DAC Network on Governance

ASSESSING THE RISKS AND IMPACT OF ECONOMIC AND FINANCIAL CRIMES FOR THE ANTI-CORRUPTION TASK TEAM

GOVNET Meeting, 3 November 2014

This document is submitted for INFORMATION under Item III. of the ACTT Agenda [DCD/DAC/GOVNET/A(2014)1]. This concept note proposes to develop a tool for assessing the threat and impact of economic and financial crime in developing countries. The secretariat is seeking the ACTT’s feedback on this concept note.

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Assessing the risks and impact of economic and financial crimes
Room Document 2 - For information

Anti-Corruption Task Team meeting
3 November 2014, Paris
CONCEPT NOTE

Assessing the risks and impact of economic and financial crimes

Taking a whole of government approach in fighting economic and financial crimes in developing countries

I. Background

For the purpose of this concept note, economic and financial crimes are defined as: crimes carried out with the primary objective of economic and financial gains. Definitions differ; countries as well as international organisations utilize varying legal definitions (Bussmann and Werle, 2006; UNODC, 2005). Usually, economic and financial crimes comprise a number of criminal practices, ranging from high level corruption and theft of state funds to small scale commercial fraud. For example, tax evasion is an economic crime in most countries, undermining the state’s ability to provide services such as security, protection of property rights, education and health. Corruption and fraud can divert public resources and lead to similar outcomes. What they all have in common is that they incur a loss of resources for victims, be they individuals, firms or state institutions.

The very recent/current issue of illicit financial flows essentially refers to the revenues generated by a set of such economic and financial crimes, or funds transferred using illicit means. Examples include the following scenarios: stolen public funds leave developing countries through shell companies and tax havens in which they are laundered; multinationals which exploit weak national legislation or technical capacities of tax authorities to avoid paying their fair share of taxes; corrupt customs systems which allow for large scale smuggling. The results are devastating. Countries lose scarce resources, while their natural resource base is eroded and illegal networks are allowed to flourish, with damaging effects for social wellbeing and stability.

Fighting crimes with extremely limited resources is particularly challenging, and developing countries are increasingly aware of their specific challenges in addressing a vast set of threats with extremely limited resources or capacity. In addition, developing countries are often more exposed to socio-economic mechanisms that further exacerbate the situation. Examples are economic stagnation which often incentivises criminal behaviour. In some instances, economic and financial crime allows for the establishment of parallel power systems and economic structures that can rival or threaten the state, thus undermining state authority. Combating all forms of economic and financial crimes is thus a priority for many partner countries. However, fighting these crimes is a resource and knowledge intensive process, requiring expertise and funds. Allocating sufficient resources for economic and financial crime is a problem for all countries (Borgers and Moors, 2007). In addition, partner countries often do not have access to the kind of technical expertise required to investigate and prosecute economic and financial crimes. It is therefore of utmost importance for developing country authorities to identify where to deploy their relatively scarce skills and resources. This requires good analytical and diagnostic tools to properly assess risks – including the likelihood and impact of certain activities and then identify and prioritize appropriate responses given current constraints.

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1 Note that the expressions “risk” and “threat” are used interchangeably throughout this report, following the approaches used in several international frameworks on risk management (including INTOSAI, ISO) and academic analyses (e.g., Di Nicola at al., 2007; Meloy, 2014).

2 As UNODC (2005) discusses, the difficulties related to defining types of crime covered by the term ‘economic and financial crime’ are plenty, if not only because recent advances in technology have created new forms of economic crime non-existent a few decades ago. The term has been used to refer to crimes such as bribery or embezzlement, fraud, smuggling, counterfeiting, money laundering, tax crimes, identify theft, insider trading, market/price manipulation and pyramid schemes. The concept is closely associated with that of white collar crime (Sutherland, 1940).
A number of risk assessment tools exist and are being used, mainly in OECD countries but also in other emerging economies, although few countries take a comprehensive and whole of government approach to assessing economic and financial crimes. Most assessments are being carried out for specific crimes and by specific institutions such as tax authorities, financial intelligence units (FIUs), etc. For example, in the area of one specific type of economic crime (money laundering), the Financial Action Task Force (FATF) has strengthened its set of recommendations by requesting countries to ‘identify, assess and understand the money laundering and terrorist financing risks for the country,… Based on that assessment, countries should apply a risk based approach (RBA) to ensure that measures to prevent or mitigate money laundering and terrorism financing are commensurate with the risks identified’ (FATF, 2012, p.11). In 2013, FATF published a specific methodology to conduct risk assessments to evaluate the level of technical compliance with anti-money laundering standards and effectiveness of the implementation of such policies (FATF, 2013). The OECD developed a Transfer Pricing risk assessment tool (OECD, 2013a). The World Bank and the IMF also have their own risk assessment tools in specific areas. In addition, some countries use risk assessment systems for financial crimes in specific sectors (FATF, N.D. a; b). However, there is no tool assessing which one of these distinct issues poses the largest threat to a given country. Such a tool could prove central in shaping and directing scarce policy resources to achieve the biggest impact. Given the complexity of economic and financial crimes, differentiated responses are needed. A risk assessment can help in answering the question: where are a country’s largest vulnerabilities? This would, in its turn, help identify the most adequate responses.

The lack of one overarching risk assessment tool is compounded by the isolation of institutions which rarely work together and focus solely on their area of responsibility. Tax authorities, FIUs, bank supervision authorities, etc. are often unable to share information that would help them uncover and/or take a strategic approach to combat criminal activities. This was one of the main findings of the OECD efforts to update its report Effective Inter-Agency Co-operation in Fighting Tax Crimes and Other Financial Crimes (OECD, 2013b). This study on the practices of tax authorities in numerous countries, including a few developing ones, found that successful prosecution of tax crimes is more likely when the different agencies working on financial crimes exchange information. However, the study also revealed that tax authorities are sometimes unable or unwilling to share important tax related information with other institutions for the purposes of combating economic crimes. Tax authorities are one example illustrating a common modus operandi in national authorities: they work in in silos, falling short of the impact the authorities could have if they worked together.

To mitigate these shortcomings, a more comprehensive approach would be needed: pulling together various institutions to generate a more integrated and complete picture of the complete set of economic and financial crimes, in order to better prioritise and plan appropriate responses. Conducting a global risk assessment exercise that looks at vulnerabilities for several different types of crimes through a collaborative approach involving several authorities is a first step in a comprehensive whole government approach to dealing with economic and financial crime.

II. Objectives of this concept note

This concept note proposes to develop a comprehensive risk assessment tool that responds to the context elaborated above. Once developed and validated, this tool will be available to partner countries’ stakeholders to help them better determine risks, prioritise and design appropriate responses and to promote a whole of government approach to combating economic and financial crimes. It aims at offering a tool that helps countries in identifying and managing their economic and financial crime risk.

This tool would also be useful for providers of development assistance, vulnerable to trends which may cause them to focus in responses that may not be adapted to the needs of partner countries in their specific context. Reform priorities are often determined by the supply of donor support rather than recipient needs.

3 For example Canada, UK, Solomon Islands or Norway.
based on actual assessments, priority setting and a serious consideration of alternative options. The illicit flows agenda risks becoming yet another such trend.

The international element of the illicit financial flows agenda makes it an appealing topic for policy makers. However, this attractiveness may tempt countries to overly limit their focus on the international element of the economic and financial crimes in question, when in fact some countries may have larger domestic challenges to deal with. For some countries, an exclusive focus on the international aspect could also provide a convenient way to deflect responsibilities towards multinational companies, lawyers and other foreign institutions when perhaps efforts should be directed towards domestic problems. For example it would be wrong to focus scarce resources and human capacities only on transfer pricing practices of multinational enterprises if the country is not hosting a significant number of MNEs. Similarly, it would be inefficient to focus on strengthening banking supervision if the financial sector is small and the country’s economy operates in cash. It is likely that a number of institutions and processes should be improved. However, focusing efforts on a few particularly pertinent items is especially important in low-capacity settings. The adequate areas to focus on can be identified as part of a careful and thorough risk assessment.

A comprehensive risk assessment, involving all relevant institutions, should generate evidence based priorities with political support behind them.

III. Proposed plan and methodology

The OECD Development Cooperation Directorate proposes to develop a risk assessment methodology to be applied by developing countries authorities building on and adapt the risk assessment model developed by the Norwegian Ministries of Finance and Justice and in collaboration with the Norwegian Economic Police (ØKOKRIM). The process to arrive at such methodology would be rolled out through the following stages:

1.) Development of risk assessment tool for partner countries:
   - Design of a methodological framework, taking into consideration the potentially limited reliable data on economic and financial crimes collected by local authorities.
   - Threats should be assessed on the basis of the likelihood of the crime occurring, and the impact of the specific crime (on society, the economy, etc.)

2.) Desk-based country studies and field validation of the methodology
   - Identify 4 developing countries committed to combating economic and financial crimes
   - Conduct desk-based reviews on the basis of available information provided by the authorities of the four countries
   - Identify data gaps, including where additional information would be sought through expert surveys or other means of data gathering
   - Complement desk study with field visits to conduct additional surveys and data gathering
   - The desk based study should include an analysis of the existing institutional structure responsible for combating economic and financial crimes and their performance
   - In addition, the analysis should offer recommendations for addressing the identified core-challenges in the country.

3.) Dissemination and validation of the Risk Assessment Tool
   - Capture key lessons and good practices from phase 2, and amend the tool accordingly.
   - Conduct in-country workshops to present and validate findings and analysis, including the criteria and weightings for determining risk levels and likely impact of most prevalent crimes

The OECD-DCD and ØKOKRIM have discussed the possibility of using the Norwegian existing methodology to prepare a tool that would be adapted to the context of developing countries, which takes into consideration the dearth of reliable and consistent statistics collected by national authorities in relevant areas.
Building on the findings from the national risk assessment, the country should be able to develop a national strategy to combat Economic and Financial Crimes that would set out priority areas, specific actions, available budgetary resources and institutional responsibilities for implementation, reporting and monitoring.

**Access to data**

A proper risk assessment will need to rely on data to get a sense of the absolute and relative level of a certain crime (fraud, corruption, etc.) in a country. However, gathering reliable data and statistics likely is a challenge. Accessing information on criminal activities, hidden by nature, poses particular challenges in any context, but especially so in developing countries, where statistics are generally of lesser quality. Relying entirely on criminal statistics will give a picture of law enforcement rather than the actual crime picture, and so would need to be complemented by additional survey data.

Data sources would be official crime statistics and administrative judicial data. This would need likely to be complemented by more targeted surveys and/or interviews amongst relevant judicial and law enforcement authorities, but also other knowledgeable and relevant individuals in the banking sector, tax authorities, customs authorities, exporters, importers, etc.

**Cross government engagement**

The development of the diagnostic tool requires testing and validation through case studies as indicated above. The process of in country validation would initiate a broader engagement framework in which several authorities involved in combating financial and economic crimes would come together within the context of this work. Collaboration on data collection, for example, will require a multi-stakeholder engagement process. This engagement is to be led by a relevant high level authority (possibly by the Ministries of Justice or Finance) and should include all relevant institutions in an effort of collecting data, and defining priorities based on the risk assessment. It is expected that such initial incentive for collaboration contributes to overcoming lack of trust and the “silo approach” often encountered. In addition, such an approach fosters political support for any resulting policies and strategies.

- The process should be led by an experienced head of economic police or equivalent with sufficiently broad knowledge of financial and economic crimes.
- At a minimum the following institutions should be involved:
  - Economic police, tax authorities, customs authorities, judicial authorities (magistrates, judges with specific responsibilities or expertise in economic and financial crimes).

**Indicative Budget**

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<th>Activity</th>
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<td>1 external sr. economic and financial crime advisor (full time for one year)</td>
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<td>4 local consultants (for 4 country pilots)</td>
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<td>Survey (design and implementation)</td>
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<td>In country workshops (4 workshops in pilot countries, incl. venue rental, logistics)</td>
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<tr>
<td>Mission (1 OECD staff + sr. financial crime advisor/ 2 missions to each 4 pilot countries)</td>
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<tr>
<td>Production of final report (includes proof reading, editing, publishing)</td>
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<tr>
<td><strong>TOTAL DIRECT COSTS</strong></td>
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<td>OECD administration charge</td>
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References


International Organization of Supreme Audit Institutions (INTOSAI, N.D.), Guidelines for Internal Control Standards for the Public Sector (INTOSAI GOV 9100), Vienna.


