 2016, ESCWA dedicated a chapter in its first issue of the Arab Sustainable Development report to addressing financing for development, which touched upon the issue of illicit financial flows. In the same year, the United Nations Conference on Trade and Development (UNCTAD) employed a methodology to analyse misinvoicing in primary commodities at the product level in a number of commodity-dependent developing countries, and found that they were losing as much as 67 per cent of their export revenue to trade misinvoicing.⁶ Figure 2 shows selected trade misinvoicing estimates and assessments.

⁵ <http://repositorio.cepal.org/handle/11362/40327>.

⁶ <http://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=1277>.

Figure 2. Selected trade misinvoicing estimates



Source: ESCWA, based on data from the Economic Commission for Africa, Global Financial Integrity, Economic Commission for Latin America and the Caribbean and UNCTAD.

14. Even when the same methodologies are used to estimate trade misinvoicing, different estimates can be reached because of differing assumptions, components and data sets. For example, according to the Economic Commission for Africa’s methodology, African countries lost around \$407 billion from trade misinvoicing over the period 2001-2010. Meanwhile, Global Financial Integrity’s analysis suggests that trade misinvoicing from Africa amounted to \$242 billion over the same period. A third approach used by Ndikumana and Boyce⁷ shows that estimated illicit financial flows from 33 African countries amounted to \$353.5 billion over the period 2000-2010. The Economic Commission for Africa maintains that such disparities are the result of using different datasets and approaches.

II. ILLICIT FINANCIAL FLOWS AND TRADE MISINVOICING IN THE ARAB REGION

15. ESCWA is holding discussions among regional and international experts to arrive at a common working definition of illicit financial flows, and a methodology to qualify and quantify illicit financial flows and trade misinvoicing. ESCWA organized an expert group meeting in Beirut, attended by international and regional experts and representatives from the Economic Commission for Africa and Global Financial Integrity. The meeting served as a platform to exchange information on the importance of curbing illicit financial flows, and to discuss the key challenges associated with their measurement. Participants identified the elements and components constituting the bulk of international financial flows, particularly in the Arab region, and discussed the economic, legal and statistical challenges associated with international financial flows in the region. The meeting also identified priority components, drivers and delivery channels for formulating coherent policy interventions at the regional level.

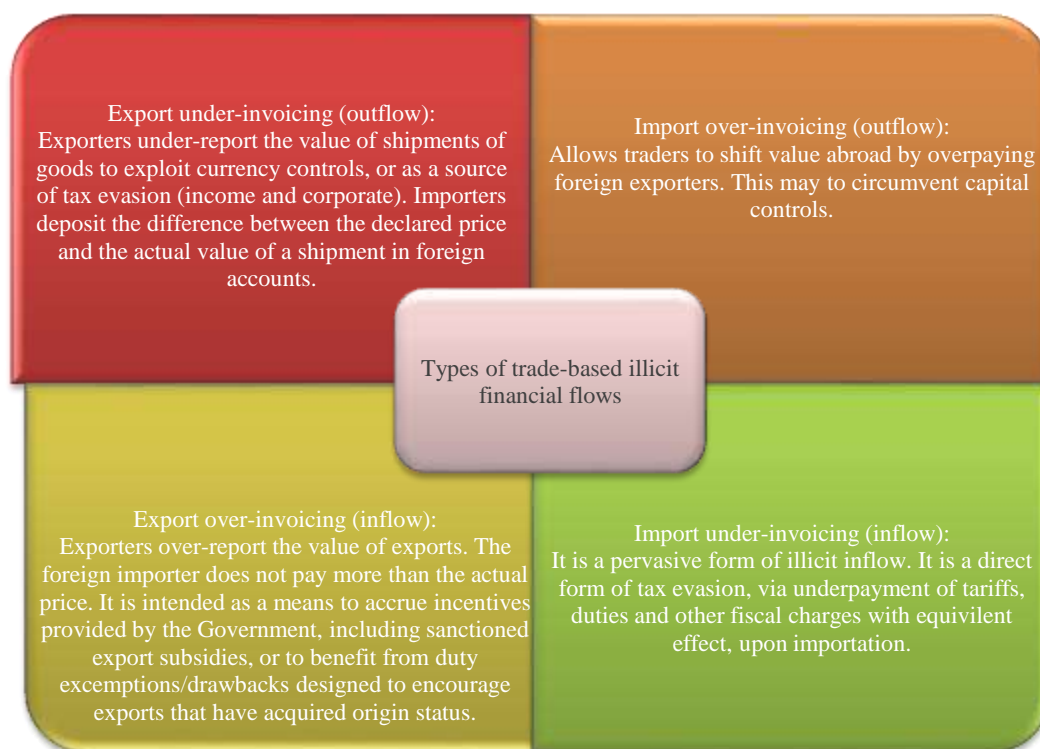
16. ESCWA is preparing a publication aimed at filling a gap in the literature by focusing on illicit flows in the Arab region, including addressing definitional issues, and identifying patterns, channels and motivations

⁷ https://www.uneca.org/sites/default/files/PublicationFiles/iff_main_report_26feb_en.pdf.

associated with such flows. The study also analyses methodology and data sources on trade-misinvoicing leakages, to provide detailed quantitative assessments of the trade-based component of illicit financial flows. It indicates that trade and financial analysis undertaken in the region might contain inaccurate data due to misinvoicing practices. Moreover, the accuracy of international trade statistics might be compromised by fake trade transactions.

17. In an attempt to provide a comprehensive account of illicit flows and trade misinvoicing in the region, ESCWA examined four channels through which trade misinvoicing occurs, so as to capture the diverse range of domestic resources leaked out of the Arab region that could have otherwise been harnessed for sustainable development, including those associated with tariff revenues and similar charges, duty drawback and export subsidy programmes (figure 3).

Figure 3. Types and channels of trade-based illicit financial flows



Source: Compiled by ESCWA.

18. The leading motivations behind trade misinvoicing can be broadly categorized as macroeconomic, governance-related and structural. Trade misinvoicing in the Arab region is evenly split between inflows and outflows. Between 2008 and 2015, total trade misinvoicing in the Arab region increased in value, volume and as a percentage of total trade. The Arab region's average trade-based illicit financial flows associated with commodity misinvoicing stood at 8.2 per cent of total non-oil trade with the world over that period, or an average of \$60.3 billion per year.⁸

19. Considering the value of total commodity trade for the Arab region in 2015, which amounted to \$1.6 trillion according to the World Integrated Trade Solutions Database, and comparing it with the dollar figure of total trade misinvoicing for the same year, nearly 4 per cent the region's total trade with the world (including

⁸ The report also illustrates how the use of alternate sources and methods can create different estimates of illicit financial flows. Some lower figures for Djibouti, Iraq, Libya and Somalia were excluded due to data limitations rather than lack of misinvoicing, although there have been numerous reports of illicit or undeclared trade in oil and antiquities, among others.

intra-Arab trade) was subject to some form of trade misinvoicing. The largest non-oil commodity categories for misinvoicing are associated with machinery, electrical machinery, vehicles and plastics, closely followed by precious stones and metals, and organic chemicals.

20. When trade misinvoicing is considered in the context of regional trade agreements, Greater Arab Free Trade Area (GAFTA) countries have a lower level of trade misinvoicing in their trade with each other than with their external trade partners, with intra-Arab trade misinvoicing at 5.1 per cent of total non-oil regional trade (compared with 9.4 percent of non-oil external trade) over the period 2008-2015.

21. These findings raise several questions with respect to the enforcement of regional trade agreements (intra and extraregional). It also holds implications for the establishment of an Arab customs union by 2021. The findings themselves are relevant to the ongoing negotiations on an Arab common customs code; a common external tariff structure for the customs union; trade misinvoicing implications arising from non-unification of the harmonized commodity description system; customs declarations, fines and other related custom offences; and a revenue collection mechanism within the customs union.
