

## Building Capacity to Combat Illicit Financial Flows

Illicit financial flows (IFFs) are generally nontransparent to tax and official statistics authorities. The money, in turn, is typically obtained via corruption, illegal activities such as trading of contraband goods, criminal activities, and tax evasion, as well as through profits earned from shady accounting practices such as faulty transfer pricing.

To build capacity to combat illicit financial flows requires: 1) building capacity to fight corruption; 2) building capacity of legal and tax authorities as well as financial firms to identify and prevent certain illegal activities associated with illicit financial flows; 3) creating incentives for individuals and businesses to keep and invest a high fraction of their profits and savings in the country, irrespective of the source of the funds; and 4) cooperation with international organizations and foreign governments, focusing on relevant incentive, regulatory and investigative mechanisms, to increase the capacity to fight illicit financial flows by getting access to information, technical assistance and logistic support, as well as launching joint initiatives to fight money laundering, tax evasion, embezzlement of state funds, nontransparent capital flight (whether of legal or of illicit funds), and abusive transfer pricing.

Fighting corruption is paramount. Corruption of taxation, financial sector, and various government department officials is a major *enabling factor* permitting criminal activities, tax evasion, and money laundering and other activities giving rise to illicit financial flows. Bribery and theft of high-level political leaders is also a contributory factor. Therefore, control of corruption via appropriate rules, processes and organization will go a long way to solving the problem of illicit financial flows. For this, necessary are general support of the population and political will of the political leadership of the country.

Building capacity of the legal system could require law reform, where the laws are inadequate, as well as improving the functioning of the organizations and bodies of the system, where such functioning is poor. Better *implementation of the laws in the books* could in fact go a long way to improve the functioning of the legal system, by enhancing the capacity to do their work, of the persons and organizations responsible for investigations and bringing charges.

Low taxation, by world standards, is also a way to fight illicit financial flows, especially by discouraging activities such as money laundering and dishonest transfer pricing. This approach could supplement other sound economic policies that encourage private sector activity in the country.

Financial institutions can greatly help in the fight against tax evasion, capital flight, and money laundering, since a substantial proportion of illegal financial transfers will get conducted via those institutions. Constraints on bank secrecy can thus be written in law and enforced. For stock markets, transparency of certain investments and major transactions can also be written into law. The fight against IFFs can, moreover, be made, legally and via regulation, a core element of *corporate governance* of these organizations.