Illicit Financial Flows: Making Sense of Confusion

Alex Erskine[1], 12 October 2018

Part III. Tackle the Drivers

This is the third and final note of a **3-part set on illicit financial flows**, intended to help UN countries achieve what they have agreed to pursue (reducing illicit financial flows between 2015 and 2030).

- **Part I, Search for Meaning**, clarifies the (previously ambiguous) concept of illicit financial flows, being all cross-border resource flows that involve an illicit source, transfer or use. Its scope needs a decision whether "illicit" means "illegal" or also "legal but morally wrong".
- **Part II, Count the Devils**, shows how useful estimates of illicit financial flows require better data on all types of crimes involved which can be fed into a Balance of Payments (BoP) analysis. (Its Annex dissects the very poor ways some over-publicised estimates are made.)

Part III, Tackle the Drivers, shows the way to make real progress in curbing illicit financial flows: a diabolical international problem like climate change, and similarly plagued by free riders (*aka* cheats). It needs coherent policies in every country and between all countries across many fields:

The missing factors where action is needed now

There has been some progress at international and country levels in finding ways to curb illicit financial flows. But there are gaps between what is being discussed and what is needed. In addition to settling the definition of illicit financial flows (Part I) and gathering credible data on illicit financial flows for BoP analysis (Part II), further progress in curbing illicit financial flows needs at least ***2 new inputs***:

1. Rigorous analysis of the existing ***incoherence in policy settings from an illicit financial flows perspective***, at country level and internationally. Perversely, many country and international policy settings encourage illicit financial flows. ***Attaining coherence*** will involve:
    a. ***Policy analysis that is 'whole of government'***, rather than blinkered to 'single issues';
    b. A ***pro-development orientation and realistic goals***, to avoid obvious failure;
    c. ***Flexible exchange rates and legal access to foreign currency***, to kill black markets;
    d. ***Building legalised markets and secure property rights***, to align community interests;
    e. ***Reining in countries' "freedom to flout" international norms***, to limit cheating;
    f. ***Fairly sharing the costs*** of developing country efforts to curb illicit financial flows;
    g. Discouraging ***high tax rates, narrow tax bases and protection from world prices***; and
    h. A focus on ***rising South-South illicit financial flows*** involving China, India and Russia.

2. ***International Monetary Fund (IMF) leadership in illicit financial flow research and policy development***. The topics listed above are central to the IMF's mandate. And the illicit financial flows agenda is making slow progress because the IMF has, until now, been missing in action. The IMF needs to start to lead, to help sustainable development ***and*** curb illicit financial flows.

Part III proceeds as follows: first the additional needs are outlined; then next steps are recommended.

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1. Rigorous analysis of the existing incoherence in policy settings from an illicit financial flows perspective.

Policy coherence from an illicit financial flows perspective involves governments having policy settings that ***not only*** achieve their development goals ***but also*** are likely to ***reduce*** illicit financial flows.

Policy incoherence from an illicit financial flows perspective are policy settings that may – or, worse, may not – achieve government's development goals but are likely to ***increase*** illicit financial flows.

Policy coherence is an approach to strategy being developed by the OECD (see OECD 2016, especially its chapter on illicit financial flows). Using policy coherence as the criteria makes it clear that many countries and the international community have ***chosen*** to exacerbate the drivers of illicit financial flows: many such flows result from policy choices. No doubt these policies were not chosen with their impact on illicit financial flows in mind, but that impact cannot be ignored.

Part III's purpose is to encourage countries to ***analyse and address the underlying causes – the drivers and facilitators – of the illicit financial flows that are occurring, before rushing into other actions***:

- Addressing the drivers and facilitators is pre-emptive, pro-active, coherent: it helps countries pursue policies that reduce illicit financial flows ***and*** promote development; whereas

- Acting only against the symptoms (e.g. increasing the chance of or penalty for getting caught and tightening rules and regulation) is delayed, reactive, incoherent: it may only drive the unwanted behaviours further underground and encourage more illicit financial flows.

The incoherence in existing country-level policy settings

Many countries have economic policies that are likely to increase illicit financial flows despite otherwise seeking to reduce them. Table 1 shows some examples of incoherence and coherence.

Table 1. Country-level economic policy settings that increase or reduce illicit financial outflows

Policy instrument available to countries	Response to policy setting that drives or facilitates illicit financial flows	Incoherence: settings likely to ***increase*** illicit financial flows	Coherence: settings likely to ***reduce*** illicit financial flows
Exchange rate regime	Incentive to use black markets	Fixed	Flexible
Capital flow restrictions	Incentive to use black markets	Tight	Loose
Corruption, thefts and lawlessness	Effect on confidence	High	Low
Inflation and fiscal deficit	Effect on confidence	High	Low
Public spending – wastefulness	Effect on confidence	High	Low
Taxation – tax rates	Incentive for tax evasion	High	Low
Taxation – tax base	Incentive for tax evasion	Narrow	Broad
Customs and other trade procedures	Incentive to engage in international trade	Frustrating to comply	Easy to comply
Protection from high or low world prices	Incentive to smuggle across borders	High	Low
Tenor/security of property rights*	Effect on investor confidence arising from payback period	Short/weak	Long/strong

Source: the author * Incl. land and intellectual property (IP) rights and leases for mining/agriculture/forestry/fishing/waste.

Examples of common country-level incoherence in policy settings, as in Table 1, include:

- choosing an uncompetitive exchange rate regime and rigid preferential access to foreign currency, which promotes corruption and drives illicit financial flows;
- announcing increased concerns regarding corruption, thefts or disrespect for the law that are not followed by effective action, or involve setting unrealistic targets, both of which unsettle social harmony and risk increasing the attraction of capital flight;
- continuing signs of waste in government spending, which undermine support for paying taxes;
- heavily taxing some activities but not others, undermining respect for tax laws;
- actions that make it harder to participate in international trade, e.g. onerous processes to clear shipments or obtain trade finance. Such actions do not align with the SDG target 17.11 "increase significantly the exports of developing countries, in particular with a view to doubling the LDC share of global exports by 2020";
- setting in-country prices away from world market prices, which induces smuggling and corruption: resources will tend to flow (cross-border) to where prices are highest;
- shortening the business horizon of companies and investors by limiting the tenor/security of property rights is likely to result in a "maximise short-term profits/"rip-them-out" mentality.

Many of these flaws are examined further below.

The incoherence in existing international policy settings

In terms of international policy settings, it seems there is now ***more coherence*** than in the past. Arguably this comes from the wide coverage/equal priority of the UN SDGs for 2030. For instance, the Base Erosion and Profit Shifting (BEPS) project being led by the OECD (registers of beneficial ownership, exchange of information, Tax Inspectors Without Borders etc.) is stepping forward towards a fairer distribution of taxation rights and should help curb some tax-based illicit financial flows.

Nevertheless, incoherence afflicts some international policies, which clash with other internationally agreed goals and serve to increase – rather than curb – illicit financial flows. The most widely-accepted example is the tightening of anti-money-laundering efforts in the 2000s and 2010s, which – while of questionable effectiveness – led banks to 'de-risk' operations in many developing countries (CGD 2015 and Woodsome *et al*. 2018). This deprived many legitimate users of access to financial services, undermining internationally-encouraged increased financial inclusion in the 'de-risked' countries.

International laws, agreements and norms are often imperfect. Their impact on reducing illicit financial flows can be weak or perverse. Flawed implementation, such as the unambitious targets and lack of enforcement in agreements to cut CO_2 emissions and reluctance to name and shame tax havens and laggards in reform efforts, e.g. convergence of tax rates, BEPS implementation, all serve to encourage countries to cheat for economic gain and thus boost illicit financial flows.

Incoherence also arises in countries' implementation of the internationally-approved policy settings. For instance:

- adding time-consuming new customs processes to curb trade-based illicit financial flows add to the impediments facing exporters and importers and deter legal trade, whereas the internationally agreed policy of boosting trade facilitation – which has demonstrable benefits in terms of incomes and welfare – has been to reduce such time-wasting; and

- tougher laws and penalties (including death sentences) to deter petty criminals e.g. drug dealers in the Philippines and poachers in some African countries (Felbab-Brown 2017a and 2017b) unfairly target the poorest in society. Helping the poorest adjust to the absence of those income opportunities and focusing enforcement, as is supported internationally, on the organisers/beneficiaries of these transnational crimes would be more coherent and effective.

Steps necessary to move towards policy coherence

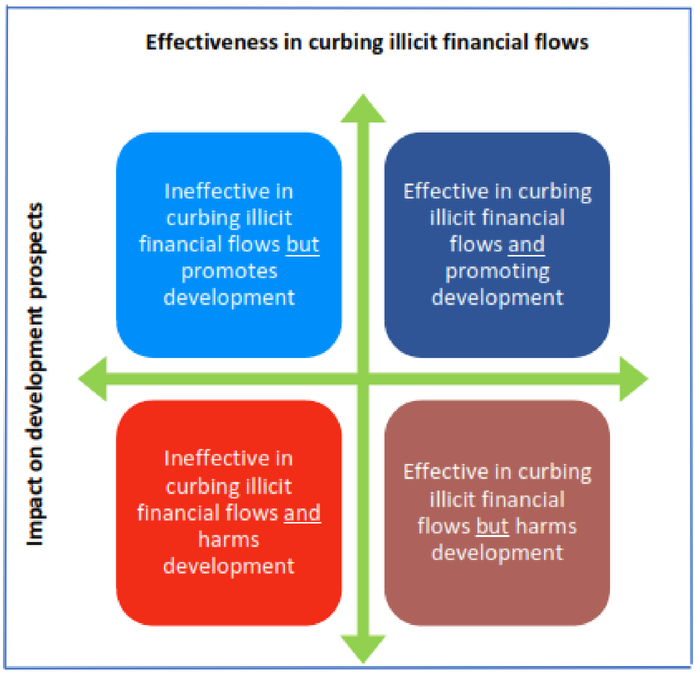
a. Promotion of 'whole of government' policy analysis, rather than 'single issue' analysis.

The diversity of the types of illicit financial flows urges caution. The many types of sources, transfers and uses that comprise illicit financial flows each involve different and specific behaviours amongst law-abiders and criminals, the powerful and powerless, business and households, industries and firms, government and non-government, the formal and informal and the residents and non-residents and foreigners and nationals. Addressing the issues is very much a 'whole-of-government' consideration for each country, bringing together all requisite skills. 'Siloed', blinkered 'single issue' approaches have contributed to current incoherence in policy settings. It's time to become more intelligent.

b. A pro-development orientation and realistic goals

Too many of the proposals to curb illicit financial flows are ***anti-development***. The worst are from the anti-globalists, who want to 'throw sand into the wheels' of international commerce and finance (to unfairly borrow words from James Tobin) without understanding what will be lost to developing countries if they cannot benefit from comparative advantage and lowering transport costs.

Figure 1. Policy choices for curbing illicit financial flows – in-country and between countries



Source: the author

Development is the ultimate goal of the SDGs, so policy choices to curb illicit financial flows need to be pro-development. The top-right policy choices in Figure 1 are the ideal, the bottom-left the least attractive. The policymakers' "Hippocratic" oath ("do the least harm") should guide tricker choices.

Set realistic goals: for a developing country (or for a region or the world as a whole) a goal of zero illicit financial flows, or even a nominal $ reduction, may not be sensible if development is also a goal.

Havocscope has made estimates of the value of ***black markets*** in 93 countries (Havocscope undated). The concepts behind black market activity are close to the concept of illicit financial flows, though they are not identical. One insight inferred from the Havocscope country estimates is that, as economic development proceeds, such illegalities rise in value but their economic importance declines.

This can be seen in a comparison of the 5 advanced economies with the highest $-value of black markets[2] with the 5 low income developing countries with the highest $ value of black markets[3]. The average black market value is around $1,9000 *per capita* in the top-5 advanced economies, very much more than the less-than-$100 *per capita* in the top-5 low income developing countries, whereas the average black market value in the top-5 advanced economies is around 5.5 *per cent* of GDP, only a bit over half of the around 10 *per cent* of GDP in the top-5 low income developing countries.[4]

The take-away is that as developing countries grow and develop, they will probably experience ***more – not less – illicit financial flows***.[5] What matters, and what should be a developing country's target, is to have less illicit financial flows than might have been expected for that stage of development and express the target level as a proportion of GDP or *per capita*. To set a nominal $ level as a target/goal could well be a straightjacket on development or bound to fail, i.e. incoherent.

c. Flexible exchange rates and legal access for foreign currency, to wipe out black markets.

Perhaps the classic example of incoherence in policy thinking from an illicit financial flows perspective is in exchange rate regimes. They are often misunderstood, even by people who should know better.

The apparent consensus in illicit financial flow thinking has been that exchange rate flexibility and easing in exchange controls has been undesirable, increasing illicit financial flows, which flow "at the push of a button" (Reed and Fontana 2011). This reflects a reactive "fear of freedom", based on (mis)perceptions that moving from fixed exchange rates and tight regulation of capital flows means a loss of control and that – as a result – crimes involving the sources, transfers and uses that make cross-border flows illicit will go unreported, undetected and unpunished. Many illicit financial flow reports call for tightening exchange controls or making their enforcement effective (e.g. High Level Panel 2015. Even the 2016 OECD Policy Coherence paper warns that illicit financial flows can lead to

[2] See Havocscope. US dollar black market crime value for USA, Spain, Italy, Japan and Canada, (countries considered as advanced economies in the WEO database).

[3] See Havocscope. US dollar black market crime value for Nigeria, Afghanistan, Myanmar, Zimbabwe and Kenya (counties proposed to be classified as low-income developing countries in IMF 2014).

[4] Of course, the levels in both groups of countries (the worst amongst their peers), in both value *per capita* and *per cent* of GDP, are undesirably high and should not be a matter for complacency.

[5] This is a recognition of reality, not an acceptance that some illicit financial flows are necessary evils. Note also that bigger countries (in GDP or population) are likely to have lower cross-border flows of all types (as a *per cent* of GDP or *per capita*) than do smaller countries. Flows between Delaware and New York or between Shanghai and Beijing are internal, whereas the flows between Singapore and Hong Kong are cross-border.

exchange rate volatility and that liberalisation of exchange controls must have regard to the risk of undermining containment of illicit financial flows.

The reality is quite different. Fixed exchange rates and tight capital controls are both worse for development (and the avoidance of crises) and for illicit financial flows. Fixed, uncompetitive exchange rates and capital controls were drivers of the Latin American debt crisis and capital flight in the 1970s and 1980s. Fixed exchange rates and tough exchange controls inevitably lead to black markets for foreign currency (Dornbusch 1983 and 1986, Agénor 1992). Black markets breed criminality, forcing otherwise-honest citizens to cross over into law-breaking for even legitimate needs, and creating opportunities for corruption in granting access to foreign exchange at the official (usually overvalued, preferential) rate to the powerful and the cronies, well described by Kingsley Moghalu, former deputy governor of the central bank of Nigeria (Moghalu 2016 and 2018). History shows that uncompetitive exchange rate regimes lead inexorably to crisis when the foreign exchange reserves run out.

By contrast, more flexible exchange rate regimes with looser capital controls help countries avoid overvalued currencies and the risk of running out of foreign exchange reserves. Anyone seeking foreign currency has to find another wishing to sell at the market rate and the central bank has no reason to be the supplier. The black markets for currencies are reduced or eliminated (see Maehle *et al.* 2013 for some African country experiences with adopting more flexible exchange rate regimes). The market works to reduce criminality and corruption.

Unfortunately, it is not only the illicit financial flows community that has forgotten the lessons learned in the Latin American debt crisis. Many countries claiming to have moved to a more flexible exchange rate regime with looser capital controls in fact seem to have squibbed on the full set of reforms required to make them sustainable. Coy 2017 observes that many countries remain in the "murky middle" – neither fully floating nor fully fixed. Ilzetzki *et al.* 2017, giving Reinhart and Rogoff's interpretation of the IMF's 2015 AREAER database[6], show the move to more flexibility has been limited. Instead, many countries have adopted the US dollar as the anchor for their local currency and have accumulated large holdings of US dollars in their foreign exchange reserves to help maintain that stable rate. They say, tartly, that "to some extent, reserves have replaced capital controls".[7]

If US interest rates keep rising: financial conditions will tighten in developing countries as demand for US dollars increases. There is real risk that developing countries will opt to stabilise their currencies against their US dollar anchor for too long, losing competitiveness and allowing their (now large) foreign exchange reserves to be drained. This could force reimposition of controls, the revival of black markets and associated criminality: it is unlikely to end well for curbing illicit financial flows.

Why is the illicit financial flows research community not challenging the widely held misconceptions over flexible exchange rates and instead advocating greater coherence in policy settings? It may be due to fear that the IMF "owns the policy space" on exchange rate regimes, and interlopers tread there at their own risk. This fear might even affect the OECD, blinkering its search for coherent policies that curb illicit financial flows. Paradoxically, the IMF has been missing in action.

There is even a delicious incoherence in the international approaches to what is seen as currency manipulation. What is regarded as unfair and therefore frowned on is if a country deliberately and artificially weakens its currency to gain unfair competitiveness, a very mercantilist sentiment. However, that would be an exchange rate setting that would do most to curb illicit financial outflows.

[6] The latest AREAER now available is IMF 2016.

[7] Jahan and Wang 2016 graph a similar plateauing and slight retreat in *de facto* capital account openness in low income developing countries.

The obverse, an uncompetitively strong currency, is what increases illicit financial outflows, *aka* capital flight. Fortunately proving unfair manipulation is difficult (Ahn 2010, Contractor 2016, Worstall 2018).

d. Encouragement for building legitimate markets and secure, longer-tenor property rights.

Another factor missing from discussions on how to curb illicit financial flows has been advocacy in favour of ***markets as mechanisms to help curb illicit financial flows***. It is not only the merits of a legal market for foreign exchange. Pursuing other favoured curbs to illicit financial flows will likely fail if policies do not also seek to build improved markets more generally throughout the economy.

Across most aspects of economic life, we rely on producers either to be "led by an invisible hand to promote an end which was no part of [the producers'] intention" (Smith 1759), or to be provided by responsive and efficient other sources (government, cooperative or self-provision). The structure and operation of each market are subject to rules and regulations. When markets work well, consumers and producers – and overall welfare and stability – gain.

Hernando De Soto saw the advantage to the poor of ***property rights*** (De Soto 1989 and 2000), which extends to all property rights, not just housing. The benefit to business is equally clear. A one-year lease/license to undertake an extractive business will result in "grabbing what you can"; a 40-year secure tenor allows a business to focus on sustainability and keeping other (unlawful) extractors out.

In addition, the rules and regulations have to be sensible in terms of tax rates, risk of industry interventions and access to secure property rights.

Markets will not always work, or always work for the common good.[8] Each market needs a sound market structure and regulatory architecture, active and competitive market participants (producers, consumers, data sources, researchers, media, agents, regulators, gatekeepers), transparency, security, regulation and enforcement/prosecutions to ensure sustainable market integrity. Markets work particularly well when participants (consumers, producers, regulators and media) become engaged in ensuring that others do not cheat, thus exposing inside traders, market manipulators etc.

e. Reining in countries' "freedom to flout" international norms, to limit cheating

Countries can ignore virtually any international law, policy or norm of behaviour for self-justified sovereignty or national security reasons. Such actions are free riding on the benefits created by the collective efforts of the international-consensus-abiding nations.

The most blatant examples of free riding, *aka* cheating, in the illicit financial flow arena today are the ***tax and secrecy havens*** protected by advanced countries (onshore and offshore). These encourage illicit financial flows from all countries and are especially disadvantageous to developing economies seeking to maintain, let alone increase, their domestic resource mobilisation (DRM).

[8] One does not have to be a pro-market ideologue to support building effective markets. But care is required. See the refreshing analysis in Shaxson 2018, which builds on a view developed by economists with Bank for International Settlements (BIS), IMF and others that too much finance is 'a bad thing' especially at higher levels of economic development, e.g. Cecchetti and Kharroubi 2012 and Arcand *et al.* 2012. Seemingly bearing this out are the findings of the current Financial services Royal Commission in Australia, Hayne 2017-18, which show the need for regular reviews of market effectiveness (behaviours and rules and regulations). However, decent financial services and a sound finance sector are essential at lower levels of development, and at every stage of development a functioning market is more self-balancing and better accommodates changes in demand and supply and technical change than a market repressed by heavy rules and regulations.

Though much discussed by financial flow-of-fund and tax specialists, e.g. Zucman/Johannesen, Shaxson 2018 and others, and despite encouraging commitments announced by various G7 and other advanced economy leaders, very little is yet happening to rein in the cheating and free riding by tax and secrecy havens within the dominions of advanced countries.

Just as the poor caught perpetrating trafficking crimes for organised criminal 'bigwigs' should be assisted by programs and training to replace their illicit incomes, tax and secrecy havens might be compensated with structural adjustment assistance direct from their advanced country overlords if they do lose their freedom to flout international norms of taxation and disclosure. Tax treaties involving developing countries also need to be reviewed and improved (Hearson undated).

More generally the 'freedom to flout' or free riding (*aka* cheating) permitted to countries opens up opportunities for arbitrage (e.g. in tax rates, investment restrictions and incentives, and industry and consumer protection), boosting illicit financial flows and undermining confidence in the rule of law.

An obvious current example is the "trade war" involving increased tariffs imposed on selected US trade partners, which undermines the World Trade Organisation (WTO), incites smuggling and breeds uncertainty and insecurity. There are longstanding problems in international trade, including the enforcement of fair Intellectual Property (IP) rights and charges (Goldstein 2018). The "trade war" seems to be sweeping away – rather than building – necessary respect for and use of the legal processes set up to deal with such disputes. Two wrongs are not the way to make something right.

It may take a while before the current phase of incoherence in using the 'freedom to flout' subsides.

f. Fair sharing of the cost of financing developing country efforts to curb illicit financial flows.

Developing countries are much more resource-constrained than advanced countries. General government expenditures in developing countries are less than in advanced countries in every sense, as a proportion of GDP and in absolute $ *per capita*. See Table 2 below. The third column, indexing government spending *per capita* to the level attained by advanced economies highlights the vast gap.

Table 2. General government expenditures in advanced and developing countries

For the 2015 year	Share of economy (per cent of GDP)	*Per capita* (in US dollars)	*Per capita* index level (Advanced economies = 100)
Advanced economies	38.8%	16,600	100
Emerging and developing economies	30.9%	1,475	8.9
Of which: Sub-Saharan Africa	*22.5%*	*372*	*2.2*

Source: the author, derived from regional data in the IMF WEO database April 2018

The consequence for developing countries are stark. Public funding for curbing illicit financial flows has to be efficient and effective. Even an extra $1 *per capita* spent on, say, intelligence and enforcement is a significant diversion of spending for poorer countries. International cooperation and assistance are needed: advanced economies can much more easily bear the main financial burden of new efforts to curb illicit financial flows. A mechanism to determine payments from advanced countries needs to be established (perhaps weighted by the incoherence of their policy settings?).

g. Discouragement of high tax rates, narrow tax bases and protection from world prices.

A wide variety of protectionist policies/infant industry/social policies deployed in developing countries, along with weak enforcement of IP rights, tend to increase illicit financial flows through encouraging smuggling and counterfeiting. Such policies also tend to boost the informal economy. The big driver of much smuggling is setting prices either lower or higher than in neighbouring countries.

Excessive taxation (especially relative to tax on the informal economy) and infuriating bureaucracy drive a lot of smuggling and exacerbate opportunities for corruption and consequent illicit financial flows. However, there is often an ambivalence in developing countries on what to do about such smuggling or even about counterfeiting. Smuggling has been a life support for the habitually large informal sector and has been the source of supply of last resort when an economy is suffering shortages. Counterfeits may be tolerated if they keep down the cost-of-living for the poorest members of society and also serve to check excessive 'rents' charged by owners of IP.

To be more effective in curbing illicit financial flows, trade facilitation is more important (see Lesser and Moise-Leeman 2019. Civil society and businesses in developing countries may need more assistance for education regarding the merits of "level playing fields", property rights (including IP) and inclusion and participation in the formal economy.

h. A focus on rising South-South illicit financial flows, e.g. involving China, India and Russia.

Many advocates in the illicit financial flow discussions are focused on the activities (real or imagined) of Western multinationals (MNEs) in their trade, investment and other interactions with developing countries. And there is well-hone criticism of advanced countries' failings regarding tax and governance policies and their implementation.

However, the fastest rising threat for developing countries of increased illicit financial flows is arguably from three influential developing countries, China, India and Russia. China's and India's so-called South-South economic and financial flows are rising rapidly. There may well be further growth to come from China's Belt and Road and other diplomatic initiatives. And the rise of the Chinese renminbi as a currency for international trade and reserves is only in its early phases.

The biggest problems may be the practices of companies from China, India and Russia. They have ranked poorly in Transparency International surveys of propensity to bribe.[9] These three countries also lag OECD countries in terms of systems for tax, governance and financial regulation. The three countries have also been a major source of flight capital.

[9] (Transparency International Bribe Payers Index 1999, 2002, 2006, 2008 and 2011 and Exporting Corruption 2015 and 2018).

2. Time for the International Monetary Fund to step up.

IMF leadership in illicit financial flow research and policy development is needed. The issues are not only complicated, they are also integral and important to the IMF's mandate. And existing policy incoherence may be partly due to the IMF being ***missing in action.***

The good news is that this might be changing. IMF Managing Director Christine Lagarde spoke in mid-September 2018 about the overlap between the UN SDGs and the IMF mandate (Lagarde 2018). But one specific overlap was still missing ... the SDG commitment to reduce illicit financial flows (16.4.1). On 7 October, however, the IMF has issued a ***one page factsheet*** listing how the IMF is engaging in fighting illicit financial flows (see IMF 2018). The IMF has at last begun to use the terminology![10]

While it is good that UNODC, UNCTAD and other agencies have been working on this, the IMF should be making a more major contribution. It is hard to imagine a set of policy and research challenges more inside the IMF's mandate than the illicit financial flows agenda. The issues raised in seeking to curb illicit financial flows have everything to do with key IMF responsibilities: the balance of payments, the exchange rate and exchange control regime, cross-border financial flows, the fiscal and tax regimes, governance, industry policy, international trade and data. Individually all useful, but what the IMF has not addressed is coherence – or incoherence – of all the several policy settings. The IMF has a ***new chief economist***, Gita Gopinath, well versed in exchange rate reforms (Grenville 2018) – is policy coherence in the illicit financial flows agenda something she might take up?

Of course, it is not just the IMF that needs to do some heavy lifting if the SDG goals of a significant reduction in illicit financial flows and increased development is to be achieved. The OECD and World Bank, all "single issue" agencies and NGOs, the advanced countries and the developing countries themselves also have to stand up and focus on what is more coherent than current policy settings.

Even with greater coherence in economic policy settings, favouring development and curbing illicit financial flows, there will be several aspects that will remain perpetually frustrating. For instance:

- **Corruption** seems intractable. There is no point in more rules/enforcement if leaders and enforcers are themselves corrupt. Eradicating corruption needs leadership from the top. However, it is very country-specific. Addressing entrenched corruption means confronting a *Catch-22*.[11] Effective local leadership in anti-corruption measures is both necessary but also too often doomed to fail. This seems especially the case in conflict-ridden states.
- **Money laundering** is hard to address through risk-managed rules on compliance. The set of policies, rules and frameworks developed to curb money laundering (AML/CFT) thus far seem to have had little success in curbing illicit financial flows. Even with recent whistleblower-led exposures (e.g. Danske Bank and the so-called Paradise and Panama Papers), we cannot know if existing AML/CFT processes are effective in deterring many illicit financial flows. Failure is not a reason to give up. Instead it should drive development of new ways to expose transfers that are illicit financial flows and yet allow legitimate transfers to flow. Unexplained Wealth Orders seem helpful and jail time for the criminals' advisers may be effective.

There is plenty for all to do and the discussions will benefit from IMF leadership.

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[10] Until a few days ago, a search on the IMF website for headlines that mentioned "illicit financial flows" and "2018" led only to a fine IMF podcast by the Centre for Global Development's Maya Forstater (Forstater 2018).
[11] See Heller 1961. A Catch-22 was subsequently explained as "a problematic situation for which the only solution is denied by a circumstance inherent in the problem or by a rule".

3. Conclusion: next steps

International

The UN-led processes on illicit financial flows and the SDGs will continue to throw light on some of the issues and complexities in curbing illicit financial flows. But the progress will remain uneven and slow.

What is needed now is for the IMF to contribute its leadership and advance proposals that are focused on coherence, promoting development as well as curbing illicit financial flows. Progress may remain uneven and slow, but it will increase the prospect that the outcome will be productive.

An alternative would be for the UN processes to mimic what the IMF would advance if it were fully participating. While that would seem a poor substitute, no doubt it would be enlightening for the bodies proceeding up that learning curve, that "stairway to IMF heaven".

Country-level

Countries do need to make more coherent the policy settings within the country's control that are driving and facilitating the types of illicit financial flows and better deploy their enforcement resources. Smart progress can then be improved through national and international intelligence and enforcement cooperation to tackle the specific economic crimes (tax evasion, corruption thefts and frauds, all trafficking crimes, smuggling and counterfeiting and money laundering).

The complexities inherent in the concept of illicit financial flows and in the types of crimes involved mean that the approach must be broad, at a whole-of-government level, to achieve coherence and yet retain needed specialist understanding.

Beware of the easy options seen in Maslow's adage regarding hammers and nails[12]. The necessary broader, more coherent approach to curbing illicit financial flows involves: agreeing a definition of illicit financial flows (Part I); compiling credible, economic-crime-based data on illicit financial flows that can be assessed in a BoP accounting framework (Part II); and rigorously seeking coherent policies that can curb illicit financial flows **and** help countries develop (Part III). It means more international cooperation and giving up on free-riding – a huge change in attitude.

Individual-level

This requires everyone to adapt to the real world. The real world has been engaged in double-entry book-keeping for over 700 years (see Hordern House 2018) and in BoP accounting for over 70 years (IMF BPM1 1948). Non-economists and non-accountants (and maybe even some of them) need some familiarity with these tools to understand the concept of illicit financial flows, the merits of policy proposals and the ultimate test: measuring the effect of efforts to curb illicit financial flows.

Concurrent with the increase in understanding of BoP accounting has been an increase in the understanding of how to avoid financial crises. The greatest incoherence of all in economic policy is the permanent pursuit of financial stability. Minsky 1986 and 1992 explain why that is bound to fail. Instead we need to come to grips with the problems – including for illicit financial flows – created by 'extreme finance' (see Shaxson 2018) and devote resources instead to improving financial services in under-financialised countries. The challenge everywhere is to build financial integrity (Cooper *et al.* 2018) and civic capital (Guiso *et al.* 2010). It seems to me achieving that would directly and coincidentally curb illicit financial flows. Perhaps a reason for another paper?

[12] "To the man who only has a hammer, everything he encounters begins to look like a nail." A. Maslow, 1966.

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