United Nations Conference on Trade and Development

Promotion of international cooperation to combat illicit financial flows and strengthen good practices on assets return to foster sustainable development:

Achievements, challenges and way forward.

Paper prepared by UNCTAD, in consultation with UNODC, in compliance with A/RES/76/196*

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Key messages for the 77th session of the 2nd Committee on the paper from UNCTAD, in consultation with UNODC, in response to resolution A/76/196.

Four main messages of the report

- IFFs are deliberately hidden and take many forms using varying channels. Therefore, UNCTAD and UNODC have developed, at the request of member States and as custodian agencies of SDG indicator 16.4.1 on illicit financial flows, concepts and a suite of methods to measure different types of IFFs. Measurement challenges differ across countries, depending on the main types of IFFs affecting the country, data availability, mandates of national institutions, statistical capacity, and national policy priorities. The suite of methods thus allows for the selection of the most suited methods to the national data environment.

- The scope and definitions for the measurement of illicit financial flows in the context of the 2030 Agenda and its indicator 16.4.1 were agreed by all member States at the UN Statistical Commission. However, IFF estimates of varying scope and methods continue to be used. There is a need to streamline work to use harmonized concepts and methodologies to quantify the various types of IFFs using the best possible data available to national authorities to avoid confusion and ensure adoption of appropriate national and regional policies and an international framework to curb IFFs and ensure assets return. Clarity about what is being measured and what is the quality of the estimates is needed for effective action and can be provided by applying agreed concepts and methods.

- Combating and curbing IFFs would not be successful if it focuses only on its financial dimension, such as financial flows related to tax evasion, trafficking or smuggling. Ability to significantly curb IFFs can only happen if the whole value chain of transaction is considered, from the production to the export, and to the retail. Steps should be taken for comprehensive accounting of IFFs by type, channel, source and destination, building on a comprehensive analysis of the activities generating IFFs in line with the first pilot studies carried out by member States.

- In May 2022, the Committee of Experts of the Conference of African Ministers of Finance, Planning and Economic Development adopted a resolution on curbing illicit financial flows and recovery of lost assets. The Conference of Ministers emphasized the need to build countries’ capacity in Africa, especially “in tax policy and administration, international tax cooperation, countering money laundering, corruption prevention and related enforcement measures, asset recovery and return, and natural resource governance”, and to this end, underlined the need “to build the capacity of African countries to tackle the gaps in institutional architecture, with a view to developing their ability to track, measure and report on the evolution of illicit financial flows under SDG 16.4.1, and to devise measures to curb illicit financial flows”.

Three new developments in the area:

- To date, 22 countries have pilot tested the measurement of selected types of IFFs in Africa, Asia and Latin America. The pilots show that IFFs can be measured using common statistical standards, methods and resources made available by UNCTAD and UNODC.
The methods are being refined based on feedback from pilots, and the work needs to be extended to other countries globally to enable transparency and reporting on IFFs in the context of the 2030 Agenda.

- The Bridgetown Covenant, as the renewed UNCTAD’s mandate, recognizes the challenges of illicit trade. The second edition of the UNCTAD Illicit Trade Forum, held in Geneva on 6 and 7 September 2022, highlighted the impacts of illicit trade on all SDGs, exacerbated by the crises, given that it precludes the possibilities for governments to generate revenues through customs and taxes, crowds out legitimate economic activity, and erodes the progress already made towards the sustainable development goals.

- According to the UNCTAD World Investment Report 2022, the proposed introduction of a minimum tax of 15 per cent on the foreign profits of the largest multinational enterprises has major implications for international investment and investment policy. The report estimates that developing countries could lose out on tax revenues due to capacity and legal constraints on the implementation of needed reforms: cross-border investment in productive assets could decline by two per cent.

Three main areas for further policy guidance by the Committee

- The 22 pilot studies have shown IFFs can be measured, and do so mainly by reusing existing data, though there is a need to improve data quality and infrastructure, skills and resources, as well as provide training to national office of statistics.

  The methods applied in the pilots have been approved by all member States of the United Nations and provide a coherent and universal statistical measure covering the entire scope of IFFs. Member States may consider making use of the agreed methods, tools and guidelines to report data on SDG indicator 16.4.1 on illicit financial flows.

- Member States could also consider committing to seeking/provide resources needed to build capacity especially in developing countries to measure IFFs to report on SDG 16.4.1. The ability to measure IFFs will convert in the possibility to curb IFFs and recover stolen assets, thus maximizing the investment on capacity building.

- Measurement of IFFs is the first step in identifying threats and risks from IFFs. This work needs to continue and expand by (1) supporting country-level IFF risk profile to inform the policy processes to curb IFFs and (2) commissioning further work to illicit trade.
Summary

Resolution A/RES/76/196 adopted by the General Assembly on 17 December 2021, “requests the secretariat of the United Nations Conference on Trade and Development, in consultation with relevant entities of the United Nations system, including the United Nations Office on Drugs and Crime, to inform the General Assembly at its seventy-seventh session about the implementation of the present resolution, through a dedicated section of the Sustainable Development Goals Pulse report and of the Trade and Development Report, elaborating in particular on the need to combat illicit financial flows and recover and return stolen assets in line with commitments contained in the Addis Ababa Action Agenda of the Third International Conference on Financing for Development and the 2030 Agenda for Sustainable Development, in the context of the COVID-19 pandemic”. This paper will respond to the request.

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I. Introduction

1. Combatting illicit financial flows (IFFs) is an integral part of the 2030 Agenda for Sustainable Development, with progress to be measured by indicator 16.4.1 on total value of inward and outward illicit financial flows. The COVID-19 pandemic, the war in Ukraine and the increasing costs of climate change and environmental challenges have had a particularly devastating impact on developing economies highlighting the critical need for addressing the financing gap. The ability to achieve the sustainable development goals (SDGs) remains fragile when IFFs continue to drain resources that would be needed to pursue sustainable development and fulfil human rights. Domestic resource mobilization, asset recovery and curbing IFFs are more critical than ever. Governments’ capacity to raise resources, including through combatting crime and recovering the proceeds of crime, and the return of stolen assets will be fundamental to achieve SDGs. IFFs are a global problem, and it will require strong international commitment and cooperation to combat them.

2. The Addis Ababa Action Agenda calls for redoubling efforts to substantially reduce illicit financial flows by 2030, with a view to eventually eliminating them, including by combating tax crimes, corruption and money laundering through strengthened implementation of national and international regulations, laws, norms and standards, and through increased international cooperation. The AAAA also calls for reducing opportunities for tax avoidance. International institutions and regional organizations are also called by the AAAA to publish estimates of the volume and composition of IFFs. To enable statistical measurement of SDG indicator 16.4.1, IFFs are defined by the Task Force on the Statistical Measurement of IFFs as financial flows that are illicit in origin, transfer or use, that reflect an exchange of value, and cross-country borders.

3. IFFs weaken state institutions by encouraging corruption and undermining the rule of law and the functioning of government institutions, including criminal justice systems. By eroding the tax base and discouraging public and private investment, they hamper structural transformation, economic growth, and sustainable development.

4. IFFs deprive governments of resources required to realize human rights. They undermine the efforts to build effective institutions to uphold civil and political rights and the rule of law. After decades of progress in human development, the 2022 Special Report on Human Security (UNDP, 2022a) analyses the recent alarming decline in Human Development Index which started even before the pandemic. The report notes the strong association of this trend with declining levels of trust and higher insecurity. The September 2022 release (UNDP, 2022b) reveals a decline in the Human Development Index for a second year in a row.

5. IFFs increase insecurity by undermining democratic processes and weakening institutions and the trust citizens have in them. They derail the achievement of equity and non-discrimination exacerbating poverty and feeding income inequality. The impacts lead to particularly dire effects for the most vulnerable, and especially women and girls. Since women and girls often have less access to health services and education, they suffer most from the negative fiscal effects of IFFs. IFFs are a systemic phenomenon that is challenging to address comprehensively, due to a lack of information but also due to the multi-faceted nature of the normative framework and tools. These and the lack of data need to be addressed as the key to curbing IFFs in a meaningful and effective way.

6. Recent years have seen notable progress in developing novel methods to measure IFFs based on more granular data, thus increasing possibilities to find traces of IFFs in official records and transactions data. After intensive global efforts led by the United Nations Conference on Trade and Development (UNCTAD) and the United Nations Office on Drugs and Crime (UNODC), as custodian agencies of SDG indicator 16.4.1, and involving experts from member States and international organizations, globally agreed concepts for measuring IFFs as SDG indicator 16.4.1 were adopted by member States at the United Nations Statistical Commission. These concepts were also endorsed at the political level by the High-Level Panel on International Financial Accountability, Transparency and Integrity for Achieving the 2030 Agenda (FACTI) (United Nations, 2021) and the Cluster V of United Nations Regional Commissions on Financing for Development in the Era of COVID-19 (United Nations, 2020).
In addition to the agreed concepts on IFFs, UNCTAD and UNODC have developed methods to measure different types of IFFs originating from tax and commercial activities and selected criminal activities. Methods to measure selected types of IFFs were pilot tested between 2018 and 2022 in 22 countries mainly in Africa, Asia, and Latin America. It contributed to the fine tuning of the global methodology to measure IFFs and enabled the reporting on SDG indicator 16.4.1 on total value of inward and outward illicit financial flows. Progress to date is reflected in the UNCTAD SDG Pulse online publication and UNCTAD’s dedicated platform on illicit financial flows.

The COVID-19 pandemic, the war in Ukraine and the disruptions in global value chains combined with the increasing costs of climate change and environmental challenges have had a devastating impact on many developing economies highlighting the critical need for addressing the financing gap, including by curbing IFFs and redirecting these flows when possible to safeguard domestic resource mobilisation, support recovery, build resilience and achieve SDGs.

II. On economic impacts of illicit financial flows on sustainable development

A. IFFs undermine Africa’s potential to achieve the SDGs

IFFs represent a major drain on capital and revenues in Africa, undermining productive capacity and Africa’s prospects for achieving the SDGs. For example, the UNCTAD’s Economic Development in Africa Report (2020) finds that, in African countries with high IFFs risks, governments spend 25 per cent less than other countries on health and 58 per cent less on education. Given that women and girls often have less access to health and education, they suffer most from the negative fiscal effects of IFFs.

Africa will not be able to bridge the large financing gap to achieve the SDGs with existing government revenues and development assistance. The report finds that tackling capital flight and IFFs represents a large potential source of capital to finance much-needed investments in, for example, infrastructure, education, health, and productive capacity.

Specific data limitations affected efforts to estimate IFFs. In fact, only 45 out of 53 African countries provide data in a continuous manner allowing trade statistics to be compared over time. The report highlights the importance of collecting more and better trade data to detect risks related to IFFs, increase transparency in extractive industries and tax collection. The UNCTAD Automated System for Customs Data (ASYCUDA), including its new module for mineral production and export, called MOSES (Mineral Output Statistical Evaluation System), are potential solutions in this effort. African countries also need to enter automatic exchange of tax information agreements to effectively tackle IFFs.

The report’s analysis also demonstrates that IFFs in Africa are not endemic to specific countries, but rather to certain high-value, low-weight commodities. Early research (UNCTAD, 2020) revealed that IFFs are highly concentrated in the supply chain of gold, diamonds, and platinum. The report provides African governments with knowledge on how to identify and evaluate risks associated with IFFs, as well as solutions to curb IFFs and redirect the proceeds towards the achievement of national priorities and the SDGs.

B. The need to improve regional cooperation and capacities on illicit financial flows, and assets recovery


Although IFFs are a major constraint to domestic resource mobilization in Africa, African governments are not yet sufficiently engaging in the reform of the international taxation system. Transparency and cooperation between tax administrations globally and within the continent is key to the fight against tax evasion and tax avoidance. There is also a need for greater capacity at the domestic and international levels to improve financial investigations, prioritise international cooperation, mutual legal assistance and quicken the pace for the recovery of stolen assets.

Regarding regional cooperation on taxation within the continent, the African Tax Administration Forum (ATAF) can provide a platform for regional cooperation among African countries. Regional knowledge networks to enhance national capacities to tackle proceeds of money laundering and recover stolen assets, including within the African Continental Free Trade Area (AfCFTA) context are crucial in the fight against corruption and crime related IFFs (UNCTAD, 2020).

Furthermore, only four countries in the region reported involvement in at least one cross-border asset return involving corruption proceeds between 2010 and 2021 (United Nations, 2022).

In May 2022, the Committee of Experts of the Conference of African Ministers of Finance, Planning and Economic Development adopted a resolution on curbing illicit financial flows and recovery of lost assets. They called “upon the international community to undertake appropriate actions at the national, regional and global levels to ensure that illicit financial flows are treated as a systemic challenge at the global level and that the international community adopts a mechanism for global coordination to systematically monitor illicit financial flows and avoid a siloed approach to tackling such flows”.

The Conference of Ministers emphasized the need to build countries' capacity in Africa, especially “in tax policy and administration, international tax cooperation, countering money laundering, corruption prevention and related enforcement measures, asset recovery and return, and natural resource governance”, and to this end, underlined the need “to build the capacity of African countries to tackle the gaps in institutional architecture, with a view to developing their ability to track, measure and report on the evolution of illicit financial flows under SDG 16.4.1, and to devise measures to curb illicit financial flows”.

### C. Tackling IFFs is a shared challenge requiring international action

Tax revenues lost to IFFs are especially costly for developing countries, where public investments and spending on the SDGs are most lacking. But IFFs aren’t just a regional or development concern. They are multidimensional and by definition a transnational issue as they have an origin and destination country and cut across different jurisdictions. Solutions to the problem must involve international tax cooperation and anti-corruption measures. The international community needs to devote more resources to track and tackle IFFs, including capacity-building for statistical, tax and customs authorities in developing countries.

African countries need to strengthen engagement in international taxation reform, make tax competition consistent with protocols of the AfCFTA, and aim for more taxing rights. African countries also need to enter automatic exchange of tax information agreements to effectively tackle IFFs. The 2022 African Conference of Ministers’ resolution calls upon the United Nations to begin negotiations under its auspices on an international convention on tax matters, with the participation of all Members States and relevant stakeholders, aimed at eliminating base erosion, profit shifting, tax evasion, including of capital gains tax, and other tax abuses. The Organisation for Economic Co-operation and Development (OECD) and the G20 countries have adopted and put in place a 15-point Action Plan on Base Erosion and Profit Shifting (BEPS) to curb the tax avoidance practices of multinational enterprises and to make the international tax system fairer (WIR 2022). As of 4 November 2021, over 135 countries and jurisdictions joined a new two-pillar plan to reform international taxation rules and ensure that multinational enterprises pay a fair share of tax wherever they operate.

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3 https://repository.uneca.org/handle/10855/48341
While we emphasize the benefits of reducing IFFs have on government budgets and fiscal space in particular in difficult times for developing countries, we may recall that these efforts are also taking place in developed countries. The international community has achieved notable success in using new transparency standards to fight offshore tax evasion through the Global Forum on Transparency and Exchange of Information for Tax Purposes. By automatically exchanging information, more than €112 billion in additional tax revenue has been identified from the start of 2009. This includes over €1.2 billion of additional revenues (tax, interest and penalties) identified by African countries through offshore tax investigations including Exchange of Information on Request (EOIR).

Data on recovery of proceeds of corruption from the UNODC-World Bank Stolen Asset Recovery Initiative (StAR) shows that as of 2021, the most active jurisdiction of asset recovery is Switzerland, followed by the United Kingdom and the United States of America. Nigeria was also very active with regard to the number of cases and success with regard to recovered proceeds of corruption (United Nations, 2022).

The so-called “Panama papers” enabled for instance France to recover a large amount of taxes and penalties (UNCTAD, 2020). Tax Inspectors Without Borders by the OECD and the United Nations Development Programme (UNDP) support countries with tax audit capacity. Developed countries have notably higher capacity to engage in activities to return assets. Similar efforts may take years for developing countries, hence the urgent necessity for collaboration and support across countries.

D. Measuring tax motivated IFFs challenges

The very nature of illicit financial flows (IFFs) and the associated lack of transparency makes estimating the public revenue loss resulting from these practices a daunting task. Notwithstanding these caveats, Baker (2005) finds two key elements. First, tax-motivated IFFs represent the bulk of IFFs as they amount for roughly two thirds of total IFFs. Second, tax-motivated IFFs mostly concern large multinational enterprises (MNEs) because these entities can rely on their numerous affiliates and subsidiaries around the world to register profits in low or no tax jurisdictions (UNCTAD TDR, 2014).

Since this pioneering work, several studies have found that the magnitude of public revenue losses due to these activities is sizeable and probably amounts to hundreds of billions per year globally. In absolute terms, these losses mainly affect high-income countries’ public finance, but when measured as a share of GDP or total tax revenues, empirical investigations often show that these leakages are larger for tax authorities of low-income countries.

Estimates on the size of IFFs have a huge spread, and often apply different concepts and methods. Some measure individuals’ offshore wealth, some trade misinvoicing and some multinational tax avoidance etc. (see for instance Fuest et al. (2011), Zucman (2014), IMF (2014), OECD (2015), Crivelli et al., (2016), Garcia-Bernando and Janský (2021)). Altogether, their diverse estimates fall within a range of $53–312 billion per year. This variability arises because of differences in methodology, data sources and assumptions (Garcia-Bernardo and Janský, 2022: table A11 provides a recent survey of the literature).

While these provide valuable indications, it is important to achieve clarity about the size and types of IFFs by developing and applying globally comparable concepts and methods to their measurement using the most granular data possible. This effort is now being undertaken by UN member States in pilot studies,

4 https://www.oecd.org/irs/transparency/
5 Following the UNCTAD Trade and Development Report 2014 terminology at https://unctad.org/system/files/official-document/tdr2014_en.pdf, this paper refers to tax-motivated IFFs whenever the international structuring of transactions or asset portfolios has little or no economic substance, and their express purpose is to reduce tax liabilities, which is in line with the agreed definition of tax avoidance, see Section III in this paper. The key criterion used is whether such flows are justified from an economic point of view. Hence, if a given international financial flow is part of a ‘tax-optimization’ scheme without any concrete related economic activity, it should be considered ‘illicit’ and thus considered as a tax-motivated IFFs.
6 Garcia-Bernardo and Janský (2022) points to a range of $90–312 billion, but it does not consider Fuest et al. (2022), which finds that globally, 3,600 large MNEs operating in 238 jurisdictions reduce their tax burden by €53 billion (15 per cent of their overall tax payments) by shifting profits to low-tax countries.
supported by UNCTAD and UNODC and all UN Regional Commissions. These efforts need to be extended to all UN member States and be supported by the UN system with sufficient resources. There is increasing consensus that tax and commercial IFFs lead to significant tax revenues losses, and similarly to IFFs from criminal activities, divert resources from essential services and sustainable development. The first country pilots provide some hope that IFFs can be measured to inform policymakers’ efforts to come up with more effective solutions to curb these leakages and recover lost assets.

E. Trade based illicit financial flows

27. Considering the tax behavior of multinational enterprises, the country-by-country reporting of the OECD’s BEPS Action Plan 13 provides an important source of data broken down by key elements of the financial statements. Yet, it does not cover all aspects of illicit trade or IFFs. The Bridgetown Covenant, as the renewed UNCTAD’s mandate, recognizes the challenges of illicit trade. The second edition of the UNCTAD Illicit Trade Forum, held in Geneva on 6 and 7 September 2022, highlighted the impact of illicit trade on all SDGs, even more compounded in times of crises, given that it precludes the possibilities for governments to generate revenues through customs and taxes, crowds out legitimate economic activity, and erodes the progress already made towards the sustainable development goals.

28. The mining industry has attracted a lot of attention given its potential huge source of IFFs from multinational companies, but also given huge scandals on minerals and metals extraction financing armed conflicts for instance. However, the impact on environment, human rights violations, poverty, gender equality, health and jobs of Artisanal and Small-Scale Miners (ASM) should also be considered a priority. 47.7 million people work in ASM across 80 countries which produce annually 20 per cent of mined golds and diamonds and 15 to 20 per cent of cobalt – an expensive and required component for modern batteries – in often harsh and risky conditions with sometimes child labor, water and air pollution, informality and under the control of armed groups or criminal networks. The role of traders and of the industry to conduct due diligence in the supply chain is key but has a cost which would have to be borne by final consumers, industry shareholders or taxpayers.

29. In the case of illegal logging of woods, the impacts are devastating for biodiversity, indigenous people, the sustainability of wood resources and population depending on it, carbon dioxide emissions, deforestation and sustainable management of forests, and may be more costly for the community and the world than the amounts lost by avoiding customs and taxes. Forestry products continue to be one of the most profitable sectors for illicit traders.

30. Similarly, illegal, unreported, and unregulated fishing may generate little IFFs, such as the absence of taxes paid from foreign vessels to fish in national waters and lost income for the national fishing industry. However, these activities also endanger the sustainability of fish stock of the future and thus the sustainability of the fishing industry not only locally, but also regionally. Indeed, fish stocks are moving across countries in the same region. A depleted fish stock will thus affect the whole region, not only one country.

31. Combating and curbing IFFs would not be successful if it focuses only on the financial dimension of it, such as tax evasion, trafficking or smuggling. Chances of significantly curbing IFFs may happen if the whole value chain is considered, from the production to the export and the retail. Steps should be taken for more comprehensive accounting of IFFs by type, channel, source and destination, building on a full analysis of the activities generating IFFs in line with the first pilot studies carried out by member States.

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8 The Bridgetown Covenant From inequality and vulnerability to prosperity for all, para 127. (rr) available at: https://unctad.org/system/files/official-document/td541add2_en.pdf
F. Efforts to address profit shifting by multinational enterprises

32. OECD’s BEPS project delivered a package of 14 actions aimed at tackling tax avoidance, improving the coherence of international tax rules and ensuring a more transparent tax environment. OECD estimates that “Developing countries’ higher reliance on corporate income tax means they suffer from BEPS disproportionately. BEPS practices cost countries USD 100-240 billion in lost revenue annually”\(^{12}\). Concerted action and cooperation of national and international stakeholders is crucial in achieving a transparent tax environment.

33. Digitalization has caused a rapid increase in the share of intangibles in international trade and investment, with a corresponding increase in opportunities for multinational enterprises to disconnect profits from real economic activities and to shift them to low-tax locations. To restore the nexus between where value added activities take place and where profits are taxed, BEPS participants reached an agreement in 2020 to work on a two-pillar approach. Pillar I aims to realign the reporting of multinationals' profits with value creation. Pillar II proposes a global minimum tax on the profits of multinational enterprises with revenues of €750 million or more. About 140 jurisdictions have joined this two-pillar plan to reform international taxation rules.

34. Whereas the two-pillar proposal arose to address tax issues caused by digitalization, the scope of Pillar II is now broader and involves fundamental changes to the international tax architecture. It aims to reduce profit shifting by multinational enterprises, improve the fairness of tax systems and increase revenue collection. It also aims to reduce damaging tax competition between countries and to set a limit to the race to the bottom in corporate income tax rates caused by countries competing to attract foreign direct investment (FDI).

35. According to the UNCTAD World Investment Report 2022\(^ {13}\), the proposed introduction of a minimum tax of 15 per cent on the foreign profits of the largest multinational enterprises has major implications for international investment and investment policy. UNCTAD (2022) estimates that developing countries could lose out on tax revenues due to capacity and legal constraints on the implementation of needed reforms: cross-border investment in productive assets could decline by 2 per cent.

36. For statistical measurement of profit shifting by multinational enterprises to assess IFF risks, UNCTAD’s Methodological Guidelines (UNCTAD, 2021) propose two methods which draw on international research and methodology, and can be selected based on nationally available data for their application (see section III below). Pilot testing the methodologies reveal several challenges relating to data availability and statistical capacity. Data gaps can be partially offset by relying on global data sets, such as OECD’s country-by-country reporting data, yet more support is needed for cross-border exchange of data for statistical purposes. Moreover, this will require enhancing the technical statistical capacity of member States, including improved availability of key official statistics and statistical business registries.

III. Measuring illicit financial flows towards achieving SDG target 16.4 and beyond

A. Scope and concept of illicit financial flows have been agreed globally for SDG indicator 16.4.1

37. As indicator co-custodians, UNCTAD and UNODC lead global methodological work to develop statistical definitions and methods to measure IFFs and support member States in developing their capacity to monitor progress towards target 16.4 to significantly reduce illicit financial and arms flows, strengthen the recovery and return of stolen assets and combat all forms of organized crime, by 2030. This is central to all the efforts described above. To ensure engagement with national statistical authorities and other experts, UNCTAD and UNODC established a Task Force on the Statistical Measurement of IFFs in January 2019, involving experts from national statistical offices, financial intelligence units, tax authorities, academia, non-
governmental organisations, and other global IFF experts. The Task Force also involves a number of international organizations, such as the United Nations Economic Commission for Africa (UNECA), Economic Commission for Latin America and the Caribbean (ECLAC), Economic Commission for Asia and the Pacific (ESCAP), Eurostat, International Monetary Fund (IMF), the Organisation for Economic Co-operation and Development (OECD) and the United Nations Statistics Division (UNSD).

38. As a result of this collaborative effort, a definition of IFFs, now globally agreed, was developed defining IFFs as financial flows that are illicit in origin, transfer or use, that reflect an exchange of value, and cross country borders.

**Figure 1: Categories of activities that may generate illicit financial flows**

![Diagram showing categories of activities that may generate illicit financial flows]

Source: UNCTAD and UNODC.

39. As reflected by figure 1, IFFs constitute four major categories:

a. **Illicit tax and commercial IFFs.** This category includes illicit practices by legal entities as well as arrangements and individuals with the objective of concealing revenues, reducing tax burden, evading controls and regulations and other purposes. This category can be divided into two components:
   i. **IFFs from illegal commercial and tax practices.** These include illegal practices such as tariff, duty and revenue offences, tax evasion, corporate offences, market manipulation and other selected practices. Some activities that are non-observed, hidden or part of the so-called shadow economy, the underground economy or the informal economy may also generate IFFs. These activities also include tax evasion, tariff, duty and revenue offences, competition offences, import/export offences, acts against trade regulations, restrictions or embargoes and investment or stack/shares offences.
   ii. **IFFs from aggressive tax avoidance.** Illicit flows can also be generated from legal economic activities through what is sometimes called harmful or aggressive tax avoidance. Aggressive tax avoidance can take place through a variety of forms, such as manipulation of transfer pricing, strategic location of debt and intellectual property, tax treaty shopping, and the use of hybrid instruments and entities. For

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14 For more detail on the distinction between legal and illegal, licit and illicit, see box 1 in SDG Pulse 2022 at https://sdgpulse.unctad.org/illicit-financial-flows/
the purposes of the measurement of the indicator, these flows need to be carefully considered, as they generally arise from licit business transactions and only the illicit part of the cross-border flows belongs to the scope of IFFs.

b. **IFFs from illegal markets.** These include trade in illicit goods and services, when the money flows generated cross country borders. Such processes often involve a degree of criminal organisation aimed at creating profit. They include any type of (illegal) trafficking in goods, such as drugs and firearms, or services, such as smuggling of migrants. IFFs are generated by the flows related to international trade of illicit goods and services, as well as by cross-border flows from managing the illicit income from such activities.

c. **IFFs from corruption.** The United Nations Convention against Corruption\(^{15}\) lists a series of criminal offences that are considered forms of corruption. These include bribery, embezzlement, abuse of functions, trading in influence, illicit enrichment and other acts. In line with the Convention, proceeds of corruption and related offences must be subject to asset recovery and return.

40. **IFFs from exploitation-type activities and financing of crime and terrorism.** Exploitation-type activities are illegal activities that entail a forced and/or involuntary transfer of economic resources between two actors. Examples include slavery and exploitation, extortion, trafficking in persons, and kidnapping. In addition, terrorism financing and financing of crime are illicit, voluntary transfers of funds between two actors with the purpose of funding criminal or terrorist actions. When the related financial flows cross country borders, they constitute IFFs. The UNCTAD and UNODC (2020) *Conceptual Framework for the Statistical Measurement of Illicit Financial Flows*\(^{16}\) reflecting these concepts was endorsed by all member States and international organizations at the 53rd Session of the United Nations Statistical Commission in March 2022.

### B. Methodologies to measure illicit financial flows are being refined in a country-led process

41. IFFs are deliberately hidden and take many forms using varying channels. Therefore, UNCTAD and UNODC have developed a suite of methods, each intended for the measurement of different types of IFFs. The measurement challenges also differ across countries, depending on main types of IFFs affecting the country, data availability, mandates of national institutions, statistical capacity, and national policy priorities. The suite of methods also allows selection of methods most suited to the national data environment.

42. To this end, in May 2021, UNCTAD (2021) published *Methodological Guidelines to Measure Tax and Commercial Illicit Financial Flows*\(^{17}\) for pilot testing by countries. The Guidelines are aimed at statistical and other national authorities with a mandate to collect and access detailed, often transactions level data. Such data available to national authorities enable the compilation of more reliable estimates. However, simpler methods are proposed in parallel with more sophisticated methods to enable IFFs’ estimation also where less data are available.

43. The methods are intended for use by government agencies that have access to granular data even at the transaction level. They comprise special quality assurance efforts to increase accuracy, for instance in bilateral efforts of statistical offices, customs and tax authorities e.g., of key trading partner countries to correct asymmetries related to reasons other than IFFs.

44. UNODC has developed and continues to enhance methods to address IFFs from criminal activities, such as smuggling of migrants, drug trafficking, illegal mining, wildlife trafficking, and trafficking in persons, providing guidance and expert support to national authorities undertaking measurement. The

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\(^{15}\) https://www.unodc.org/unodc/en/treaties/CAC/


methods adopt a bottom-up approach, which requires to estimate the size of the value generated by illegal market and other criminal activities, to derive the value of related cross-border transactions associated with IFFs.

45. The approach taken by UNCTAD and UNODC considers the multi-dimensional nature of IFFs, identifies the main types of IFFs to be measured and lays out a framework in line with existing statistical definitions, classifications, and methodologies, aligned in particular with the System of National Accounts and the Balance of Payments Manual. Work continues to develop a comprehensive classification of IFFs, refine the suite of methods and develop approaches to aggregate various estimates of IFFs into a single indicator to enable reporting on SDG indicator 16.4.1.

C. Countries need stronger support to track illicit financial flows and report data on SDG 16.4.1

46. National statistical systems already have some of the data needed for the measurement of IFFs, but these data are scattered across a range of authorities. Relevant data are often held by the police and ministries and councils of justice, financial intelligence units and other government agencies collecting information on seizures and criminal offences. In addition, tax authorities collect data for assessing the tax gap, and they exchange country-by-country reporting data on multinational enterprises. Customs’ data and statistics on international trade in goods and services provide useful information on commercial IFFs.

47. Measuring IFFs requires close collaboration within the national statistical system and with administrative data providers in a country. It also benefits from bilateral or multilateral collaboration of agencies across countries. National statistical offices, as the focal point for coordinating the compilation of SDG indicators lead and coordinate the work to bring national stakeholders together to collate data and measure IFFs. Collaboration between the national statistical office, central bank, customs offices, law enforcement agencies, tax and revenue authorities, relevant ministries, financial intelligence units and anti-corruption authorities is key to tracking and curbing IFFs. Civil society and the academia are also often involved in consultations and research related to IFFs.

48. Country pilots are central to building national capacity to measure IFFs and testing the feasibility of measurement. To date, 22 countries have participated in pilot measurement of IFFs (see map 1). Pilot studies started in 2018, led by UNODC, in Latin America with the measurement of selected types of IFFs from illegal markets activities. In the first pilots, Colombia, Peru, Ecuador, and Mexico measured IFFs from selected illegal markets, such as drugs trafficking and smuggling of migrants. Estimates in Mexico, for instance, show that an inflow of IFFs equivalent to around $12 billion was generated annually by drug trafficking activities conducted between 2015 and 2018.
49. Similarly, inward IFFs from cocaine trafficking were estimated for Peru ($1.48 billion annually between 2015 and 2017) and Colombia (range: $1.5 billion - $10.2 billion for 2019). Smuggling of migrants is instead estimated to have generated an annual average of $1.1 billion in inward IFFs for Mexico and $13.6 million in outward IFFs for Ecuador (2016-2018 data). Pilots also addressed the measurement of IFFs from illegal gold mining and trafficking in persons, even if data in such cases did not allow for a sufficiently robust estimate.

50. In 2021, eleven interested African countries and six countries in Asia and the Pacific joined the pilot testing of statistical methodologies to measure IFFs, with UNCTAD and the respective UN Regional Commissions, UNECA and ESCAP. In addition, Egypt is pursuing the measurement of tax and commercial, as well as drug trafficking related IFFs in the context of United Nations Joint Fund Support to Egypt for Integrated SDGs Financing.

51. The country pilot studies start by a national IFFs risk assessment, followed by a mapping of relevant national stakeholders, a review of data availability and quality; and calculation of initial IFF estimates with one or two selected methods. To coordinate work, pilot countries formed national inter-agency working groups composed of technical experts of key institutions possessing relevant data and mandates to address IFFs.

52. To support countries in their efforts, in 2021-2022, UNCTAD organized 33 workshops with UNECA and ESCAP, often in collaboration with UNODC, to enhance national capacity to measure tax and commercial IFFs. In total, 1561 participants attended these capacity-enhancement activities, including almost 800 different individuals. These training activities include three regional workshops, eleven national kick-off events and 18 national training workshops as well as one six-day interregional methodological training workshop for Africa and Asia.

53. The pilots concluded by establishing Action Plans to steer further work to address data gaps and identify resources and tools for regular measurement of IFFs. In Africa, eleven pilots finished in June 2022; Egypt and countries in Asia are expected to produce preliminary results by autumn 2022 and finalise pilot activities by the end of 2022. Half of the 22 pilot countries have at least initial estimates of selected IFFs, and the other half is currently in the process of compiling estimates. Countries with initial estimates include four in Latin America and seven in Africa, whilst the rest are currently finalizing their work.

54. These pilot studies have shown that it is possible to estimate many types of IFFs by using existing data at the most detailed available level. The pilot process has helped countries strengthen their capacity to

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20 Angola, Benin, Burkina Faso, Gabon, Ghana, Mozambique, Namibia, Nigeria, Senegal, South Africa, Zambia.
21 Bangladesh, Kyrgyzstan, Maldives, Nepal, Viet Nam, Uzbekistan.
track and curb IFFs, and Action Plans are in place to steer further efforts. The pilots have also provided critical information for refining statistical methods to measure IFFs, e.g., to enhance reliability of weighting procedures and propose alternative methods were necessary. This will lead to refinement of global methods to measure IFFs after the current pilot testing concludes in the remaining Asian countries by the end of 2022.

55. Countries selected methods for pilot testing of the measurement of tax and commercial IFFs depending on the types of illicit flows affecting the country most and reflecting on data availability. Most countries tested the measurement of IFFs from trade misinvoicing with 14 countries testing the enhanced partner country method and 10 countries applying the price filter method on transactions level data. Four countries measured the distribution of multinational enterprise groups’ profits and corporate taxes, and two compared multinationals and non-multinationals to assess aggressive tax avoidance patterns. Two countries tested the estimation of IFFs from offshore wealth.

56. The preliminary results of pilot testing activities confirm the feasibility of measuring IFFs, yet there are challenges in coordinating work, accessing data, addressing data gaps, applying the methods and finally achieving an overall measure of all IFFs. Early feedback shows that support by national and international consultants and experts, training, guidance and resources provided by international organizations and the forming of national inter-agency working groups at the technical level are crucial for compiling statistics on IFFs.

57. The Action Plans prepared by countries reveal the need for serious investment in data if IFFs are to be curbed. These gaps may refer to lack of resources, serious data gaps, problems in data sharing for statistical purposes, poor quality of basic statistics and lack of data integration and technical skills. The Action Plans provide a tool for governments and donors to invest in data to curb potentially large flows of IFFs.

D. The UN system, donors, non-governmental organizations, and member States to join efforts

58. To date, no country reports data on SDG indicator 16.4.1, including developed countries. The 22 pilot studies have shown IFFs can be measured, and more importantly mainly by reusing existing data while improvements in data quality and infrastructure, skills and resources will be needed. Measurement of illicit financial flows and reporting on SDG 16.4.1 would not have been possible without internationally agreed concepts and methods. Now after the first estimates of selected IFFs applying those, almost all pilot countries have expressed their interest to measure all IFFs affecting their country to start reporting on SDG indicator 16.4.1. The goal of a global project on IFFs, led by ECA and carried out by all UN Regional Commissions with the substantive support by UNCTAD and UNODC, is to support the first countries globally to start reporting official statistics on IFFs. The custodian agencies have shared the tools, resources and guidelines to enable all interested countries to start reporting data on illicit financial flows.

59. While agreed concepts exist for SDG indicator 16.4.1, varying IFF estimates applying different methods and concepts continue to be used, often all referred to as IFFs, even when a subset or a particular type of IFFs, like tax evasion by individuals, is being measured instead of all IFFs. There is a need to streamline work to use harmonized concepts and methodologies to quantify IFFs and using the best possible data available to national authorities. This will help to avoid confusion and ensure adoption of appropriate national and regional policies and a stronger international framework to curb IFFs and ensure assets return. Clarity about what is being measured and what is the quality of the estimates is needed for effective action and can be provided by applying agreed concepts and methods, and where needed, contributing to their further refinement for global application.

60. The United Nations System, member States and international organizations need to step up support to improve data on IFFs and fulfill the commitment to report on SDG indicator 16.4.1 to give countries a real chance to curb IFFs in line with national priorities. This will require technical expertise and substantive leadership from UNCTAD and UNODC and joint efforts of the UN Regional Commissions and all partner
organizations. We need the data first to design effective measures to understand and curb IFFs and target our efforts correctly avoiding loss of resources and time.

61. All pilot countries have flagged the need for continued and scaled up financial support to strengthen the capacities of national authorities to empower them to measure and monitor all relevant IFFs affecting the countries on a regular basis and to start reporting on SDG indicator 16.4.1 globally. Support will be needed for increased transparency and dissemination of IFF statistics, also to monitor progress, and to raise awareness among high level government representatives of the newly developed tools to address IFFs.

62. The need to measure IFFs is pressing and political will is increasing in the face of multiple challenges which require financing. Several pilot countries are establishing dedicated government units to track and curb IFFs inspired by the new opportunities to engage in concrete efforts. These efforts need the full support of the global community to succeed.

63. Measurement of IFFs is the first step in identifying threats and risks from IFFs. This work needs to continue and expand, with further steps covering also conducting a country risk profile on the IFFs, which will inform the policy processes to curb IFFs. Such work also envisages partnering with national, regional and international stakeholders.

64. The refined tools and methods are available for all interested countries to use globally\textsuperscript{22}, and the co-custodian agencies should be equipped to support this work. To this end, a global UN capacity development project will start in 2023 in a joint effort of UN Regional Commissions, relying on methodological support, guidance and training by UNCTAD and UNODC, and led by UNECA reflecting on lessons learned with the many pilots carried out in Africa. However crucial, this project still falls short compared to the expectations of countries, as it will only be able to involve 2-3 pilot countries per region while countries who conducted first pilots need to continue towards comprehensive and regular measurement of IFFs. The global project will be an important step towards global reporting on IFFs as it will enhance the capacity of developing countries across regions to measure and curb IFFs, enhance their investigative and analytical capacities and improve domestic resource mobilisation to strengthen socio-economic resilience to pursue the 2030 Agenda.

65. UNCTAD and UNODC invite all interested countries to test the measurement of IFFs that affect their economies the most. Estimating IFFs will not only provide clarity on the scope of IFFs, but also help improve the quality of key macroeconomic statistics, such as GDP, by improving their coverage and exhaustiveness, and increasing understanding of the magnitude of IFFs affecting economies.

66. In addition to the project activities, the statistical Task Force will continue its work to support countries in the pilot testing of the measurement of IFFs with a view to developing a global \textit{Statistical Framework for the Measurement of Illicit Financial Flows} with practical and methodological guidance in line with the Conceptual Framework. This will include a classification of activities generating IFFs, linked to existing statistical frameworks, practice and concepts, and recommended methods to measure different types of IFFs in SDG indicator 16.4.1.

67. Beyond the specific objective to offer statistical tools to measure IFFs for the monitoring of SDG Target 16.4\textsuperscript{23}, UNODC will keep itself engaged in promoting the generation of IFFs estimates to respond to its broader mandates to fight against money laundering, transnational organised crime, corruption and related offences, as defined by the United Nations Convention against Transnational Organised Crime (UNTOC) and to the United Nations Convention against Corruption (UNCAC). Particularly, UNODC will continue to develop measurement and statistical information because:

\textsuperscript{22} For resources and tools, please refer to: https://unctad.org/statistics/illicit-financial-flows

\textsuperscript{23} “By 2030, significantly reduce illicit financial and arms flows, strengthen the recovery and return of stolen assets and combat all forms of organized crime”
a. IFF estimates encourage countries to produce richer and high-quality sets of baseline data on predicate offences, that can improve the overall monitoring of crime trends;

b. Institutions engaged in the fight against money laundering can use IFFs estimates to complement information needed to understand the money laundering and terrorist financing risks that they face as well as how their systems are working to prevent and mitigate such risks;

c. IFFs estimates can strengthen international cooperation on the recovery of assets by facilitating the identification of countries at the origin/destination of cross-border transfers of criminal proceeds.

68. Furthermore, UNODC through the Stolen Asset Recovery Initiative (StAR) in partnership with the World Bank has collected data on international recoveries and returns of proceeds of corruption which provides insights into the current state of cross-border repatriation practices of the State Parties to the United Nations Convention against Corruption. Based on survey data alone, US$4.1 billion in corruption proceeds have been returned to countries since 2010. While not a comprehensive picture of all relevant returns, the quantity of corruption proceeds tied up in recovery actions offers new figures on the scale and global spread of recovery actions under chapter V of the Convention.

69. The United Nations entities work in collaboration with member States and non-governmental organizations to share resources and inform decision makers and the public that we now have globally agreed concepts and methods to track illicit financial flows and are providing support to developing countries to advance this important work. Joint efforts are needed to enable global reporting of data on illicit financial flows under SDG 16.4.1 and enable more informed and effective policy response. Developed countries will also benefit from the newly available tools, guidelines and their refinement based on country experience in order to fill the gap in the reporting on this challenging SDG indicator in the future.

IV. Recommendations and conclusions

70. While considerable progress has been made, in different institutional and policy-making contexts, to combat IFFs, over-arching remaining challenges stand out, independently of specific types of IFFs:

a. The 22 pilot studies have shown IFFs can be measured, and do so mainly by reusing existing data, though there is a need to improve data quality and infrastructure, skills and resources. It must be consider committing to seeking/provide resources needed to build capacity especially in developing countries to measure IFFs to report on SDG 16.4.1. The ability to measure IFFs will convert in the possibility to curb IFFs and recover stolen assets, thus maximizing the investment on capacity building.

b. The methods applied in the pilots were endorsed by the United Nations Statistical Commission and provide a coherent and universal statistical measure covering the entire scope of IFFs. It should be considered making use of the agreed methods, tools and guidelines to report data on SDG indicator 16.4.1 on illicit financial flows by all national statistical offices, international organisations and other stakeholders.

c. Measurement of IFFs is the first step in identifying threats and risks from IFFs. This work needs to continue and expand by (1) supporting country-level IFF risk profile to inform the policy processes to curb IFFs and (2) commissioning further work to illicit trade.

71. Given its universal membership, the United Nations is well-placed to strengthen its role in further leading the development and implementation of statistical methods and guides to measure all types of IFFs, with an aim to report on SDG 16.4.1, to apply a coherent, harmonized and universal data comparable among
countries and to inform policy making in curbing IFFs. The existing agreed methods by the UN Statistical Commission followed by the pilots in countries have demonstrated the validity and applicability of these methods. As an example of an implementation tool, the UNCTAD ASYCUDA includes a new module for mineral production and export, which is a potential avenue for generating the needed data on IFFs related to mineral extraction at the custom level.

72. Regarding the UNCTAD mandate in relation to illicit trade, the second edition of the UNCTAD Illicit Trade Forum, held in Geneva on 6 and 7 September 2022, highlighted the impacts of illicit trade on all SDGs, exacerbated by crises, given that it precludes the possibilities for governments to generate revenues through customs and taxes, crowds out legitimate economic activity, and erodes the progress already made towards the sustainable development goals. Examples of artisanal and small-scale miners, illegal logging and illegal, unreported, and unregulated fishing have shown the extent to which those activities negatively impact the environment, the human rights, health, education, gender equality and social and economic dimensions.

73. Regarding the proposed introduction of a minimum tax of 15 per cent on the foreign profits of the largest multinational enterprises, in addition to raised concerns about the global efficacy of the reform, according to the UNCTAD World Investment Report 2022, developing countries could lose out on tax revenues due to capacity and legal constraints on the implementation of needed reforms: cross-border investment in productive assets could decline by two per cent.

74. Regarding regional cooperation and international actions, the cross-border nature of IFFs necessitates strengthen collaboration among countries. In that sense African countries need to strengthen engagement in international taxation reform, make tax competition consistent with protocols of the AfCFTA, and aim for more taxing rights. Positive signs are developing such as at the recent Conference of African Ministers of Finance which emphasized the need to build countries' capacity in Africa, especially “in tax policy and administration, international tax cooperation, countering money laundering, corruption prevention and related enforcement measures, asset recovery and return, and natural resource governance”, and to this end, underlined the need “to build the capacity of African countries to tackle the gaps in institutional architecture, with a view to developing their ability to track, measure and report on the evolution of illicit financial flows under SDG 16.4.1, and to devise measures to curb illicit financial flows”. Such commitments need to be replicated in other international fora.

25 https://repository.uneca.org/handle/10855/48341
References


