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Illicit Financial Flows and Corruption in Asia

Sarah Lain, Haylea Campbell, Anton Moiseienko,
Veerle Nouwens and Inês Sofia de Oliveira



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Executive Summary

THIS PAPER EXAMINES trends in illicit financial flows (IFFs) across eight pre-selected focus countries in Asia: Kyrgyzstan; Tajikistan; Afghanistan; Pakistan; India; Nepal; Bangladesh; and Myanmar. For the purposes of this research, IFFs are defined as ‘money illegally earned, transferred, or used that crosses borders’.¹ The study provides an assessment of routes, actors and sources of IFFs in and between these Asian countries.

IFFs are complex. They can stem from flows of illicit goods (such as narcotics and counterfeit money), but they also include illicit finance generated from legitimate or legal trade, including jade, gold and white goods. IFFs are often facilitated by a range of actors, with collusion between public and private, legal and illegal, and criminal and political. With this in mind, identifying trends related to products is not as useful as better understanding the individual flows related to certain business practices or commodities. A key finding from this study was that the term ‘illicit financial flows’ is often misunderstood and confused by governments working on the issue for those activities that are implicated in IFFs, such as corruption or money laundering.² As a result, IFFs are under-researched. Through an examination of both the national and international risks facing certain countries in Asia, which continues to have the highest levels of illicit outflows in dollars in the developing world, this paper should act as a gateway for wider and more in-depth research into IFFs.

The main objective of this paper is to better understand how IFFs work from and between the focus countries, as well as how they link to financial centres elsewhere. The paper aims to inform development agencies and international donors, particularly the Department for International Development (DfID), on how to improve their interventions to combat IFFs. The research for this paper is based on desk research carried out by RUSI’s regional and thematic experts, as well as two in-country workshops (in New Delhi and Bishkek) and remote telephone interviews carried out over six months. The two regional workshops brought together experts and officials from the focus countries to explore regional factors in more depth.

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1. World Bank, ‘Illicit Financial Flows (IFFs)’, 7 July 2017, <<http://www.worldbank.org/en/topic/financialsector/brief/illicit-financial-flows-iffs>>, accessed 16 October 2017.
 2. Money laundering is defined by Interpol as ‘any act or attempted act to conceal or disguise the identity of illegally obtained proceeds so that they appear to have originated from legitimate sources’. Interpol, ‘Money Laundering’, <<https://www.interpol.int/Crime-areas/Financial-crime/Money-laundering>>, accessed 19 October 2017.

Recommendations

This paper offers a number of recommendations to tackle IFFs in Asia:

Further Research

1. Increase understanding of IFFs in relation to the focus countries through supporting IFF-specific research centres (for example, analytical fusion centres³) at the national and multinational levels, involving both the public and private sectors. While connections need to be made between countries, this paper demonstrates that each state must carefully consider the individual criminal infrastructure within their own borders that facilitate IFFs. This paper found that there is no core funding for such research and that the funding that does exist is inconsistent.
2. Form a better understanding of the role that the private sector plays in IFFs. For example, there was not much data about the role that the Tajik or Kyrgyz real-estate sectors might play in money laundering and broader IFFs.
3. Update knowledge on informal money transfer systems, such as *hawala* and *hundi*.⁴ More research should also be carried out on emerging technologies that facilitate payments, such as bitcoin.
4. A possible extension to this project could be to explore the role of countries in Southeast Asia as destinations, sources and transit countries in the illicit flows between China and the rest of Asia.

Donor Interventions

1. Support should be given, where possible, to improving existing border crossings and creating new ones in areas where there is a high level of informal crossing. Note that the success of such crossings will depend on there being the political will to implement and manage them properly.
2. Donor interventions must take into account economically viable alternatives to illicit sources of income where relevant. For example, the destruction of Afghanistan's poppy fields in a bid to get rid of the narcotics trade was detrimental for the local economy because a substitute crop of similar value was not identified. Lessons can be drawn from the UN Office on Drugs and Crime's (UNODC) alternative development approach.⁵

3. Analytical fusion centres bring together different government departments at all levels; these could also include external international participants.

4. *Hawala* is a traditional system of transferring money used particularly in Arab countries and South Asia, whereby the money is paid to an agent who then instructs an associate in the relevant country to pay the final recipient. *Hundi* is a similar system used in India, it is an unconditional order in writing made by a person directing another to pay a certain sum of money to a person named in the order.

5. UNODC, 'Alternative Development', <<http://www.unodc.org/unodc/en/alternative-development/index.html>>, accessed 8 November 2017.

3. Support should be given to those donor interventions that enhance the integrity of the formal banking system in order to increase financial inclusion and draw money from the shadow economy into the formal system. Helping to bridge civil society engagement with financial regulatory bodies would help to achieve this.
4. More work should be done to engage with major financial centres, such as Dubai, Singapore, China and the UK, as well as offshore jurisdictions, to investigate the operational and intelligence gaps that prevent investigation and prosecution where appropriate in relation to IFFs.
5. International donors should look to support anti-IFF civil society groups that include private and public sector expertise, as well as investigative and analytical capacity. More support should also be given to business-oriented civil society organisations that are committed to promoting prosperity through business sector reforms.
6. Support more in-depth analysis – both in government structures and at civil society level – of the data that new laws or systems produce (such as declaration of income for government officials). This will not only improve the effectiveness of systems, but also provide non-governmental actors with an evidence base with which to hold government to account.

Donor Behaviour

1. International donors need to pre-empt the potential abuse of international aid through corruption and embezzlement. This can be done through putting conditions on the aid given, such as audits at international standards that are verified by independent third parties.
2. International donor organisations should also collaborate more and better coordinate their efforts to avoid duplication and improve the effectiveness of interventions.

Introduction

ILLICIT FINANCIAL FLOWS (IFFs), defined here as ‘money illegally earned, transferred, or used that crosses borders’.¹ More specifically, they are ‘the proceeds from both illicit activities, such as corruption (bribery and embezzlement of national wealth), criminal activity, and the proceeds of licit business that becomes illicit when transported across borders in contravention of applicable laws and regulatory frameworks (most commonly in order to evade payment of taxes)’.²

IFFs have a significant impact on the economic and social development of countries because they usually represent losses to state tax revenue that could otherwise be spent on government services, such as healthcare, education and security. IFFs also deter foreign investment as funders cannot be assured that their money will not be siphoned off and used for other activities. Corruption among political and administrative actors is an important enabling factor for IFFs. The prevalence of corruption itself can undermine the integrity of the formal banking system and trust in governance structures, which pushes some legitimate business activity into the informal or shadow economy. This is compounded by poor financial literacy or lack of access to the formal banking system in many of the countries into which this money flows illegally, further enabling IFFs. Non-profit, IFF-focused research and advisory organisation Global Financial Integrity (GFI) has estimated that, in the developing world, the highest levels of illicit outflows in dollars emanate from Asia. As such, this paper examines the problem of IFFs in Asia, with a particular focus on the following countries: Kyrgyzstan; Tajikistan; Afghanistan; Pakistan; India; Nepal; Bangladesh; and Myanmar.

To illustrate the role that IFFs play in Asia, this paper looks at three different types of IFFs: the cross-border trade in illicit goods; the illegal cross-border trade of legally acquired goods; and the illegal use of funds produced by cross-border trade. For the first type of IFF, the paper gives two case studies: the heroin trade coming from Afghanistan and the trade in counterfeit currency in India. For the second type of IFF, the case of the jade trade from Myanmar is examined. And for the third type of IFF, the paper considers the broader case of cross-border trade and movement of goods in Asia. Although not an exhaustive analysis of the source of funds relevant to the paper’s focus countries, these case studies were selected for two reasons: first, the significant impact these types of IFFs have on several of the focus countries; and second, the importance attributed to these types of IFFs by those who took part in the RUSI workshops in Bishkek and New Delhi, as well as by those interviewed by the authors as part of the research for this paper. These case studies demonstrate the extent to which licit activity, not just illicit activity, fuels IFFs.

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1. World Bank, ‘Illicit Financial Flows (IFFs)’, 7 July 2017, <<http://www.worldbank.org/en/topic/financialsector/brief/illicit-financial-flows-iffs>>, accessed 16 October 2017.
 2. Dev Kar and Devon Cartwright-Smith, ‘Illicit Financial Flows from Developing Countries: 2002–2006’, Global Financial Integrity, December 2008, p. 7.

IFFs usually involve actors from various different sectors, including: corrupt political elites; administrative or law enforcement bodies, such as border guards, the police or tax authorities; those working in the private sector; and criminal elements. IFFs may even involve ordinary citizens working in lawful business but using illicit methods, such as tax evasion, to move money out of the country to a more secure banking system. These actors from different sectors do not always cross paths, but often they do. For example, there is believed to be a nexus between political elites and criminal groups in the Afghan drug trade. Such intersections warrant further investigation.

The methods by which this money moves or is legitimised is facilitated by the practices of money laundering, tax evasion and mis-invoicing (a method of illicitly moving money across borders by deliberately misreporting the value of a commercial transaction).³ The shadow economy, or underground economy,⁴ plays a significant role. Although informal practices, such as *hawala* or *hundi* play a role in moving money generated from legal or illegal activity, the formal banking system is also often a necessary feature. These informal and formal systems often interact with each other. Financial centres – such as Dubai, Singapore, China, the UK and offshore jurisdictions – provide a crucial international link in the chain of formal and informal practices that facilitate IFFs. Other corporate vehicles – such as export–import companies, shell companies and company formation agents – also facilitate the movement of illicit funds. As such, examining these countries as a ‘region’, as the pre-determined grouping implies, is less useful than first understanding each focus country’s individual risks in relation to illicit inflows and outflows, relevant commodities or related activity, as well as other countries that connect them. Looking first at each pre-selected country internally before examining their international connections is key.

International donors and aid organisations have a challenging and complex task in devising interventions to combat IFFs. The phenomenon is generally under-researched and often misunderstood. For example, information on how the finance of the drugs trade from Afghanistan works is reliant on a study from 2006 by Edwina Thompson entitled ‘The Nexus of Drug Trafficking and Hawala in Afghanistan’.⁵ More up-to-date research is needed. When the authors discussed IFFs with country experts and financial intelligence units, it was clear that the risks IFFs posed, as well as associated processes such as money laundering, were viewed through

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3. Global Financial Integrity, ‘Trade Misinvoicing’, <<http://www.gfintegrity.org/issue/trade-misinvoicing/>>, accessed 18 October 2017.
 4. The IMF defines the shadow economy as including illegal activities and unreported income from the production of legal goods and services, either from monetary or barter transactions. In essence, the shadow economy is ‘all economic activities that would generally be taxable were they reported to the tax authorities’. See Friedrich Schneider and Dominik Enste, *Hiding in the Shadows: The Growth of the Underground Economy* (Washington, DC: International Monetary Fund, 2002), p. 2.
 5. Edwina A Thompson, ‘The Nexus of Drug Trafficking and Hawala in Afghanistan’, in Doris Buddenberg and William A Byrd (eds), ‘Afghanistan’s Drug Industry: Structure, Functioning, Dynamics, and Implications for Counter-Narcotics Policy’, UNODC and World Bank, pp. 155–88.

a national lens. Interventions tend to focus on parts of the enabling features of IFFs, such as corruption or money laundering, rather than the issue as a whole. An additional challenge is the lack of political will in many of the focus countries to comprehensively tackle the issue, given that corruption plays an enabling role.

Dedicated programmes that specifically address IFFs are needed – programmes that help to equip civil society and other non-governmental stakeholders with the tools they need to hold their respective governments to account. Existing initiatives tend to focus on transparency and disclosure, which has typically produced large amounts of information; however, the analytical capacity or tools to make meaningful sense of such information needs to be developed. In particular, an investigative element is crucial in any attempt to hold political actors to account. This could have the knock-on effect of helping to address those societal attitudes that, often understandably, produce apathy towards corruption – or more abstract concepts such as IFFs – due to the perceived futility of attempts to change what is often a very entrenched way of getting things done.

Finally, international donors could do more to improve their approach to interventions. There were perceptions from those who took part in the workshops and those interviewed for this paper that international donors often fail to coordinate and so they duplicate each other's efforts. Greater collaboration and coordination between donors themselves was recommended. Moreover, there was a perception that grants or funding were often going to NGOs that were not always effective, in part due to a lack of local knowledge or country expertise. Many felt a degree of conditionality was required to avoid international aid programmes being abused, whether this be demanding audits by international standards or making aid contingent on proof of reform. Numerous experts noted that, to counter IFFs, initiatives should focus on supporting legitimate business activities, protecting property rights and providing an evidence and analytical base to help hold governments accountable where possible.

I. Global Illicit Financial Flows and Their Impact on Development

IFFS ARE DEFINED as ‘the proceeds from both illicit activities, such as corruption (bribery and embezzlement of national wealth), criminal activity, and the proceeds of licit business that become illicit when transported across borders in contravention of applicable laws and regulatory frameworks (most commonly in order to evade payment of taxes)’.¹ The term is somewhat problematic – it became apparent during the RUSI workshops in Bishkek and New Delhi that its exact meaning can be confusing. As non-profit IFF-focused research and advisory organisation Global Financial Integrity (GFI) has noted, it may include: a drug cartel using trade-based money-laundering² techniques to mix legal money from the sale of used cars with illegal money from drug sales; an importer using trade mis-invoicing to evade customs duties, VAT or income taxes; or a corrupt public official using an anonymous shell company to transfer dirty money to a bank account in the US.³ This paper provides case studies to help to illustrate ways in which IFFs travel.

IFFs are a complex phenomenon and can incorporate multiple activities, such as corruption, money laundering and criminal trade, as well as licit business activity. The World Bank has highlighted this complexity by stating that ‘IFFs reduce resources, but they are also symptomatic of other issues that constrain poverty reduction and shared prosperity, such as vested interests and weak transparency and accountability’.⁴

A key challenge is that IFFs are difficult to identify and track. GFI has estimated that in the developing world IFF outflows ranged between \$620–970 billion in 2014, with inflows ranging between \$1.4–2.5 trillion in the same year.⁵ The estimated dollar levels of illicit outflows are

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1. Kar and Cartwright-Smith, ‘Illicit Financial Flows from Developing Countries: 2002–2006’.
 2. Money laundering is defined by Interpol as ‘any act or attempted act to conceal or disguise the identity of illegally obtained proceeds so that they appear to have originated from legitimate sources’, see Interpol, ‘Money Laundering’, <<https://www.interpol.int/Crime-areas/Financial-crime/Money-laundering>>, accessed 19 October 2017. Trade-based money laundering is defined by the Financial Action Task Force (FATF) as ‘the process of disguising the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimise their illicit origins’, see FATF, ‘Trade-Based Money Laundering’, <<http://www.fatf-gafi.org/publications/methodsandtrends/documents/trade-basedmoneylaundersing.html>>, accessed 19 October 2017.
 3. GFI, ‘Illicit Financial Outflows from India \$22 Billion–\$27 Billion per Year’, 20 April 2009.
 4. World Bank, ‘Illicit Financial Flows (IFFs)’.
 5. GFI, ‘Illicit Financial Flows to and from Developing Countries: 2005–2014’, April 2017, pp. 6, 8.

largest in Asia. Outflows are estimated to have grown between 9–9.8% per year from 2004–14, reaching between \$272–388 billion in 2014.⁶ The table below shows the estimated scale of IFFs for this study's focus countries.

Table 1: Estimated Scale of IFFs in Focus Countries

Country	Illicit Financial Flows (Outflows)	Illicit Financial Flows (Inflows)	Total Trade (sum of country's exports and imports in US\$ millions)
Afghanistan	Low: 5% High: 24%	Low: 35% High: 36%	8,300
Bangladesh	Low: 9% High: 13%	Low: 6% High: 18%	70,069
India	Low: 1% High: 3%	Low: 5% High: 13%	778,246
Kyrgyzstan	Low: 0% High: 0%	Low: 11% High: 64%	7,629
Myanmar	Low: 4% High: 39%	Low: 15% High: 35%	27,526
Nepal	Low: 0% High: 0%	Low: 3% High: 16%	8,266
Pakistan	Low: 0% High: 0%	Low: 4% High: 16%	72,140
Tajikistan	Low: 4% High: 4%	Low: 0% High: 1%	6,170

Source: GFI, 'Illicit Financial Flows to and from Developing Countries: 2005–2014'; 'Low' estimates assess IFFs between developing countries and advanced economies, as defined by the IMF Direction of Trade Statistics. In cases where there are sufficient statistics of a given developing country's trade with at least 30 advanced economies for each of the ten years covered by the report, 'low' estimates are based on those statistics. Where such data is unavailable, the 'low' value is assessed by calculating the discrepancy between the global value of its imports and exports and adjusting it by the proportion that trade with advanced economies represents of its global trade; 'High' estimates cover all the country's trade. If data is available on a given country's trade with at least 30 advanced economies, the percentages of trade mis-invoicing are scaled up to obtain a global estimate, on the assumption that mis-invoicing in trade with developing countries is at least as common as in trade with advanced economies. If such data is unavailable, 'high' estimates are based on the discrepancies between a given country's worldwide imports and exports.

6. *Ibid.*, p. 6.

GFI's methodology of relying on discrepancies in trade statistics to identify trade mis-pricing has its limitations. For instance, if IFFs go both ways between two countries, they will be cancelled out in bilateral trade statistics and therefore will not be reflected in the data used by the GFI.⁷ Conversely, not all recorded trade mismatches are indicative of deliberate mis-invoicing and/or criminality – for example, countries of origin and/or destination may not be recorded consistently when goods transit through one or more states.⁸ Therefore, while GFI's data provides a useful benchmark for discussion, these estimates are cited here for illustrative purposes only and the inherent difficulty of measuring IFFs should be kept in mind.

Impact of IFFs on Economic Development

Although IFFs are difficult to identify and trace, they have significant negative impact on the economic development of the countries involved. For source or hub countries, IFFs deprive the state budget of money to spend on government services, such as healthcare, education and security. As one multilateral development bank has noted, 'if flight capital was saved and invested in the domestic economy of the country of origin it would increase income per capita and help to reduce poverty'.⁹ As the OECD has noted, the activities that generate IFFs are particularly corrosive. For example, the involvement of political corruption in particular diverts public money from public use to private consumption, as it is often ultimately spent on personal goods such as high-end luxury goods or real estate.¹⁰ This in turn enhances the inequality between those benefiting from IFFs and ordinary citizens.

Fewer funds for government-provided services as a result of illicit financial outflows can also have a knock-on effect in terms of increasing a government's inclination to borrow to fill in the gaps, thus increasing indebtedness. Swiss academic Marc Herkenrath, who has examined IFFs in Africa, has argued that IFFs can 'force the governments concerned to resort to flight-driven external borrowing ... IFFs compound government indebtedness and hence dependence on foreign aid'.¹¹ Thus, IFFs can hinder a country's ability to move beyond 'developing' status into greater self-sufficiency.

The corruption associated with IFFs also undermines the integrity of the formal financial sector. If citizens view those in a position of power, whether in government or regulatory functions, as protecting vested interests over citizens' interests, they are less likely to trust formal institutions

7. Volker Nitsch, 'Trade Mispricing and Illicit Flows', in Peter Reuter (ed.), *Draining Development? Controlling Flows of Illicit Funds from Developing Countries* (Washington, DC: World Bank, 2012), pp. 319–20.

8. *Ibid.*, p. 312; see also Maya Forstater, 'It's Not Aid in Reverse, Illicit Financial Flows are More Complicated Than That', *The Guardian*, 18 January 2017.

9. African Development Bank (AfDB), OECD, United Nations Development Programme (UNDP) and United Nations Economic Commission for Africa (UNECA), *African Economic Outlook 2012* (Paris: OECD, 2012).

10. OECD, 'Illicit Financial Flows from Developing Countries: Measuring OECD Responses', 2014.

11. Mark Herkenrath, 'Illicit Financial Flows and their Developmental Impacts: An Overview', Graduate Institute of International and Development Studies, 5 March 2014.

with their money. This deters citizens from using formal financial institutions to deposit funds, as well as discouraging foreign and domestic investment. Money and business may then get pushed into the informal economy, further reducing tax revenue and investment in social services.

It is challenging to accurately assess the economic impact of IFFs, given the methods used by those involved in them. One masking method includes mis-recording IFF-related funds as positive investment into a country. For example, sometimes the funds related to IFFs re-enter the country of origin through round-tripping, where they may be recorded as foreign direct investment (FDI). This may also involve licit money leaving a country, to then be laundered through a corporate entity elsewhere, particularly through an offshore jurisdiction, such as the British Virgin Islands (BVI), to then be reinvested back into the country of origin as FDI.¹² The incentives foreign investors receive, such as lower tax rates or favourable financial services, encourage such schemes.¹³

In more serious cases, IFFs can play a key role in fuelling conflict. For example, in the areas controlled by the Taliban in Afghanistan, the cultivation and trafficking of opiates fuels the insurgency, and control of the opium is, in itself, a cause of violence.¹⁴ The mining of jade in Myanmar, detailed below, has produced funds that have also facilitated conflict.¹⁵ This also contributes to limits on the economic development of a country. According to the World Bank, the fastest transforming countries have taken between fifteen and 30 years to raise their institutional framework from the level of a fragile state to that of an institutionalised state.¹⁶

12. Dev Kar and Sarah Freitas, 'Illicit Financial Flows from China and the Role of Trade Misinvoicing', *Global Financial Integrity*, October 2012.

13. Sony Kapoor, 'Illicit Financial Flows and Capital Flight', *Re-Define Briefing Paper*, December 2007.

14. FATF, 'Financial Flows Linked to the Production and Trafficking of Afghan Opiates', pp. 42–49.

15. Global Witness, 'Jade and the Generals', 17 May 2017.

16. World Bank, *World Development Report 2011: Conflict, Security, and Development* (Washington, DC: World Bank, 2011), p. 10.

II. Sources of Funds and Financial Flows

TO ILLUSTRATE THE role that IFFs play in Asia, this paper looks at three different types of IFFs: the cross-border trade in illicit goods; the illegal cross-border trade of legally acquired goods; and the illegal use of funds produced by cross-border trade. For the first type of IFF, the paper gives two case studies: the heroin trade from Afghanistan and the trade in counterfeit currency in India. For the second type of IFF, the case of the jade trade from Myanmar is examined. And for the third type of IFF, the paper considers the broader case of cross-border trade and movement of goods in Asia.

A key factor that facilitates such IFFs is weaknesses in cross-border administration or policing, particularly corruption. Although not an exhaustive analysis of the source of funds relevant to this paper's focus countries, these case studies were selected based on the importance attributed to them in the workshops and interviews, as well as the impact these types of IFFs have on several of the focus countries. A notable theme running through the research is that there are not necessarily clear-cut 'regional' trends when examining the focus countries, given that there are many unique national features for each country as to the source of funds and who is involved. A repeated observation from the workshops and interviews was that the focus countries do not see themselves as a region and therefore do not necessarily examine IFFs – which are cross-border in nature – in detail.

Narcotics Trade

The narcotics trade is one of the most prominent sources of funds for IFFs linking four neighbouring focus countries: Afghanistan; Pakistan; Tajikistan; and Kyrgyzstan.¹ Afghanistan is the origin country of the drugs, with Kyrgyzstan and Tajikistan often acting as consumption and transit countries for the drugs to Europe, as well as an intermediary for handling finance. Consumers in Europe provide the funds back to Afghanistan. Pakistan operates as a consumption country and as a financial centre for drug money.²

Afghanistan is the largest opium producer and exporter in the world, and opium is the main ingredient in heroin.³ In 2016, the UNODC estimated that opium production had increased by

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1. UNODC, 'West and Central Asia', <<https://www.unodc.org/unodc/en/drug-trafficking/central-asia.html>>, accessed 19 October 2017.
 2. FATF, 'Financial Flows Linked to the Production and Trafficking of Afghan Opiates', p. 15.
 3. US Department of State, '2016 International Narcotics Control Strategy Report Volume I: Drug and Chemical Control: Afghanistan', March 2016.

43% compared with 2015.⁴ The figures state that southern Afghanistan has the largest share of national opium production, at 54%, with the northeastern, northern and central regions accounting for 10% of opium production.⁵

A report from June 2014 published by FATF, the global standard-setter on anti-money laundering and counterterrorist financing, explains in detail some of the ways in which the money associated with Afghanistan's narcotics trade is laundered.⁶ A key role is played by money or value transfer services (MVTs), which FATF defines as 'financial services that involve the acceptance of cash, cheques, other monetary instruments or other stores of value and the payment of a corresponding sum in cash or other form to a beneficiary by means of a communication, message, transfer, or through a clearing network to which the MVTs provider belongs'.⁷ Transactions involved may use intermediaries and a final payment to a third party.⁸ In South Asia in particular, *hawala* or *hundi* are the main terms used for this process, and *hawaladars* (*hawala* brokers) provide the service.

The 2014 FATF report notes that money from those buying the drugs in, for example, Western Europe is transferred to producers in Afghanistan via the formal banking system in intermediary countries, namely Pakistan, Iran, UAE and China (see Figure 1 on the next page). Thompson, who has researched this process and conducted extensive fieldwork in Afghanistan, notes that Dubai operates as a central 'clearing house' for many of these transactions.⁹ This highlights the fact that the formal banking sector in countries such as Dubai plays as important a role as informal banking. The money from these intermediary countries is then transferred to a *hawaladar* in Afghanistan, who deals with fund transfers on behalf of the drug trafficker, at times without knowledge of the illicit source of finance. Illustrative of the crossover between drug trafficking and legitimate trade, the drug trafficker might use *hawaladars* to assist in importing goods to legitimise the money. As noted by the FATF report, '[b]y the time the goods or money arrive in Afghanistan, it is often impossible to link them to their illicit origin'.¹⁰

Reference has also been made to illicit activities of import–export companies registered in China that may transfer funds into Afghanistan, as well as *hawaladars* in Afghanistan controlling import–export companies to transfer money to recipients in China. This is likely to be part of trade-based money-laundering schemes. Some transactions may show under- or over-invoicing, or simply use fictitious invoices, to avoid customs duties in both countries. This is a way to move illicit payments for drugs out of the country, or they may be used to balance debts between *hawaladars*.¹¹

4. UNODC, 'Afghan Opium Production Up 43 Per Cent: Survey', 23 October 2016.

5. *Ibid.*

6. FATF, 'Financial Flows Linked to the Production and Trafficking of Afghan Opiates'.

7. FATF, 'Guidance for a Risk-Based Approach: Money or Value Transferred Services', February 2016, p. 7.

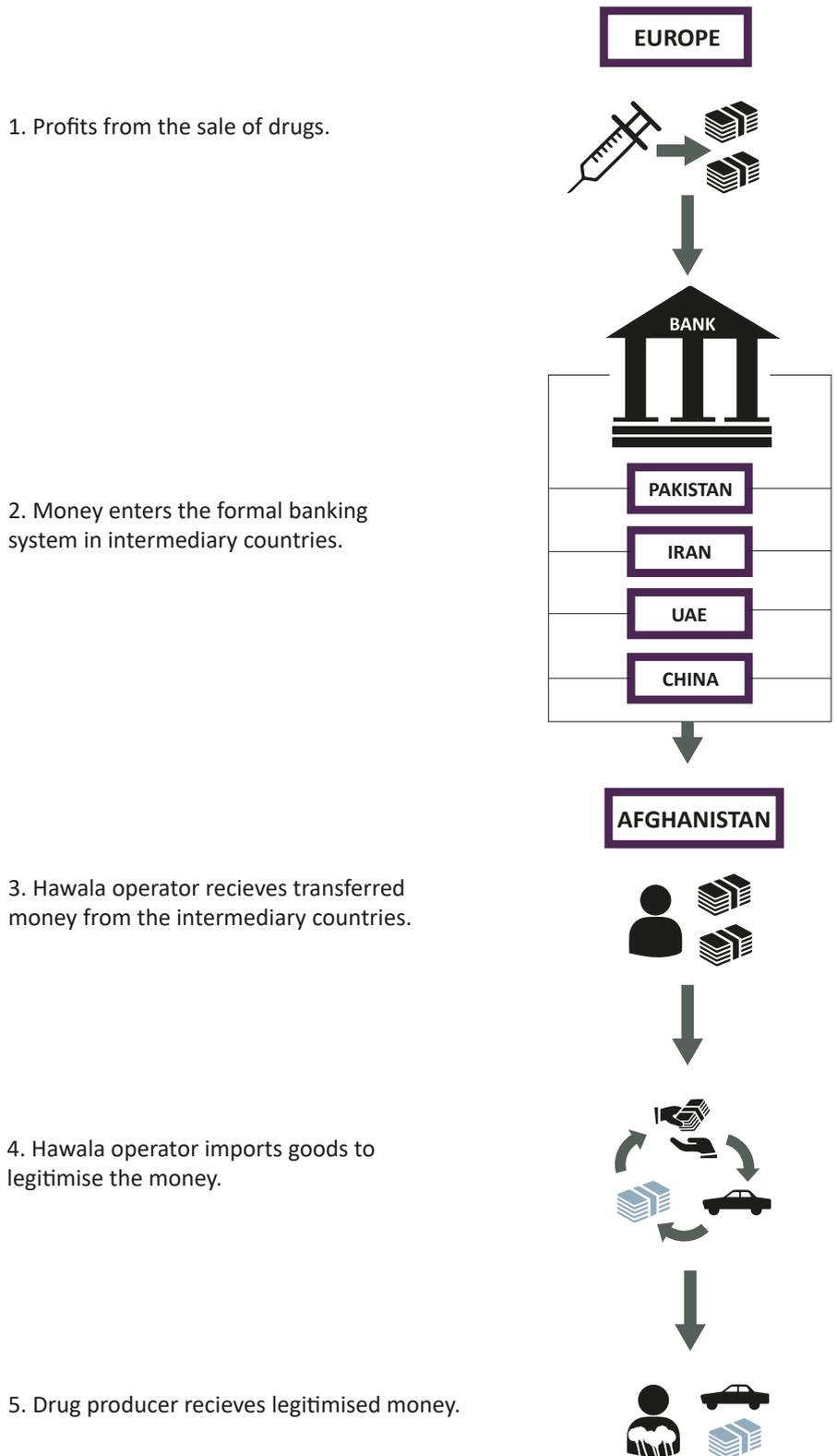
8. *Ibid.*

9. Thompson, 'The Nexus of Drug Trafficking and Hawala in Afghanistan'.

10. FATF, 'Financial Flows Linked to the Production and Trafficking of Afghan Opiates', p. 19.

11. *Ibid.*

Figure 1: Transferring Drug Profits from Dealers in Europe to Producers in Afghanistan



One case from Rosfinmonitoring, Russia's financial monitoring service, highlights the involvement of Central Asian countries in drug trafficking, particularly as coordinators and fixers. In this case, an individual based in Kyrgyzstan was identified as a regional coordinator for the smuggling of heroin from Afghanistan to Russia through Kyrgyzstan, Tajikistan and Kazakhstan. The finance was handled in the UAE. They allegedly redistributed trafficking proceeds to pay criminal network members and buy vehicles with secret compartments to hide heroin.¹²

Money may also be moved in simpler ways, such as using couriers to physically fly money out of the country. For example, according to Afghan customs records, more than \$3 billion in cash was 'openly flown out of Kabul International Airport' between 2007 and 2010.¹³ Although this money was suspected to be a mix of aid money and proceeds of corruption, profit from the narcotics trade was also thought to be included.¹⁴ Furthermore, US investigators believed that top Afghan officials were involved in this activity.

A key research gap when examining the drugs trade is the lack of up-to-date information about how proceeds are laundered, particularly through the *hawaladars*. Although FATF and other organisations have examined this, a lot of the information relies on a 2006 UNODC and World Bank report, and particularly Thompson's research within the report.¹⁵ Therefore, policymakers would benefit from updated research, specifically on the IFFs involved in the drug trade.

Counterfeit Currency

India faces a very real problem of counterfeit currency. Last year's demonetisation drive,¹⁶ in which old 500 and 1,000 rupee notes were stripped of their legal tender, was aimed not only at tackling corruption and increasing tax revenues, but also at combating counterfeit notes, which the government views as a serious crime problem. At the time, Prime Minister Narendra Modi specifically referenced fake Indian currency notes (FICN) as being one of the reasons for the demonetisation initiative.¹⁷ Indian officials have blamed neighbouring Pakistan for this phenomenon. In December 2015, then Minister of State for Home Affairs Haribhai Parthibhai Chaudhary stated that FICN were printed in 'sophisticated presses' in Pakistan and that this Pakistani enterprise 'created a self sustaining criminal network in the South and South-East Asian Region for infusing FICN into India'.¹⁸

12. *Ibid.*

13. Matthew Rosenberg, 'Corruption Suspected in Airlift of Billions in Cash from Kabul', *Wall Street Journal*, 25 June 2010.

14. *Ibid.*

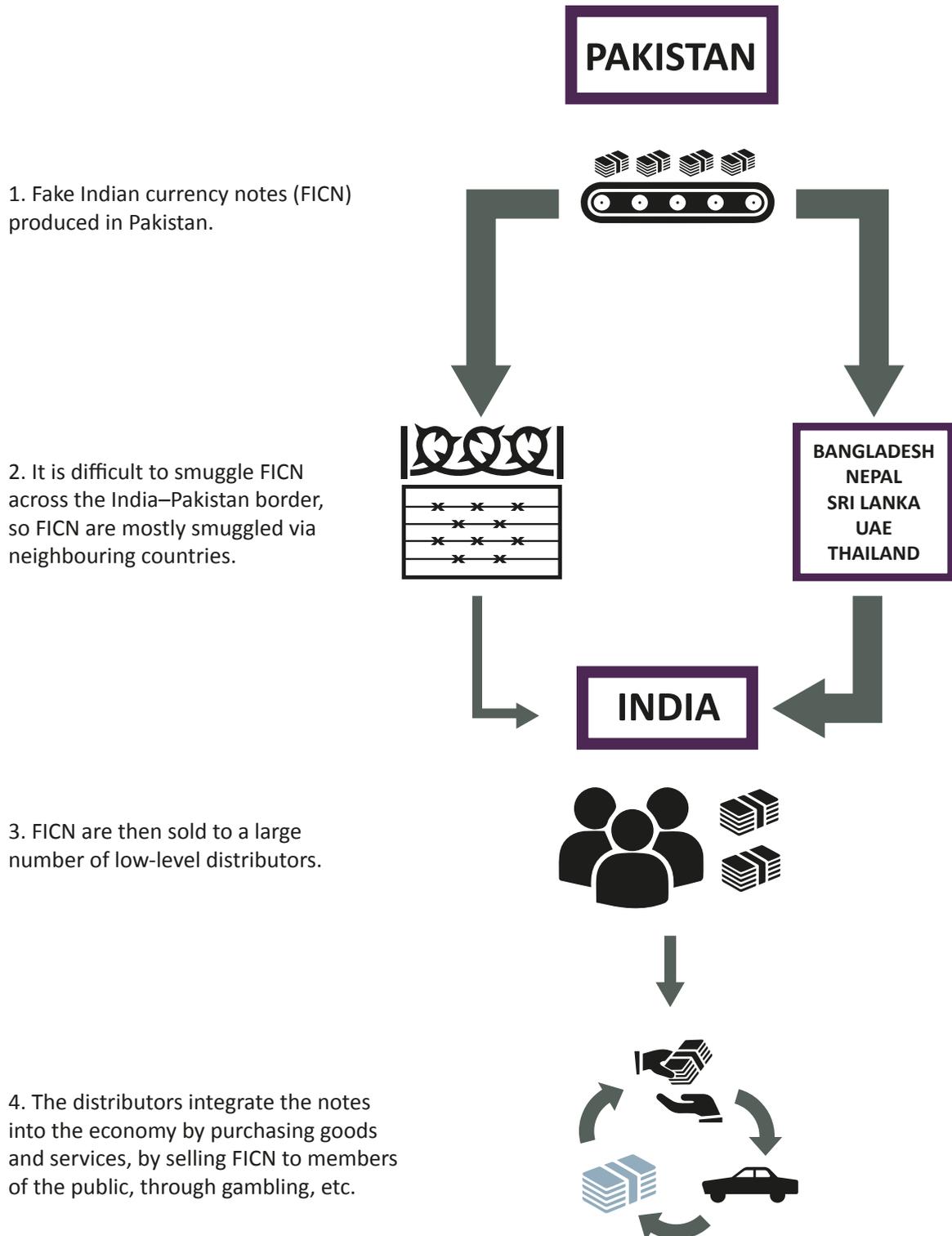
15. Thompson, 'The Nexus of Drug Trafficking and Hawala in Afghanistan'.

16. Ravi Prakash Kumar, 'What is Demonetisation and Why Was it Done', *Economic Times*, 9 November 2016.

17. *Wall Street Journal*, 'Full Text of Indian Prime Minister Narendra Modi's Speech on Replacing Largest Rupee Notes', 8 November 2016.

18. Shaurya Karanbir Gurung, 'Pakistan, the Biggest Contributor of Fake Rs 500, Rs 1000 Notes; PM Narendra Modi's Historic Move Justified', *Economic Times*, 10 November 2016.

Figure 2: Smuggling Counterfeit Currency into India



These notes are smuggled from Pakistan into India via Bangladesh, Nepal, Sri Lanka, the UAE and Thailand (see Figure 2 on the previous page).¹⁹ These Indian border countries are used because of the ease with which goods, illicit or otherwise, are able to cross the border. The India–Pakistan border is highly militarised and therefore cross-border activity is difficult. Following the demonetisation drive, in February 2017 it was reported that Indian Border Security Forces had started to intercept packages of counterfeit 2,000 rupee notes at the Pakistan border.²⁰ Typically, counterfeit notes are sold to a large number of low-level distributors, who then integrate the notes into the economy by purchasing goods and services, selling counterfeit currency to members of the public, indulging in gambling, etc.²¹ The proceeds of trade in counterfeit notes are most often smuggled abroad by cash couriers.²² A 2013 FATF report highlights the reported link between organised crime, terrorist financing and counterfeit notes in India.²³

Jade

Jade mining is a lucrative and highly opaque industry in Myanmar, overwhelmingly controlled by elite members of society and military families. The process of procurement of a licence for jade mining is reserved for those with political connections, to the detriment of the local population. A recent Global Witness film stated that the regulation and transparency of the jade-mining sector in Myanmar is key to peace in a country that has been ravaged by conflict.²⁴ Myanmar's Kachin State is home to many of the country's jade mines. According to Global Witness, the army and ethnic armed groups both exploit natural resources and local communities in the state by taking 'huge revenues from taxation and extortion'.²⁵ This exploitation in turn funds and fuels the ongoing conflict.²⁶

It is estimated that \$31 billion of jade was mined in Myanmar in 2014 alone, with 1 kg of the best jade in Kachin State sold for millions of US dollars.²⁷ The total amount mined in 2014 is equivalent to half of Myanmar's GDP, indicating the extent of its profitability.²⁸ However, despite these massive sums of money, very little makes its way back into the local economy or into public spending, which would provide citizens with healthcare, education and other necessities.²⁹

19. FATF, 'Money Laundering and Terrorist Financing Related to Counterfeiting of Currency', June 2013.

20. Rajesh Ahuja and Sreyasi Pal, 'Demonetisation 100 Days: Fake Rs 2000 Notes Entering India Through Bangladesh', *Hindustan Times*, 16 February 2017.

21. FATF, 'Money Laundering and Terrorist Financing Related to Counterfeiting of Currency', pp. 26–27.

22. *Ibid.*, pp. 27–28.

23. *Ibid.*, pp. 35–41.

24. Global Witness, 'Jade and the Generals'.

25. Global Witness, 'Myanmar's Multi-Billion Dollar Jade Trade Contributing to Ethnic Armed Conflict, New Film Shows Ahead of Landmark Peace Talks', press release, 17 May 2017.

26. John Zaw, 'Sharing of Resources is "Key to Long-Lasting Peace" in Myanmar', *Mekong Eye*, 27 May 2017.

27. Global Witness, 'Jade and the Generals'.

28. *Ibid.*

29. Daniel Pye, 'The Dark Shadow of Myanmar's Jade Trade', *Financial Times*, 26 September 2016.

The state regulator Myanmar Gems Enterprise (MGE) oversees jade mining. MGE acts as both a regulator and operator-owner in joint ventures with private mining companies. In Myanmar, state enterprises such as MGE rely on a system whereby 100% of investments are borne privately, but profits are shared between the state enterprise and the private company.³⁰ Transparency is a key issue, however, and jade thus provides a source of funds for illicit finance. MGE has in the past failed to disclose key activities and provide annual reports. According to Myanmar's first Extractive Industries Transparency Initiative (EITI) report, half of reported extractive revenues (more than \$200 million) do not go into central treasury accounts, but rather into 'other accounts' held by state-owned enterprises that are not open to public scrutiny.³¹ Other complicating factors noted in the EITI report include 'poor data quality, the use of paper-based systems, a lack of unique tax identification numbers, the lack of a publicly available mineral licence registry and minimal reporting on the extractive assets of military holding companies'.³²

Recent reports also indicate growing Chinese involvement through joint ventures, in collusion with the Myanmar military.³³ Due to sanctions against Myanmar, China has been the primary investor and buyer in the minerals sector and has cornered the market, leading to the government being unwilling to reform the sector.³⁴ Buyers fly in from Hong Kong, Taiwan and mainland China.³⁵ There are reports of these Chinese-owned companies registering jade at deflated prices to avoid taxes, before selling them to shell companies that in turn sell it at market prices. Global Witness estimated that the value of Myanmar's jade production in 2014 should have amounted to \$31 billion, half of the country's GDP that year. In reality, only \$1 billion of jade was sold at the 2014 annual emporium – run by MGE – in the capital, Naypyitaw, for which \$90 million had been paid in taxes.³⁶ The discrepancy between the total value of jade mined in Myanmar and the actual figure at the official sale hints at existing concerns over illicit unofficial sales, smuggling across the border to China and manipulation of the jade valuation during official sales.³⁷

Indeed, several ways to avoid taxation on jade have been documented, providing a source of illicit finance. The first was tax evasion at the mine site. While jade is usually subject to 20% value tax when it is mined, companies reportedly pay off officials to reduce or avoid the tariff. Low-value stones are also sometimes used for official valuations. According to the report,

30. Extractive Industries Transparency Initiative (EITI) Myanmar and Moore Stephens, 'EITI Report for the Period April 2013–March 2014: Oil, Gas and Mining Sectors', December 2015, p. 35.

31. Pye, 'The Dark Shadow of Myanmar's Jade Trade'.

32. World Bank, 'Myanmar Launches First Report on Extractive Industries Revenue', 28 April 2016.

33. Hnin Yadana Zaw, 'Chinese Jade Miners in Overdrive Ahead of New Myanmar Government', *Reuters*, 16 December 2015.

34. Zaw, 'Chinese Jade Miners in Overdrive Ahead of New Myanmar Government'.

35. Pye, 'The Dark Shadow of Myanmar's Jade Trade'.

36. Jonah Fisher, 'Myanmar Elite "Profits from \$31bn Jade Trade"', *BBC News*, 23 October 2015.

37. *Ibid.*

\$6.2 billion in mine site tax was estimated to have been lost in 2014, likely in part due to tax evasion.³⁸

The second method is tax evasion at the emporium, which involves selling high-valued jade at a lower price and ensuring that shell companies can secure a bid to buy the jade at a fraction of the cost. As a result of the deflated price, sales tax is also lowered and the shell company can legally transport the stone to China where it is recut and sold at market value. According to Pye, a source estimated that 60% of 2014 emporium sales involved this method of tax evasion, which large Chinese-owned front companies reportedly use for around 80% of the jade they sell.³⁹

The third method is market manipulation, in which buyers bid on stones they have no intention of collecting and paying for, thereby restricting the supply and commanding high prices for the jade they have already purchased. There are also reports of stones being repurchased at very high costs with no explanation, believed to be for money laundering. Smuggling has also been documented, with estimates of 50–80% of jade being smuggled by companies directly to China, bypassing officials on both sides of the border.⁴⁰ Given that China is the world's largest importer of jadeite, and most of the jadeite mined in Myanmar's Kachin State ends up in China, the official Chinese figure for 2014 of \$12 billion in imports seems implausible and inexplicably low.⁴¹

Cross-Border Trade and Movement of Goods

A key insight from the New Delhi workshop was that 'borders are not barriers, they are bridges', reinforcing the notion that IFFs are facilitated by porous, unofficial or poorly managed borders, particularly in the South Asian context.⁴² They are facilitated by cross-border trade-based money laundering, which is the 'process of disguising the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimise their illicit origins'.⁴³ Border communities traditionally trade common goods with counterparts in neighbouring countries, not necessarily using official border crossings. Insufficient official border crossings between countries in the region encourage the use of informal border crossing routes.

Formal border crossings are often poorly managed and vulnerable to exploitation. India's land border stretches for 15,000 km, which makes it unmanageable to police in its entirety. The India–Nepal border is open and border officials are complicit with smugglers, resulting in the facilitation of goods crossing the border. This is also particularly true of the Tajikistan–Afghanistan border. On the Myanmar–India border, there are three official crossings, but tribes are allowed to cross and move freely within a 16 km distance of the border with visa-free

38. Pye, 'The Dark Shadow of Myanmar's Jade Trade'.

39. *Ibid.*

40. Global Witness, 'Jade: Myanmar's "Big State Secret"', 23 October 2015, p. 36.

41. *Ibid.*

42. Authors' interview at New Delhi workshop, 11 April 2017.

43. FATF, 'Trade Based Money Laundering', 23 June 2006.

access.⁴⁴ China is Myanmar's main trading partner, with 83% of its border trade conducted with its bigger neighbour. This contributes to China's ability to divert illicit trade through Myanmar and into India, as the China–India border is heavily guarded.⁴⁵

Informal trading networks have been 'significantly established' at the one official Myanmar–China border crossing between Muse and Ruili.⁴⁶ There is also illicit activity on the border between India and Bangladesh, with kingpins involved in organised crime, human smuggling and the smuggling of FICN into India. Smaller traders are involved in duty arbitrage, where products are bought on one side of the border and sold on the other – prescription drugs containing narcotic drugs and psychotropic substances are a key example, which are increasingly sold illegally to supply a growing demand in South Asia.⁴⁷ The tactics involved in this illicit trade include diversion from India's pharmaceutical industry, illicit manufacture and cross-border smuggling.⁴⁸ The 2016 annual report by the UN's International Narcotics Control Board notes that the manufacture, smuggling and abuse of amphetamine-type stimulants are significant in South Asia.⁴⁹ It highlights the illicit production at clandestine factories in India, smuggling of methamphetamine from Myanmar's southeastern border to Bangladesh, and an escalating trend in trafficking of psychotropic substances to Nepal.⁵⁰

There have been some efforts to address this. The 'free movement regime' (FMR) in place for these border communities in India and Myanmar is now under review by a committee set up by India's Union Home Ministry.⁵¹ As the home minister Rajnath Singh stated, the FMR is being 'misused by militants and trans-border criminals who smuggle weapons, contraband goods and fake Indian currency notes'.⁵² This is the second time a committee is reviewing the issue of free movement by border communities, indicating a continued concern over the exploitation of unmonitored and informal border crossings.

The way in which trade is reported is also an issue. Cross-border trade between China and Kyrgyzstan was raised as a vulnerability, as well as commodity trade between enclaves of Kyrgyzstan, Tajikistan and Uzbekistan. Multiple people interviewed in Kyrgyzstan mentioned that with China–Kyrgyzstan cross-border trade, there is a discrepancy in the customs figures

44. Narender Kumar, 'Border Management with Myanmar: A Strategic Imperative', *CLAWS Journal* (Summer 2014).

45. Authors' interview at New Delhi workshop, 11 April 2017.

46. Authors' interview with consultant on Myanmar, 21 April 2017.

47. *Economic Times*, 'Prescription Drug Abuse Growing in India: UN Report', 5 March 2014.

48. *Ibid.*

49. UN International Narcotics Control Board (INCB), *Report of the International Narcotics Control Board for 2016* (Vienna: INCB, 2016).

50. *Ibid.*

51. *The Hindu*, 'Panel to Study Free Movement along Myanmar Border', 12 June 2017.

52. *Ibid.*

between Beijing and Bishkek.⁵³ Kyrgyzstan's customs authorities reported that in 2015 it imported \$1.05 billion of goods from China, but the Chinese claimed \$4.3 billion. One representative at the Bishkek workshop noted that this was connected to 'contraband'. Contraband trade has the potential to increase on this border, given that Kyrgyzstan is now a member of the Eurasian Economic Union, which also includes Russia, Kazakhstan, Belarus and Armenia. Technically, Kyrgyzstan is supposed to increase tariffs on its border with China, yet re-exportation of Chinese goods accounts for a significant part of Kyrgyzstan's GDP.⁵⁴ One representative from Pakistan said that the under-invoicing of exports was also an issue. They noted that someone might sell goods to somebody in the UK for £100, but report it as being sold for £80. The additional £20 goes to an offshore account, and is unreported.⁵⁵

The increase in ASEAN economic integration through the Economic Community, as well as intra-Asian trade initiatives such as the China–ASEAN and India–ASEAN Free Trade Agreements, have been noted by the UNODC as risks for heightened illicit trade. As it states in a 2014 report, '[a]s the region increases connectivity creating and strengthening trade linkages, threats arising from trafficking and associated criminality are coming truly integrated within the region and in connections to regions beyond'.⁵⁶ Regional integration 'has facilitated the illegal flow of substances [drug and precursor chemical trafficking] within the region and exploited connections with neighbouring regions'.⁵⁷ It finds that the illicit trade in drugs, precursor chemicals and counterfeit medicines between South Asia and ASEAN is growing,⁵⁸ as are illicit flows of environmental goods.

In particular, heroin and synthetic drugs are trafficked into Southeast Asia from China, Myanmar and India, while the diversion of precursor chemicals from licit trade channels are used for methamphetamine, heroin and other drug production and 'increasingly involved pharmaceuticals from legitimate manufacturers'.⁵⁹ This illicit trade has now started to 'spill over' into countries such as Brunei, the Philippines and Singapore. Indeed, China imports some precursors through shipments via Singapore and Malaysia. Moreover, the link between Central, South and Southeast Asia can be seen through the flows of the heroin trade – narcotics from Afghanistan are increasingly moved by Pakistani networks to Malaysia where the drugs are redistributed to China and Australia, among others.⁶⁰ The UNODC report noted that the

53. Authors' interview with former law enforcement officer in Bishkek; authors' interviews at Bishkek workshop, 11 April 2017; see also Anna Yalovkina, 'New Trade Rules No Barrier to Kyrgyz Contraband', Institute for War and Peace Reporting, 15 June 2015.

54. Roman Mogilevskii, 'Re-export Activities in Kyrgyzstan: Issues and Prospects', University of Central Asia, Working Paper No. 9, 2012, p.15.

55. Authors' telephone interview with NGO representative in Pakistan, 28 April 2017.

56. UNODC, 'Protecting Peace and Prosperity in Southeast Asia: Synchronizing Economic and Security Agendas', February 2016, p. 19.

57. *Ibid.*

58. *Ibid.*, p. 45.

59. *Ibid.*, p. 20.

60. *Ibid.*, p. 35.

criminal drug-trafficking networks in Indonesia originate in India, Nepal and Pakistan and have recruited Cambodian, Indonesian and Thai nationals.⁶¹ As for counterfeit medicines, greater trade facilitation in Southeast Asia, along with stricter law enforcement in India and China over time, has helped to enable criminal groups exploit countries with weaker legislation, such as Myanmar and Vietnam, and relocate key aspects of production to these countries, while counterfeit ingredients are still sent from China to Southeast Asia. However, the UNODC report also found that the presence of infectious diseases in the Greater Mekong sub-region has driven the demand for counterfeit medicines that contain only limited quantities of active ingredients.⁶²

61. *Ibid.*

62. *Ibid.*, p. 31.

III. The Role of Power Structures and Actors Involved in IFFs

Power Structures in Illicit Financial Flows

WHEN 'POWER STRUCTURES' are discussed in the literature about IFFs, the term is often used in two different senses. It refers either to the systemic conditions that determine how political and economic power is exercised in a given society and channelled through its institutions,¹ or to the actors or groups of actors that exercise such power, which may also be called 'power elites'.² Regardless of the exact terminology used, it is helpful to look at both the relevant society's governance framework, and the interests of power elites who shape the political processes within that framework, to understand how these enable IFFs.

Power structures may be embedded in formal institutions or exist informally in the extra-legal space. In the latter case, 'the leadership of these structures may be situated within or parallel to the state, or they may constitute an armed opposition to it'.³ Power structures may indicate individual players or groups, such as political actors, criminal groups and private sector players, and they often interact to facilitate IFFs. Almost by definition, both formal and informal power structures have a profound impact on many aspects of political and economic life, including the efficiency and integrity of public administration. This then plays a significant role in IFFs as an enabling and motivational factor. Since the countries concerned have diverse constitutional setups and historical backgrounds, the factors at play differ, but certain common tendencies are evident. Importantly, in all the focus countries in this paper, informal power relations often override legal institutions and processes.

Actors Involved in Illicit Financial Flows

There is often a nexus between political, criminal, civilian and private sector actors involved in IFFs, and during the workshops some commonalities in the dynamic between some countries

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1. See, for example, David Lewis and Abul Hossain, "Beyond the Net"? Institutions, Elites and the Changing Power Structure in Rural Bangladesh', in David N Gellner and Krishna Hachhethu (eds), *Local Democracy in South Asia: Microprocesses of Democratization in Nepal and its Neighbours* (Thousand Oaks, CA: Sage, 2008).
 2. See, for example, David Knoke, *Political Networks: The Structural Perspective* (New York, NY: Cambridge University Press, 1990); C Wright Mills, *The Power Elite* (Cary, NC: Oxford University Press, 2000).
 3. Michael Miklaucic, 'Contending with Illicit Power Structures: a Typology', in Anne Peters et al. (eds), *Non-State Actors as Standard Setters* (New York, NY: Cambridge University Press, 2010), p. 191.

were identified. This section seeks not only to understand the key players involved in IFFs, but also how they may interact in the generation of illicit finance and their movement across borders.

Bribery and corruption are key facilitators among those involved in IFFs. This may include the direct involvement of state actors (such as members of the political elite, law enforcement, border force and administrative authorities) in generating or profiting from the illicit finance. It may also be expressed as compensation to those actors for turning a blind eye to illegal activity. It may be the fixing of a state or private sector procurement tender, or a failure to provide transparent reporting on projects that mask the movement of illicit funds.

The World Bank estimates the amount of annual bribery worldwide at \$1 trillion.⁴ The UN Economic and Social Council noted in 2005 that ‘capital flight through corruption is one of the main causes of poverty in the South, i.e. the developing countries. More than half of the Southern countries’ debts are in the form of private capital deposited in tax havens controlled by banks of the North [the developed world]’.⁵ Reducing bribery and corruption is key to addressing illicit financial flows.

Bribery and corruption are particularly challenging, as they require political will to tackle. A repeated theme throughout the research and both workshops has been that there is not enough political will to sincerely tackle corruption, in particular due to the vested interests among political elites. This does make interventions challenging, but this paper seeks to base recommendations on the assumption that the political will is unlikely to change unless aid donors put more pressure on this issue.

Political Actors

Corruption among the political elites plays a significant role in IFFs in the focus countries, while the role that the central government plays differs. It can be relatively centralised and directed from the very top, as in Tajikistan, or, in contrast, the prevalence of IFFs can be enabled by a central government that is too weak to challenge the decentralised power elites who generate and benefit from IFFs, such as in Afghanistan and Myanmar. The central government can institute seemingly strong legislation, but suffer from a lack of political will and technical expertise to enforce it, as in Kyrgyzstan. And it may occupy various stages in between, as in Bangladesh, India, Nepal and Pakistan.

In Tajikistan, political and economic control is often a family affair. President Emomali Rahmon’s friends and associates reputedly control most of the valuable businesses in what has been called

4. World Bank, ‘Six Questions on the Cost of Corruption with World Bank Institute Global Governance Director Daniel Kaufmann’, 2016.

5. UN Economic and Social Council, ‘Corruption and its Impact on the Full Enjoyment of Human Rights, in Particular, Economic, Social and Cultural Rights’, 22 June 2005.

a ‘family state’.⁶ According to a 2017 Freedom House report, ‘[c]orrupt officials control key public economic assets’ and Rahmon’s daughter Ozoda was appointed head of the presidential administration in 2016.⁷ The constitution has also been altered to allow Rahmon’s son, Rustam Emomali, to run for president in 2020.⁸ Even state organisations tasked with countering corruption suggest a conflict of interest. In 2015, Rahmon appointed his son as director of the Agency for State Financial Control and Combating Corruption (he is now the mayor of Dushanbe).⁹ Prior to that, he had been the head of the Customs Service.¹⁰ The customs sector, in turn, is generally the most lucrative of the public sector departments. As regards drug trafficking in particular, it has been reported that ‘not a single drug trafficking group is able to operate without support from high-ranking officials’.¹¹

When looking at sources of illicit funds, one expert noted that key actors in the narcotics trade in Tajikistan have changed over time, moving from criminal groups towards political actors. They noted that ‘every region has a leader of the narco-economy, and they are like warlords’.¹² Therefore, this market is fragmented in nature.¹³ In the wake of the 1992–97 civil war, former warlords were allowed to retain control over drug trafficking while at the same time being ‘co-opt[ed] into the establishment’.¹⁴ Some of this centralised power is also tied up with post-conflict stability in Tajikistan. While Rahmon’s laissez-faire attitude to drug trafficking facilitated peace-building in Tajikistan in the short term, De Danieli makes the point that it also ‘prevented the development of legitimate and accountable state institutions in the medium to long term’.¹⁵ The post-war period has seen Rahmon consolidate his power so that latent regionalism remains suppressed, in contrast to Afghanistan or Myanmar.

Administration Bodies, Law Enforcement and the Military

Administrative bodies, such as customs and tax authorities, and law enforcement agencies, such as the border force and police, play a pivotal role in IFFs in most focus countries. Bribery

6. Alexander Cooley and John Heathershaw, *Dictators without Borders: Power and Money in Central Asia* (New Haven, CO: Yale University Press, 2017), pp. 107–11.

7. Freedom House, ‘Nations in Transit 2017 – Tajikistan: Country Profile’, p. 2, <<https://freedomhouse.org/report/nations-transit/2017/tajikistan>>, accessed 26 October 2017.

8. *Ibid.*

9. Rustam Emomali, ‘Biography: Chairman of the City of Dushanbe’, <<http://dushanbe.tj/ru/chairman/biography>>, accessed 11 October 2017.

10. Catherine Putz, ‘Thanks Dad! Tajik President’s Son Gets a New Job’, *The Diplomat*, 12 January 2017.

11. Filippo De Danieli, ‘Beyond the Drug-Terror Nexus: Drug Trafficking and State-Crime Relations in Central Asia’, *International Journal of Drug Policy* (Vol. 25, No. 6, 2014), pp. 1235, 1239.

12. Authors’ interview at Bishkek workshop, 11 April 2017.

13. De Danieli, ‘Beyond the Drug-Terror Nexus’, pp. 1235, 1237.

14. De Danieli, ‘Inadvertent Impact: Heroin and Stability in Tajikistan’, in Eric Gutierrez (ed.), ‘Drugs and Illicit Practices: Assessing their Impact on Development and Governance’, Christian Aid Occasional Papers, October 2015, p. 10.

15. *Ibid.*, p. 11.

and corruption are particularly prevalent on borders, such as the Afghanistan–Tajikistan border, where it is believed that some border guards, immigration and customs officials are directly engaged in the drug trade.¹⁶ Similarly, officials on both the India–Bangladesh and Bangladesh–Myanmar borders are reported to be corrupt, with one report claiming that officials collude to enable human traffickers (a source of IFFs) evade arrest.¹⁷ Senior officers at the Indian Border Security Force admit corruption among their ranks, but also maintain that the chief problem in combatting this issue is the lack of manpower and lethal weapons which would deter smugglers, particular those smuggling cattle.¹⁸ Corruption also persists on the India–Nepal border.¹⁹ According to a study based on interviews with Nepalese border officers, some of them bribe their superiors in order to be hired, and officials who try to dismiss corrupt subordinates can themselves be fired.²⁰

Apart from land borders, corruption and complicity also facilitate the physical movement of cash by air. An NGO expert based in Pakistan said that couriers often take cash from the drug trade out of the country by air, allegedly with the collusion of customs officials and airport security.²¹ This is in line with the US Department of State's assessment that corruption hinders effective drugs control in Pakistan.²² As already mentioned, there have also been reports of moving cash, with the collusion of officials, by air out of Kabul International Airport.

Tax authorities in the focus countries appear to be affected by the same problems of corruption and inefficiency. It is suggested that the tax revenue-to-GDP ratio, which 'can be regarded as one measure of the degree to which the government controls the economy's resources',²³ is two or three times lower in the focus countries than in developed OECD economies (see Table 2). Weak taxation systems produce a vicious circle because in the absence of funds it is difficult for the state to fulfil its functions and gain legitimacy in the eyes of the public. This issue is closely related to the problems of corruption and the shadow economy, which are considered later in this paper.

16. Filippo De Danieli, 'Counter-Narcotics Policies in Tajikistan and their Impact on State-Building', in John Heathershaw and Edmund Herzig (eds), *The Transformation of Tajikistan: The Sources of Statehood* (Abingdon: Routledge, 2013), p. 147.

17. US Department of State, 'Trafficking in Persons Report 2016', June 2016, p. 89.

18. Sandhya Ravishankar, 'Why Cattle Continue to be Smuggled from West Bengal's Border Areas to Bangladesh', *Economic Times*, 29 March 2015.

19. Authors' interview at New Delhi workshop, 11 April 2017.

20. Jason Miklian, *Illicit Trading in Nepal: Fueling South Asian Terrorism* (Oslo: International Peace Research Institute, January 2009), p. 11.

21. See also M Ilyas Khan, 'Is Heroin Being Smuggled on Pakistani Planes into Heathrow?', *BBC News*, 20 May 2017.

22. US Department of State Bureau for International Narcotics and Law Enforcement Affairs, '2016 International Narcotics Control Strategy Report, Volume I: Drug and Chemical Control', p. 240.

23. OECD, 'Tax Revenue', 2017, <<https://data.oecd.org/tax/tax-revenue.htm>>, accessed 11 October 2017.

Table 2: Tax Revenues-to-GDP Ratio in Focus Countries

Country	Tax Revenues to GDP
Afghanistan	7.2% in 2013
Bangladesh	8.5% in 2015
India	11% in 2013
Kyrgyzstan	17% in 2015
Myanmar	3.9% in 2005
Nepal	16.8% in 2015
Pakistan	10% in 2014
Tajikistan	9.8% in 2004
OECD average	34.3% in 2015

Sources: Trading Economics, World Bank and OECD; Trading Economics, 'Afghanistan – Tax Revenue (% of GDP)', <<https://tradingeconomics.com/afghanistan/tax-revenue-percent-of-gdp-wb-data.html>>, accessed 11 October 2017; Trading Economics, 'Bangladesh – Tax Revenue (% of GDP)', <<https://tradingeconomics.com/bangladesh/tax-revenue-percent-of-gdp-wb-data.html>>, accessed 26 October 2017; Trading Economics, 'India – Tax Revenue (% of GDP)', <<https://tradingeconomics.com/india/tax-revenue-percent-of-gdp-wb-data.html>>, accessed 26 October 2017; Trading Economics, 'Kyrgyzstan – Tax Revenue (% of GDP)', <<https://tradingeconomics.com/kyrgyzstan/tax-revenue-percent-of-gdp-wb-data.html>>, accessed 26 October 2017; World Bank, 'Myanmar – Tax Revenue (% of GDP)', <<https://data.worldbank.org/indicator/GC.TAX.TOTL.GD.ZS?locations=MM>>, accessed 20 October 2017; Trading Economics, 'Nepal – Tax Revenue (% of GDP)', <<https://tradingeconomics.com/nepal/tax-revenue-percent-of-gdp-wb-data.html>>, accessed 26 October 2017; Trading Economics, 'Pakistan – Tax Revenue (% of GDP)', <<https://tradingeconomics.com/pakistan/tax-revenue-percent-of-gdp-wb-data.html>>, accessed 26 October 2017; Trading Economics, 'Pakistan – Tax Revenue (% of GDP)', <<https://tradingeconomics.com/pakistan/tax-revenue-percent-of-gdp-wb-data.html>>, accessed 26 October 2017; OECD, 'Revenue Statistics – OECD Countries: Comparative Table', <<https://stats.oecd.org/Index.aspx?DataSetCode=REV>>, accessed 11 October 2017

Criminal and Militarised Groups

Clearly, criminal groups have a role in IFFs, although this varies depending on the specific context of the focus country. Afghanistan is probably the most extreme case in terms of the blurring of lines between official, warlord, criminal and civilian groups involved in the key sources of illicit funds in the drug trade. An expert working on border issues in Tajikistan said that apart from the Taliban in Afghanistan, a key player in the drugs trade, a 'plethora' of organised criminal groups are involved, some of which are affiliated with Daesh (also known as the Islamic State in Iraq and Syria, or ISIS).²⁴ Another expert, based in northern Afghanistan, noted that poppy cultivation may also be conducted by local farmers, civilians, opposition groups and government

24. Authors' telephone interview with an individual working on border issues in Dushanbe, 2 May 2017.

militias, which might ‘bounce between pro-government, opposition and criminal groups’ in terms of their affiliation.²⁵

The difficulty of the fight against illicit trafficking in Afghanistan has been compounded by the inclusion in central government of former warlords and strongmen, as well as the ability of government actors to act seemingly with impunity. For instance, the help reportedly given by Colonel Abdul Raziq (the provincial police chief allegedly involved in human rights’ abuses as well as drug trafficking,²⁶ although he denies the allegations) was instrumental in ensuring support for Ashraf Ghani in Kandahar, the winner of the 2014 presidential elections.²⁷ The Afghan government’s inclusion of local elites and warlords means that the impact of anti-corruption and anti-trafficking measures is bound to be limited.

The situation in Myanmar has parallels to Afghanistan, as a large proportion of illicit trafficking is either tolerated or directly carried out by militarised elites that the government cannot control. This has also been influenced by political transition. After the military junta relinquished its power in Myanmar in the wake of the democratisation process that started in 2011, some of its members took over a substantial share of the country’s illicit economy, including the lucrative trade in timber and jade.²⁸ Parts of Myanmar are de facto controlled by ethnic armed groups, in particular the drug-producing states of Kachin in the north and Shan in the east.²⁹ A representative from an international financial institution who had worked in Dushanbe also alleged that other security actors, namely employees of the Russian military base in Tajikistan, may also be involved in the narcotics trade.³⁰

The convergence between political parties, especially at the local level, and criminal groups is often a way to fill gaps in formal political governance, as in Nepal. Two studies in 2012 and 2013 reported that ‘Nepali citizens rely on a range of informal arrangements to fill the void created by a weak state’.³¹ Although Nepalese organised crime groups are not particularly well organised or powerful in their own right, political parties rely on them for money and muscle in exchange

25. Authors’ telephone interview with security expert based in northern Afghanistan, 25 May 2017.

26. Matthew Green, ‘US Takes Risks with Ties to Afghan Strongman’, *Financial Times*, 12 March 2010.

27. Vanda Felbab-Brown, *Afghanistan Affections: How to Break Political-Criminal Alliances in Contexts of Transition* (Tokyo: United Nations University Centre for Policy Research, 2017), p. 18.

28. Vanda Felbab-Brown, *Myanmar Maneuvers: How to Break Political-Criminal Alliances in Contexts of Transition* (Tokyo: United Nations University Centre for Policy Research, 2017).

29. US Department of State Bureau for International Narcotics and Law Enforcement Affairs, ‘International Narcotics Control Strategy Report, Volume II: Money Laundering and Financial Crimes’, March 2016, p. 56.

30. Authors’ interview with individual from an international financial institution, 10 April 2017, Bishkek.

31. The Asia Foundation, *A Guide to Government in Nepal: Structures, Functions, and Practices* (Kathmandu: The Asia Foundation, 2012); See also Camino Kavanagh (ed.), ‘Getting Smart and Scaling Up: The Impact of Organized Crime on Governance in Developing Countries – A Case Study of Nepal’, New York University Center on International Cooperation, June 2013, p. 53–96.

for impunity.³² Consequently, crimes such as drug smuggling, illegal logging, and wildlife and human trafficking remain unaddressed.³³ Local politicians on the India–Bangladesh border are known to have been complicit in the trade in FICN, which are often used to finance election campaigns or even buy votes.³⁴ Quasi-criminal strongmen – known as *mastaan* in Bangladesh – often serve as a link between criminal groups, politicians, and local businesses.³⁵ A recent study based on the survey of 340 Bangladeshi journalists highlighted the dual role of *mastaan*, who engage in crimes for profit (especially land grabbing, drug trafficking and extortion), but also contract out their services to politicians during periods of electoral violence.³⁶

At times the political acceptance of illicit activity differs at the federal versus regional level. In India, political interests of regional leadership often override nationwide legalisation in a bid for re-election, as every politician has a financial backer, whose influence redirects political interests.³⁷ In the New Delhi workshop, participants regularly noted that ‘the law on paper was different from the law on the ground’. A regular example was the illegal smuggling of cattle from India into Bangladesh for slaughter, which runs counter to national legislation, but is permitted at the state-level as it acquiesces to the demands of various local ethnic groups which drive the demand for beef.

In Kyrgyzstan, there has historically been some interplay between politics and criminal groups, writing in 2014, academic Alexander Kupatadze contends that ‘[a] number of MPs are semi-legalised criminals that sought immunity and access to decision-making through elections but continue to protect criminals or engage in criminal activity themselves’.³⁸ However, Kupatadze notes that the inter-penetration of crime and politics was at its highest before 2010, indicating that there has been some improvement since President Kurmanbek Bakiyev was ousted in April of that year. As with Tajikistan, there appears to have been some crossover between political and criminal activity in the drugs trade. One notorious example is the wrestler-turned-MP Bayman Erkinbaev, who allegedly engaged in drug trafficking before being killed in 2005. After that, his business was reportedly taken over by another MP and martial arts champion, Sanjar Kadiraliev, who in turn was killed in 2009.³⁹

There is some evidence of this also in Pakistan’s border areas, with most evidence pointing to human trafficking as the criminal source of funds. Although not cited by respondents throughout the research for this paper, it illustrates the nexus between political players and criminals. The US

32. Kavanagh, ‘Getting Smart and Scaling Up’, pp. 57–58.

33. *Ibid.*, p. 58.

34. Authors’ interview at New Delhi workshop, 11 April 2017.

35. Manzoor Hasan, Jonathan Rose and Sultan Muhammed Zakaria, ‘The Real Politics of Bangladesh: The Inside Story of Local Power Brokers’, *Research for Action in International Development*, 2015.

36. *Ibid.*, pp. 8–9.

37. *BBC News*, ‘The trouble with political financing in India’, 28 September 2012.

38. Alexander Kupatadze, ‘Kyrgyzstan – A Virtual Narco-State?’, *International Journal of Drug Policy* (Vol. 25, No. 6, 2014), pp. 1178, 1180.

39. *Ibid.*, p. 1180.

2016 Trafficking in Persons report notes that ‘Pakistan is a source, transit, and destination country for men, women, and children subjected to forced labor and sex trafficking’.⁴⁰ According to the same report, some persons involved in human trafficking are associated with political parties or even hold public office, which they use to protect their criminal business, up to the point that when victims attempt to escape, the police return them to their traffickers.⁴¹ There have been other examples of drug lords financing local politicians’ election campaigns, for example, ‘Imam Bheel, who was named by President Obama in 2009 as a Significant Foreign Narcotics Trafficker ... is believed to be a key financier of a leading political party in Balochistan’.⁴² This has also been the case in Myanmar. Most of the victims are transported to other Asian states, especially Thailand and China, the Middle East, and the US.⁴³ The report notes pervasive corruption and alleged links between some traffickers and high-level officials.⁴⁴

Private Sector

There is often a blurred line between ‘public and private’ in many of the focus countries. For example, it has been reported that in India public officials can obtain a stake in a business if they provide services to its owners.⁴⁵ In all the focus countries, the involvement of public officials in private business was mentioned, presenting what many deemed a conflict of interest, if not a violation of law.

The private sector tends to play a dual role in IFFs. On the one hand, businesses participate in the shadow economies by evading taxes or applicable regulations. This is particularly relevant to India, Afghanistan, Kyrgyzstan and Tajikistan. On the other hand, private sector actors may knowingly or unknowingly provide opportunities for laundering the proceeds of crime, as in the property sector. One representative from a UN organisation in Tajikistan said, ‘Dushanbe has no thriving commerce – it is very poor. But over the last decade there has been a huge construction boom. Where does the money come from? Dushanbe is built on narcotics’.⁴⁶ In Myanmar, one of the country’s largest property developers, Asia World, is known to have its roots in the heroin trade.⁴⁷ Business transactions are often carried out in cash, including property purchases, and less than 25% of the adult population has a bank account.⁴⁸ In Pakistan, it has been reported that the source of the property purchaser’s funds or even his/her identity are often not properly

40. US Department of State, ‘Trafficking in Persons Report: June 2016’, p. 294.

41. *Ibid.*, p. 295.

42. Safiya Aftab, ‘Post 2014: The Regional Drug Economy and Its Implications for Pakistan’, Barcelona Centre for International Affairs, February 2014, pp. 16–17.

43. US Department of State, ‘Trafficking in Persons Report: June 2016’, p. 112.

44. *Ibid.*, p. 114.

45. *The Economist*, ‘Fighting Corruption in India: A Bad Boom’, 15 March 2014.

46. Authors’ telephone interview with UN representative from organisation in Tajikistan, 2 May 2017.

47. Thomas Fuller, ‘Profits of Drug Trade Drive Economic Boom in Myanmar’, *New York Times*, 5 June 2015.

48. US Department of State Bureau for International Narcotics and Law Enforcement Affairs, ‘International Narcotics Control Strategy Report, Volume II’, p. 56.

identified, while payments can be made in cash.⁴⁹ This also counts for purchasing property abroad. In Afghanistan and Pakistan, much of the illicit finance is believed to be invested in Dubai property.⁵⁰ An NGO expert in Pakistan also said that money was often taken out of the country through small cargo vessels, travelling from Karachi to Dubai to then invest in property.

In some cases, there are reports of financial institutions captured by criminal interests, as in Afghanistan.⁵¹ The most well-known example of this is the Kabul Bank scandal, where the bank's founder, Sherkhan Farnood, and its former chief executive, Khalilullah Ferozi, were sentenced to five years' imprisonment after being convicted of stealing \$810 million from the bank.⁵² Also convicted were a number of the bank's employees, as well as some officials of the Afghan Central Bank and other state institutions. Funds had been embezzled from the bank by means of fraudulent insider loans and overpayments for goods and services, with much of the money transferred to Dubai.⁵³ Ghani reopened the investigation into the Kabul Bank fraud by presidential decree two days after his inauguration. He had fought the election on an anti-corruption platform and the case was of symbolic importance, especially since Mahmood Karzai, the brother of Afghanistan's former president, was among the alleged beneficiaries of the fraud. Save for Farnood and Ferozi, no other beneficiaries of fraudulent loans were convicted, although some of them were required to repay the bank.⁵⁴ On the one hand, the Kabul Bank scandal demonstrates that even in highly corrupt countries, such as Afghanistan, prosecutions can be launched if they are a central promise of the president's electoral campaign. On the other hand, it is telling that most of the well-connected individuals allegedly involved in the fraud were never prosecuted, including Mahmood Karzai and the current First Vice-President Abdul Rashid Dostum.⁵⁵

49. Aftab, 'Post 2014: The Regional Drug Economy and Its Implications for Pakistan', p. 15; US Department of State Bureau for International Narcotics and Law Enforcement Affairs, 'International Narcotics Control Strategy Report, Volume II', p. 138.

50. Authors' telephone interview with anti-corruption expert in Pakistan, 24 April 2017.

51. US Department of State Bureau for International Narcotics and Law Enforcement Affairs, 'International Narcotics Control Strategy Report, Volume II', p. 27.

52. *BBC News*, 'Kabul Bank Fraud: Ghani Reopens Afghan Corruption Case', 1 October 2014.

53. Grant McLeod, *Responding to Corruption and the Kabul Bank Collapse* (Washington, DC: United States Institute of Peace, December 2016), p. 2.

54. *Ibid.*, pp. 4–5.

55. *Ibid.*

IV. Methods of Moving and Hiding Money

THIS CHAPTER EXPLORES some of the methods that are used to move funds across borders, which are of particular relevance to the focus countries. It also touches on enabling factors in the political economy. As mentioned, political corruption is a facilitating factor in all the focus countries. However, there are also cultural attitudes towards corruption that in some ways contribute to the acceptance of corruption that assists IFFs.

Money Laundering

Money laundering is clearly a key activity for legitimising the funds involved in IFFs. FATF estimates the amount of money laundered annually through the smuggling of cash across international borders to be ‘between hundreds of billions and a trillion US dollars per year’.¹ Furthermore, global money-laundering transactions are estimated to be between 2 and 5% of global GDP, yet the percentage of global IFFs currently seized by authorities stands at 1%.²

There are efforts to tackle money laundering at an international and sub-regional level. FATF, Eurasian Group on Combating Money Laundering and Financing of Terrorism (EAG) and the Asia/Pacific Group on Money Laundering (APG) provide crucial guidance to the focus countries on how to structure and implement effective regimes to prevent illicit funds from being housed in and through banks and financial institutions in various Asian countries. Most of the focus countries do engage on this and have active Financial Intelligence Units. However, the focus of these guidelines tends to be national, and they do not necessarily examine the international and cross-border nature of IFFs. For example, the Financial Intelligence Service (FIS) in Bishkek noted that for their recently completed National Risk Assessment, they did not examine risks around IFFs leaving the country, but rather risks of money laundering and terrorist financing within Kyrgyzstan itself.³ As one representative said in the Bishkek workshop, ‘the flows going out are unknown – there need to be investigations like that of Global Witness on Bakiyev’.⁴

Therefore, there is a need to look beyond the national structures to understand how there might be links with other countries and financial systems. The EAG has examined typologies that usefully provide specific information about the key challenges facing participating member states

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1. FATF, ‘Money Laundering Through the Physical Transportation of Cash’, October 2015, p. 3.
 2. PWC, ‘Global Economic Crime Survey 2016: Adjusting the Lens on Economic Crime – Preparation Brings Opportunity Back into Focus’, 2016, p. 41.
 3. Authors’ interview at Bishkek workshop, 12 April 2017.
 4. Authors’ interview at Bishkek workshop, 11 April 2017.

regarding, for example, tax crimes and associated money laundering.⁵ It is notable that India and Kyrgyzstan did not take part in the research on tax crimes and associated money laundering, which is greatly needed. Research alone will not solve the issue of money laundering, but it will help to better understand IFFs and produce more comprehensive measures.

Details on these links may also overcome some of the hurdles associated with the anti-money-laundering regulatory bodies, such as FATF, the EAG and the APG. In the workshops, it was noted that there is a risk that the implementation of such recommendations can become ‘token’, in that they are legislated for so that countries are removed from blacklists with no intention of actually implementing or enforcing the legislation properly. This may be in a bid to unlock aid money or investment. Moreover, there is a perception, at least in the EAG, that cultural factors play a role. In the Bishkek workshop, for example, there were concerns that the EAG consists mainly of former Soviet countries, which may bring ‘cultural baggage’ to the way they evaluate countries. In particular, one NGO representative highlighted Russia’s influence in the organisation, stating they may ‘influence the interpretation’ that goes into mutual evaluations.⁶

In countries where not all citizens use the formal banking system, and where there are informal payment systems such as *hawala* and *hundi*, more contextual knowledge is required to ensure that the associated reforms with recommendations are not box-ticking exercises or a simple translation of unclear terminology from English to local languages. This is an area where more training could help. Kyrgyzstan’s FIS noted that they are now beginning to advocate a risk-based approach, a relatively new methodology culturally. Banks are not necessarily used to analysing their role in such a way, so more capacity-building in this area could be useful.

Even where legislative frameworks are proposed, political exposure in business and vested interests can have a negative impact. For example, Kyrgyzstan is currently reviewing its anti-money-laundering (AML) law. One expert from the Anti-Corruption Business Council said the issue with the AML law was that too few MPs were attending the parliamentary sessions when the topic is discussed. They mentioned ‘only six out of 120 showed up. The problem is that many MPs come from business, so they are less likely to accept such laws’.⁷ A conflict of interest law has also stalled. This is not necessarily an issue unique to the region, but it was believed to be a relevant factor for the corruption that facilitates IFFs. Even if such laws are passed, they will only be as good as their enforcement, and this is further limited if there is a lack of political will.

It appears that there has been a concentration within interventions on tackling corruption and encouraging transparency rather than examining the systematic frameworks, which allow IFFs to be laundered. Framing development interventions in addressing money laundering may add another avenue for engagement. One expert researching corruption on the border between Afghanistan and Tajikistan said that the Tajik authorities were not willing to talk about issues of corruption, even to reassure donors that they are implementing anti-corruption reform. This

5. EAG, ‘Tax Crimes and Money Laundering Typology Research’, November 2013.

6. Authors’ interview with an individual working on anti-corruption in Bishkek, 12 April 2017.

7. *Ibid.*

was echoed by one expert, who said that it felt futile to begin discussions with state authorities in Tajikistan framed around fighting corruption, given the local political sensitivities.⁸ Framing issues within the scope of furthering the financial and economic integration of Southeast Asia as part of ASEAN's Economic Community would be beneficial.

Tax Evasion and Mis-invoicing

Tax evasion and mis-invoicing are significant factors in the movement of IFFs in Asia, given that they consist of illegally hiding income from tax authorities and usually moving it abroad. This is complex, as the source of funds may be legal, but the schemes used to enable the transfer of money abroad to avoid taxation may be illegal. GFI has pointed to trade mis-invoicing as the 'primary measurable means for shifting funds in and out of developing countries illicitly', estimating that an average of 87% of illicit financial outflows were due to the fraudulent mis-invoicing of trade.⁹ The Asian Development Bank (ADB) has highlighted tax reform as a key issue that must be tackled to aid development in the region, with one of the main messages that 'transparency is crucial'.¹⁰ The ADB has recognised the importance of building regional information-sharing networks, and have created two regional groupings to tackle the problems – the Study Group on Tax Administration and Research, and the Pacific Islands Tax Administrators Association.

The weakness in the tax system in India is significant. Recent data collected on India's tax returns for 2015–2016 led the country's Union Finance Minister to conclude that over decades, tax evasion had 'become a way of life' and that India was 'largely a tax non-compliant society'.¹¹ A regularly cited example in the New Delhi workshop was the over-invoicing to move funds offshore and then recycling them back into India via attractive tax havens. In India, the government encourages exports by reimbursing or subsidising export duty costs. The perverse result of this scheme is that it encourages criminal actors to overstate the value of the goods they export – via over-invoicing for the export – thus increasing the duty payable on the export that is reimbursed by the state.¹² In India, exporters were given tax relief through duty drawbacks, cash assistance and income-tax exemption, which encouraged the practice of over-invoicing exports.¹³ This is exacerbated by weaknesses in the justice system, a trend across all focus countries.¹⁴ In particular, in India even simple court cases are reported to last for four to five

8. Authors' telephone interview with an individual working on border issues in Dushanbe, 2 May 2017.

9. GFI, 'Illicit Financial Flows to and from Developing Countries: 2005–2014'.

10. Yuji Miyaki, 'How Developing Asia Can Better Fight Tax Evasion', Asian Development Blog, 15 April 2016.

11. *Times of India*, "'Tax Evasion a Way of Life": Only 76 Lakh Indians Showed Income of over Rs 5 Lakh, Says Arun Jaitley', 1 February 2017.

12. Authors' interview at New Delhi workshop, 11 April 2017.

13. S Murlidharan, 'Black-Money Returning as Export Receipts', *The Hindu*, 24 October 2011.

14. David Lewis and Abul Hosain, *Understanding the Local Power Structure in Rural Bangladesh* (Stockholm: Swedish International Development Cooperation Agency, 2008), p.58; Felbab-Brown, 'Myanmar Maneuvers', p. 21; Felbab-Brown, 'Getting Smart and Scaling Up', pp. 64–66.

years, meaning that businesses have an incentive to abandon legal avenues in favour of informal understandings.¹⁵

Document fraud also facilitates tax fraud in India. Dummy invoicing appears to be a popular way to move money. It was also noted that India fails to share information with countries such as Mauritius. Although tax evasion is committed through round-tripping¹⁶ via countries such as Mauritius, the National Institute of Public Finance and Policy (NIPFP) estimated that the flow of money from illegal activity abroad ranged from less than 1% to 7% of India's GDP between 2000 and 2010.¹⁷ Instead, specific sectors are grossly under-reporting incomes, while others are being used as a way of concealing black money in the name of tax-exempted income in, for example, the agriculture sector.¹⁸

Over the past two years, the Indian government has actively sought to address the issue of tax evasion. In 2016, India amended its tax treaty with Mauritius in a bid to address tax loopholes and prevent round-tripping. The agreement will subject hedge funds and short-term portfolio investors to short-term capital gains tax at 15%.¹⁹ Moreover, on 8 June, India signed on to the OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (BEPS).²⁰ However, it was also noted at the New Delhi workshop that more than 40 committees have been created to tackle problems of IFFs and corruption, increasing the risk of duplication and confusion.²¹ The central government was also criticised in the New Delhi workshop for placing heavy emphasis on creating a 'perfect law', which is in turn used as a scapegoat for the failure to address ongoing problems in the country.²²

Trade with other countries, particularly China, can exacerbate the issue of mis-invoicing. For example, the Economist Intelligence Unit has said 'after an eightfold increase since 2002, about 40% of Bangladesh's \$40 billion in annual imports comes from China and Hong Kong, where underinvoicing is rife. Typically, a Chinese exporter invoices a Bangladeshi buyer for, say,

15. Authors' interview at New Delhi workshop, 11 April 2017.

16. Defined by the Hong Kong Monetary Authority as 'transactions where funds are reinvested into the original jurisdiction after being deposited in a foreign entity (often in a tax haven with no record keeping requirements', see Hong Kong Monetary Authority, 'Guidance Paper: Anti-Money Laundering Controls over Tax Evasion', March 2015, <<http://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2015/20150331e1a1.pdf>>, accessed 20 October 2017.

17. Vipul Vivek, 'Flow of Black Money Abroad Ranged from Less Than 1% to 7% of India's GDP Between 2000–2010', *Hindustan Times*, 19 May 2017.

18. Prabhaskar K Dutta, 'Why Decline in GDP Growth Rate is Good News for Indian Economy', *India Today*, 1 June 2017.

19. Amy Kazmin and Simon Mundy, 'India Closes Tax Loophole with Mauritius', *Financial Times*, 11 May 2016.

20. *Business Standard*, 'To Avoid Cross Border Evasion India Signs OECD Multilateral Convention', 8 June 2017.

21. Authors' interview at New Delhi workshop, 11 April 2017.

22. *Ibid.*

\$1, instead of \$10, evading Chinese foreign-exchange controls on most of the income; the importer pays \$1 through official channels, saving duties on \$9, which is transferred via *hundi*'.²³

Shadow Economy

Shadow economies are sources and outlets for illicit inflows in particular. GFI has noted that there is 'significant evidence' in their case studies that 'illicit financial flows both drive and are driven by the underground economy'.²⁴ Shadow economies are under-studied in most of the focus countries. The ability to do such research is particularly challenging not only because it is, by nature, an opaque subject, but also due to political sensitivities in some places, such as Tajikistan, due to political corruption and vested interests. It is important, however, to understand this in more detail to ascertain how the shadow economy facilitates IFFs.

Other countries, however, have expressed interest in understanding more about this issue. Representatives from the Ministry of Economy in Bishkek noted that the last time this was properly researched was by the World Bank in 2012. Since then, the Kyrgyz government has produced a 2015–2017 National Plan to tackle the shadow economy.²⁵ The main aim is to try to trace money and bring it into the formal banking system. This can be challenging, given that many in rural areas do not necessarily use banks. The plan has implemented steps to reduce administrative barriers and reduce tax to incentivise people to comply.²⁶

Another country with a significant shadow economy is India, where it is now as much as two-thirds of the overall economy (see Table 3). According to Arun Kumar, a participant at the New Delhi workshop, 90% of this illicit finance remains in India, with only 10% leaving the country (of which 30–40% is round-tripped and laundered back into India via places such as Mauritius).²⁷ It was noted that the bulk of the shadow economy is legal businesses, often taking advantage of legal ways to avoid tax, such as dividing business income among family members.²⁸

23. *The Economist*, 'Bangladesh Worries about Falling Remittances', 8 June 2017.

24. Dev Kar and Joseph Spanjers, 'Illicit Financial Flows from Developing Countries: 2003-2012', GFI, 16 December 2014, p. 20.

25. National Bank of Kyrgyzstan, 'Joint Statement of the Government of the Kyrgyz Republic and the National Bank of the Kyrgyz Republic on the Main Directions of Economic Policy for 2016' ['Sovmestnoye zayavleniye Pravitelstva Kyrgyzstana Respubliki i Natsionalnovo banka Kyrgyzskoy Respubliki ob osnovnikh napravleniyakh ekonomicheskoy politiki na 2016 god'], 24 March 2016, <<http://www.nbkr.kg/DOC/08042016/000000000041515.pdf>>, accessed 27 October 2017.

26. Authors' interview with an individual working in finance in Bishkek, 12 April 2017.

27. Authors' interview with Arun Kumar, New Delhi workshop, 11 April 2017.

28. *Ibid.*

Table 3: Estimated Size of Shadow Economies as % of GDP Focus Countries²⁹

Focus Country	Estimated Size of the Shadow Economy as % of GDP
Afghanistan	Estimates unavailable due to the lack of data.
Bangladesh	Approximately 40–60%. Various estimates include 37% in 2007, 34.9–35.5% in 2005, 39.5%–42.6% in 2013, and 67.3% in 2010.
India	Estimates range from 21% using the Multiple Indicator-Multiple Cause (MIMIC) model, which does not take into account criminal activities, to 62% according to Professor Arun Kumar using the ‘fiscal approach’ and taking into account criminal activities. According to a report by the National Sample Survey Organisation (an Indian government office) in 2011–12, ‘75% of the working population in rural areas and 69% in urban areas were employed in the informal sector’.
Kyrgyzstan	Most estimates range within 40–60%. These include 39% according to Minister of Economy Arzybek Kozhoshev in December 2016, ²⁰ 40–60% according to Prime Minister Djoomart Otorbaev in 2015, ²¹ and 44.9–46.5% in 2013 according to an academic study. However, the IMF estimated the Kyrgyz shadow economy at 25% in 2012.
Myanmar	Estimates range from 48.5% in 2005 according to Friedrich Schneider and Dominik Enste to 55.1% in 2013 according to the GFI.
Nepal	Estimates range from approximately 35% to 60%. Various academic studies produce estimates such as 36.1% in 2006, 49.4 in 2013, and 60.76% in 2011.
Pakistan	36%.
Tajikistan	Estimates range from approximately 30% to 60%. The IMF estimated the Tajik shadow economy at more than 30% in 2012. Tajikistan’s National Development Strategy, which cites this figure, also suggests that underpaid tax alone amounts to 17% of GDP. Academic estimates include 45.5% in 2007 and 60–63% in 2013.
OECD average	Estimates range from an average of 16.6% for 25 high-income OECD countries in 2007 to an average of 18.3% for all OECD countries in 2010.

Sources: Bertelsmann Stiftung, ‘Afghanistan Country Report 2016’, p. 14; Friedrich Schneider and Dominik Enste, *The Shadow Economy: An International Survey* (Cambridge: Cambridge University Press, 2013), pp. 39–44; Friedrich Schneider, Andreas Buehn and Claudio E Montenegro, ‘Shadow Economies All over the World: New Estimates for 162 Countries from 1999 to 2007’, *Policy Research Working Paper 5356*, World Bank; Mai

29. Note on methodology and definitions: The term ‘shadow economy’ normally denotes all economic output that is either illegal as such – for example, the production and distribution of drugs – or is produced covertly because of associated illegalities, such as tax evasion or breach of labour regulations. Unless specified otherwise, sources cited in the table rely on the Multiple Indicator-Multiple Cause (MIMIC) model that predicts the value of goods and services produced in secret, but does not necessarily reflect the size of the ‘criminal’ sector.

Hassan and Friedrich Schneider, 'Size and Development of the Shadow Economies of 157 Worldwide Countries: Updated and New Measures from 1999 to 2013', *Journal of Global Economics* (Vol. 4, No. 3, 2016), pp. 7, 10; Sheikh Touhidul Haque, 'Underground Economy of Bangladesh: An Econometric Analysis', *Research Study Series No. FDRS 01/2013*, June 2011; Hassan and Schneider, 'Size and Development of the Shadow Economies of 157 Worldwide Countries', pp. 6, 7, 8, 9, 10; Arun Kumar, 'The Scourge of the Black Economy in India: Origins, Causes and Remedies', *The Wire*, 5 May 2017; Bertelsmann Stiftung, 'BTI 2016: India Country Report', p. 16; Kaktus Media, 'The Shadow Economy in Kyrgyzstan is 39%', 29 December 2016, <http://zanoza.kg/doc/350086_glava_mnfina:_tenevaia_ekonomika_v_kyrgyzstane_sostavliaet_39.html>, accessed 27 October 2017; News Portal of Countries of Eurasia, 'The Scale of the Shadow Economy in Kyrgyzstan', 27 April 2017, <<http://eurasianews.info/ekonomika/masshtaby-tenevoj-ekonomiki-v-kyrgyzstane.html>>, accessed 27 October 2017; IMF, 'Regional Economic Outlook: Middle East and Central Asia', November 2012; Christine Clough, 'Nearly US\$100 Billion Flowed Illegally through Myanmar from 1960 to 2013, Finds New GFI Report', *GFI*, 9 September 2015; Nirmal Kumar Raut, Namuna Chalise and Puja Thapa, 'Measurement of the Underground Economy in Nepal: A Currency Demand Approach', *Economic Journal of Development Issues* (Vols 17 and 18, No. 1–2, 2014); *National Development Strategy for the Republic of Tajikistan Until 2030 (2016)*, <http://khovar.tj/wp-content/uploads/2017/01/NSR-2030_russkij.pdf>, accessed 27 October 2017; Friedrich Schneider and Andreas Buehn, 'Shadow Economies in Highly Developed OECD Countries: What Are the Driving Forces?' October 2012, p. 19

Perceptions of Corruption

In all the focus countries, public perceptions towards corruption more broadly reflect the difficulty in tackling IFFs and the occasional lack of space to discuss the enabling factors. An NGO expert in Pakistan agreed with this, saying that 'people generally see it as bad but feel nothing can be done, as it is endemic'.³⁰ Moreover, in countries such as Tajikistan, there is little to no space in civil society to debate this issue given tight political controls.

Bribes are not necessarily seen as a corrupt act. Paying a bribe is often the path of least resistance to getting things done. For example, when required to pay a fine for a traffic violation in Kyrgyzstan, it was noted in the Bishkek workshop that the official process is so complicated that it is much more convenient to pay a bribe and have the fine disappear.³¹ If things were simplified and, for example, processed quickly online, people would be more likely to pay the fine rather than a bribe. This was echoed by an expert in Tajikistan, who noted that the legal way to get things done on the border with Afghanistan is time consuming and expensive, and paying bribes speeds the process up, although only marginally.³² In India, red tape incentivises bribery, as do heavy penalties for non-compliance with a number of onerous regulations.³³ In Myanmar, petty corruption is almost culturally engrained in the daily lives of citizens.³⁴ Political

30. Authors' telephone interview with an anti-corruption expert in Pakistan, 24 April 2017.

31. Participant in Bishkek workshop, 12 April 2017.

32. Authors' telephone interview with an individual working on border issues in Dushanbe, 2 May 2017.

33. *The Economist*, 'Fighting Corruption in India'.

34. Khaing Sape Saw, 'Tackling Myanmar's Corruption Challenge', *Focus Asia: Institute for Security and Development Policy*, April 2015.

corruption spans across lobby groups to high-level officials to get sector interests and major projects off the ground.³⁵

In positions that facilitate IFFs, such as those working in the border force, bribery and corruption is a means by which employment is gained and kept. Certain positions, such as jobs with the border agency and customs authority, are viewed as lucrative 'because of the bribes that will be received'.³⁶ To secure such jobs, people not only have to pay for the position, but also need to curry favour and be recommended by someone with a position high up in the authorities. This puts the employee under pressure to recoup his or her investment or return the favour to the patron who facilitated the employment. It is often a way to supplement a salary on which it is not possible to survive. As one expert said, 'you cannot earn enough if you do not engage in corruption'.³⁷ This was echoed by an anti-corruption NGO in Bishkek, who said 'to have a position in the state, you need to invest in it'.³⁸ In both Tajikistan and Kyrgyzstan it was noted that the money required increases the higher up the political chain of command someone goes.³⁹

Such attitudes lead to an inherent mistrust in formal systems. At the Bishkek workshop, it was noted that many citizens avoid paying tax because they did not feel it financed things that were for their benefit, due to corruption. This has an impact on private sector investment. Investments in Kyrgyzstan and Tajikistan tend to be mobile, such as in livestock, rather than fixed, such as in manufacturing. As one representative from an international financial institution in Bishkek noted, 'people don't want to put a stake in the ground, as it can then be taken away'.⁴⁰ People in the retail industry, for example, will invest in multiple small shops rather than one large department store. In 2015, an NGO working in Tajikistan told this representative that there is little incentive in building and expanding private enterprise, 'when you know that if it is successful, it will just be taken away by the authorities'.⁴¹

35. *Ibid.*

36. *Ibid.*

37. Authors' telephone interview with an individual working on anti-corruption efforts in Tajikistan, 20 April 2017.

38. Authors' interview at Bishkek workshop, 11 April 2017.

39. *Ibid.*

40. Authors' interview with an individual from an international financial institution, Bishkek, 10 April 2017.

41. *Ibid.*

V. The Role of Financial Centres and Systems in Facilitating and Preventing IFFs

LARGE FINANCIAL CENTRES, such as Singapore, the UK, the UAE, some offshore jurisdictions, China and Hong Kong, as well as India to some extent, have been identified through research and the regional workshops as facilitators of international transfers and smuggling efforts. China has already been mentioned, given its role in the finance of Afghanistan's narcotics trade, as well as illicit cross-border commerce with Kyrgyzstan. The Tax Justice Network notes in its Financial Secrecy Index that Dubai has been implicated in a number of money-laundering schemes, including those run by the Indian underworld boss Dawood Ibrahim and the Pakistani engineer Abdul Qadeer Khan, who was involved in nuclear proliferation.¹ Of even greater relevance in the present context is the role of the UAE as the largest recipient of cross-border drug-related IFFs.² The UK plays a similar role, albeit to a lesser degree.³ These global financial centres must do more to address their role in the movement of illicit finance, given their reputation for either receiving and facilitating the transfer of funds or by allowing its businesses and real-estate markets to flourish through the investment of non-transparent wealth. Part of this will be to better understand how the IFFs are generated in the countries of origin.

Recent efforts have been made in the UK to enhance transparency and combat money laundering, including the introduction of the People With Significant Control register,⁴ which seeks to enhance transparency of beneficial ownership of UK companies, and Unexplained Wealth Orders, which can be used to investigate the source of wealth behind assets, as part of the Criminal Finances Act.⁵ However, London's reputation as a money-laundering capital is difficult to overcome as 'billions' are thought to continue to make their way through the country according to the National Crime Agency's assessment in 2015.⁶ An additional difficulty is when prosecution in the UK is based on the need to prove corruption that has been hidden, often by corrupt officials from the countries of origin using offshore entities. This was particularly

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1. Financial Secrecy Index, 'Narrative Report on United Arab Emirates (Dubai)', 2015, p. 4
 2. FATF, 'Financial Flows Linked to the Production and Trafficking of Afghan Opiates', p. 20.
 3. *Ibid.*, p. 21.
 4. UK Government Department for Business, Innovation & Skills, "'People with Significant Control' Companies House Register Goes Live', 30 June 2016.
 5. Florence Keen, 'Unexplained Wealth Orders: Lessons for the UK', *RUSI Occasional Papers*, (25 September 2017).
 6. HM Treasury and Home Office, *UK National Risk Assessment of Money Laundering and Terrorist Financing*, Pu1851 (London: The Stationery Office, 2015), para. 6.3.

challenging in the case of Maxim Bakiyev, the son of former Kyrgyz president Kurmanbek Bakiyev, who owns a £3.5-million mansion in the UK through an anonymous company, despite being accused of grand corruption at home.⁷ The UK government has since pledged to create a beneficial ownership register of properties owned by companies in the UK. However, without verification mechanisms, those who wish to hide beneficial ownership through proxies will continue to do so.

The UK was repeatedly raised in both workshops as having a government that turns a blind eye to the issue of money laundering. Whitehall needs to do more outreach through its development programmes on this issue to highlight the ways in which the UK is improving its own system and to enhance information-sharing where appropriate with the focus countries to ensure that this negative reputation is addressed. Additionally, the UK needs to do more operationally to understand how it is being used to launder money, genuinely plugging the ‘intelligence gaps’ identified in the 2015 *UK National Risk Assessment of Money Laundering and Terrorist Financing*.⁸

Integrity of Financial Institutions

Bringing people into the formal banking sector is a good way to tackle IFFs, as it allows for more monitoring of financial transactions and helps to diminish activity in the shadow economy. As already mentioned, however, this is a significant issue in the focus countries, in part due to a mistrust of the formal banking system because of perceived corruption. Greater independence between power structures and financial institutions is required to enhance public trust towards formal banking. There is also a lack of access to financial services. In 2014, only 23% of those aged fifteen and over in Myanmar had a bank account,⁹ and most adults receive their salaries in cash.¹⁰ By contrast, in the same year and accounting for the same age bracket, 31% of Bangladeshis,¹¹ 34% of Nepalese,¹² and 53% of Indians¹³ had bank accounts.

This has shaped some interventions. In 2016, the World Bank and the Myanmar government set up the Financial Sector Development Project to promote the development of the financial

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7. *Global Witness*, ‘Former Kyrgyz President’s Son Lives in £3.5m Surrey Mansion Despite Convictions for Attempted Murder of UK Citizen and Grand Corruption at Home’, 24 March 2015.
 8. HM Treasury and Home Office, *UK National Risk Assessment of Money Laundering and Terrorist Financing*.
 9. World Bank, ‘Financial Inclusion Data/Global Findex – Myanmar’, <<http://datatopics.worldbank.org/financialinclusion/country/Myanmar>>, accessed 12 October 2017.
 10. Alexandra Drees-Gross and Nagavalli Annamalai, ‘Building an Inclusive Financial Sector in Myanmar: The Road Ahead’, World Bank blog, 26 September 2016.
 11. World Bank, ‘Financial Inclusion Data/Global Findex – Bangladesh’, <<http://datatopics.worldbank.org/financialinclusion/country/Bangladesh>>, accessed 12 October 2017.
 12. World Bank, ‘Financial Inclusion Data/Global Findex – Nepal’, <<http://datatopics.worldbank.org/financialinclusion/country/Nepal>>, accessed 12 October 2017.
 13. World Bank, ‘Financial Inclusion Data/Global Findex – India’, <<http://datatopics.worldbank.org/financialinclusion/country/india>>, accessed 12 October 2017.

sector by increasing its provision of services.¹⁴ Its aim is also to incentivise people to move to the formal banking sector where possible. For example, in Bangladesh, more people are using *hundi* apps to transfer money from abroad, due to the fact that the government controls the exchange rate, making remitting money through banks unattractive. The authorities have identified fifteen illegal mobile apps, making it increasingly difficult to tackle this.¹⁵

Strengthening access to micro-finance would be beneficial, with some initiatives already undertaken. For example, the United Nations Development Program (UNDP) in Nepal launched an Enhancing Access to Financial Services project from 2008 to 2012 that sought to increase access in rural areas to an additional 333,000 people (mostly poor women), strengthen the micro-finance institutions, and bolster the policy environment to enable micro-finance in Nepal.¹⁶

Both workshops overall found that the lack of implementation of anti-money-laundering standards among financial institutions and other private businesses is a challenge. Despite being better regulated than some of its neighbours, such as Myanmar and Bangladesh, India's financial institutions often do not devote sufficient efforts and resources to AML compliance; many of them are understaffed and have not yet developed a culture of compliance with KYC (Know Your Customer) rules.¹⁷ There are reports of illicit funds being moved from India to neighbouring countries and then on to offshore financial centres.¹⁸ Furthermore, and across all case studies, the risk of banks being used to facilitate crime is increased exponentially if they are captured by criminal groups or subject to undue influence by political elites. The Bank of Baroda incident is a prime example: between 2014 and 2015, a group of employees in one branch of a state-owned Indian bank allegedly conspired with 59 account holders to make suspicious transfers to foreign destinations totalling \$922 million.¹⁹

Compared with other focus countries, Kyrgyzstan has a relatively 'liberal' financial system in that international transfers and currency operations can be made easily, probably reflective of the fact that more than 30% of Kyrgyzstan's GDP depends on remittances from abroad. This is also the result of improvements in corporate governance undertaken by the Kyrgyz government to meet international standards to operate and conduct transactions in US dollars. The regional attractiveness of this system is shown by the fact that residents of Uzbekistan, who are subject to strict currency controls, use Kyrgyz banks to make international transfers or convert currency

14. World Bank, 'Myanmar Expands Access to Financial Services with World Bank Support', press release, 20 December 2016.

15. *The Economist*, 'Bangladesh Worries about Falling Remittances'.

16. UNDP, 'UNDP Microfinance and Financial Services Projects', December 2014, <http://www.us.undp.org/content/dam/washington/docs/CountryPapers/NEW_Papers/Microfinance%20and%20Financial%20Services.pdf?download>, accessed 20 October 2017.

17. Authors' interview at New Delhi workshop, 11 April 2017.

18. *Ibid.*

19. Nyshka Chandran, 'How a \$1B Banking Swindle Took Place in India's Capital', *CNBC*, 21 October 2015.

and then smuggle the cash back home.²⁰ However, one Bishkek workshop participant noted that they believed this liberal system also makes it attractive as a 'hub' for money laundering.²¹

20. Authors' interview at Bishkek workshop, 11 April 2017.

21. *Ibid.*

VI. Assessment of Efforts by International Donors and Organisations

A SPECIFIC SUGGESTION RELEVANT to this research was that resources should be better focused on understanding IFFs both nationally and internationally regarding the focus countries. Field trips to each country would be a better way to understand how IFFs function. As already mentioned, the countries themselves do not necessarily view themselves as part of any defined 'region'. Focusing solely on regional trends and flows is less productive until a more detailed country-by-country evidence base is formed.

This was noted when discussing regional frameworks for information-sharing, with no one body dedicated to IFFs. In South and Southeast Asia, the World Bank and UNODC Stolen Asset Recovery Initiative (StAR) works with developing countries and financial centres to prevent the laundering of the proceeds of corruption.¹ This initiative was noted several times in interviews as the only initiative of its kind in South and Southeast Asia in the area of IFFs. Another organisation, the Asset Recovery Inter-Agency Network Asia Pacific, an informal network of experts and practitioners in the Asia-Pacific region, works in the field of asset-tracing, freezing and confiscation, in which India and Pakistan are involved. However, the network focuses only on specific corruption cases and the facilitation of the return of stolen assets, rather than IFFs. A framework such as the UNODC's Central Asia Regional Information and Coordination Centre offers the legal framework and mechanism for information-sharing on drug trafficking. Member states include Azerbaijan, Kazakhstan, Kyrgyzstan, Russia, Turkmenistan, Tajikistan and Uzbekistan. However, this is limited in scope. A dedicated analytical and information-sharing organisation for IFFs would be beneficial. It should include more actors at the official level, particularly as corruption and political will are hindrances in dealing effectively with IFFs.

An alternative could be to create a financial subcommittee in regional organisations, such as ASEAN, to address these issues. As of 2015, ASEAN finance ministers and central bank governors meet yearly to address opportunities and challenges in a bid to create regional integration as part of the ASEAN Economic Community.² The IMF, World Bank and ADB take part in these annual gatherings and could all play a role in addressing region-wide challenges to understanding IFFs through these current frameworks. Indeed, the IMF has begun to examine cross-border flows

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1. Stolen Asset Recovery Initiative, <<http://star.worldbank.org/star/>>, accessed 12 October 2017.
 2. Bank Negara Malaysia, 'Joint Statement of the 1st ASEAN Finance Ministers' and Central Bank Governors' Meeting (AFMGM)', 21 March 2015, <http://www.bnm.gov.my/documents/2015/20150321_Joint_Statement.pdf>, accessed 12 October 2017.

and financial integration in ASEAN.³ However, it was noted in the New Delhi workshop that SAARC (South Asian Association for Regional Cooperation) is not a realistic regional platform to engage with as tensions between India and Pakistan hamper any decision-making among the members. Instead, further research on interventions is required at the national level of each of the focus countries and the sub-regional level where a grouping of countries is politically viable and makes sense based on the relevant IFFs, such as the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation. According to a 2016 Economist Intelligence Unit report, which assessed and ranked the illicit trade environment in seventeen Asia-Pacific countries, developing countries Myanmar, Laos and Cambodia performed the worst in their efficiency in deterring and combating illicit trade.⁴ Due to the combination of insufficient political will in South Asia to function regionally through SAARC, and the illicit flows that run through Southeast Asia and link China and Central and South Asia, there is an argument for integrating ASEAN into a solution to tackle illicit flows in Asia. Indeed, this will be increasingly important given the rising illicit activity across Southeast Asia, with ASEAN struggling to address the challenges that come with regional trade integration. As the 'champion' of the economic community pillar of ASEAN, Singapore could be well placed to lead on this issue during its chairmanship of ASEAN in 2018.

Assessment

There were both negative and positive comments about how effective efforts by international donors and organisations have been in tackling IFFs. Overall, there was a general feeling that efforts were undermined by the fact that international donors at times seemed uncoordinated and even in competition. In a telephone interview, an expert working on development projects in Tajikistan, for example, criticised international donors for refusing to work together on border management, instead of each having their own programmes.⁵ However, it was noted that in some cases this was unavoidable. For example, the security situation in Afghanistan often physically prevented donors from coordinating, as they were confined to their own compounds.⁶

Despite this, there was a strong sense of duplication and fragmented approaches to tackling core issues facing the priority countries. One Bishkek workshop participant said, for example, that judicial reform was being worked on by numerous aid organisations and donors, such as the Swiss Agency for Development and Cooperation, USAID, the EU and the German Corporation for International Cooperation GmbH (GIZ). Another criticism was that donors tried to tackle too many issues at once. Focusing on one issue and putting more effort and resources into tackling it was a recommendation. For example, a financial investigator from the FIU in Afghanistan suggested that, instead of broad capacity-building, donors should concentrate on the specific vulnerabilities that are being exploited in IFFs by criminal groups or other stakeholders.⁷ This was often not helped by the frequent change of personnel in some donor positions. Programmes

3. Geert Almekinders et al., 'ASEAN Financial Integration', IMF Working Paper, WP/15/34, February 2015.

4. Economist Intelligence Unit, 'The Illicit Trade Environment Index', 2016.

5. Authors' telephone interview with a consultant working on Tajikistan and Afghanistan, 2 May 2017.

6. *Ibid.*

7. Authors' telephone interview with a financial investigator in Afghanistan, 15 May 2017.

with sustained engagement by a consistent group of experts or at least a project lead built the best trust and respect with local populations or stakeholders, as well as crucial local knowledge.

Relevant international donor initiatives in the area of IFFs have tended to focus on anti-corruption and transparency. Although these are welcomed in particular by civil society in the focus countries, there are still issues with the way that they are implemented. Part of this pertains to the lack of analysis applied to some of the information resulting from transparency initiatives. For example, in Kyrgyzstan, a system has been implemented whereby public officials declare their income, property and liabilities. Although most appear to comply, it was noted that this data is then not analysed, which would result in real accountability. One representative from an international financial institution said that, although there are declarations, ‘an oligarch will put his mother who is in her 90s as a shareholder of a Ukrainian company, claiming not to be involved in the business’.⁸ Although this initiative forms the evidence base for investigation, there appears to be no formal mechanism for questioning those public officials who may, for example, earn far more than their official salary. This is where civil society can play a strong role in using transparency measures, such as asset declarations or beneficial ownership registers, to hold public officials to account.

A suggestion made in the New Delhi workshop was linked to this in terms of the need to create a system for information-gathering and analysis. Participants noted that in complying with recommendations from international organisations, such as FATF, relevant Indian financial institutions were inundated with information and data that they were unable to process due to capacity limitations. Participants noted that it was ‘humanly impossible’ for banks to even run KYC checks due to the sheer amount of data they hold. Either legislation needs to be targeted to the countries’ capacity level, or more assistance should be provided in training and technology. An example of an area where this has worked is the Aadhaar biometric ID system to regulate government social services such as healthcare to citizens. Aadhaar, however, is also used in financial regulation to regulate four basic banking transactions: balance enquiry, cash withdrawal, cash deposit, and Aadhaar to Aadhaar Funds Transfer.⁹ In their efforts to address IFFs and regulate the financial systems in South and Southeast Asia, aid organisations could consider practical solutions that help build capacity to register citizens in a formal system, instead of only enforcing high-level legislation, which can at times overlook such basic issues.

It was noted that another area of focus for international donors is enacting legislation, which is the building block of the rule of law, transparency and anti-corruption. However, in both workshops there was a perception that foreign interventions focus too much on creating new legislation. This is undermined easily if enforcement is still weak or the interpretation of laws is manipulated for political gain. Although challenging to address, more thought needs to go into tackling these associated issues, or legislation risks legitimising political interests in some instances through a misinterpreted legal framework. It may not always be malicious, however,

8. Authors’ interview with an individual working at an international financial institution, Bishkek, 10 April 2017.

9. Pratik Bhakta, ‘How the Aadhaar-Based Payment Modes Work’, *Economic Times*, 29 March 2017.

and it was noted that part of the issue is that there needs to be training on *how* to interpret and read new legislation. This is something with which donors can assist in the form of legal training.¹⁰

To combat some of the issues around political will and corruption, some pointed to a degree of conditionality of assistance as a good way to improve implementation and avoid tokenism. For example, one expert who was researching corruption at the Tajikistan–Afghanistan border said that the Afghan authorities were very open about discussing improvements they claim to have made on improving governance, and it was suspected that this was mainly to secure more aid.¹¹ One respondent warned ‘any offer is accepted in Kyrgyzstan, because all [government] departments want a piece of the pie’.¹² Aid could therefore be used simply to enhance budgets of government departments. Numerous stories of aid money ending up in the pockets of corrupt officials in Afghanistan have made headlines in the Western press.¹³ A consultant examining corruption at the border between Afghanistan and Tajikistan reinforced this point, saying there is a risk that ‘governments are playing a bit of a game ... they want the same products from all donors and will therefore ask for more than they need. Donors need to make sure that the requested equipment is needed and not being misused’.¹⁴

A representative from an international financial institution in Bishkek noted that grants are a specific source of risk, with some organisations giving the ‘same grants over and over’, rather than focusing on the right type of assistance.¹⁵ To combat this, they suggested that international donors should stop giving grants altogether, as these do not necessarily incentivise development.

Another key specific area of concern linked to IFFs that could be tackled by international donors is the lack of transparency and corruption of government procurement contracts in all the focus countries. This is particularly relevant in light of China’s Belt and Road Initiative,¹⁶ which has already seen a huge surge in investment into the Central, South and Southeast Asian regions. These are often accompanied by non-transparent loan agreements or grants and there is a perception across Central Asia that Chinese contracts often involve bribery, particularly where there is political interest.¹⁷ There have been previous allegations that Chinese deals in countries

10. Authors’ interview with an individual working on anti-corruption, Bishkek, 10 April 2017.

11. Authors’ telephone interview with an individual working on anti-corruption in Tajikistan, 20 April 2017.

12. Authors’ interview at Bishkek workshop, 11 April 2017.

13. Jamil Danish, ‘Afghanistan’s Corruption Epidemic is Wasting Billions in Aid’, *The Guardian*, 3 November 2016.

14. Authors’ telephone interview with an individual working on anti-corruption in Tajikistan, 20 April 2017.

15. Authors’ interview with an individual working for an international financial institution, Bishkek, 10 April 2017.

16. State Council of the People’s Republic of China, ‘The Belt and Road Initiative’, 12 October 2017, <<http://english.gov.cn/beltAndRoad/>>, accessed 12 October 2017.

17. Raffaello Pantucci and Sarah Lain, *China’s Eurasian Pivot: The Silk Road Economic Belt*, RUSI Whitehall Paper 88 (London: Taylor and Francis, 2017).

such as Kazakhstan have included payments that personally enrich the political elite.¹⁸ In Myanmar, the lure of Chinese investment overrides that of the West, given the blind eye that is turned to issues of human rights in exchange for strategic economic and political support.¹⁹ Furthermore, whereas studies such as that by *Global Witness* on the military junta's monopoly of the jade industry was of concern to the West, the demand of jade in China and the ownership of industries matters little to Beijing.²⁰

Scepticism was also expressed in the Bishkek workshop about whether the level of technical expertise among some donor and international organisations was good enough and that projects were being recycled across countries and institutions. A perception was that Central Asia is not necessarily a priority area for donors, so 'good specialists don't come to Central Asia'. There was further criticism that it was treated like a box-ticking exercise and therefore not focused on results. One NGO specialist feared that the same data or project work is 'recycled' through the international organisation. They said they knew someone at the UNDP who had conducted analysis on corruption in the healthcare sector. This individual then worked at the ADB and subsequently OSCE, allegedly using the same report. Another spoke of the fact that a 'find-and-replace' function had clearly been used in a report, demonstrating the fact that it was not country specific. This could simply be a result of the lack of communication from such organisations, which has led to such negative perceptions. Improved engagement with local communities and actors would assist in combating this.

Even when all of the above challenges have been addressed, the necessity of long-term consistent engagement and trust building is key. A UNDP border management programme between Tajikistan and Afghanistan was praised as being effective, partly because of the long-standing participation of the project manager. In-depth and long-term engagement is crucial to building trust. The UNDP runs an annual programme of 'building bridges' that brings together middle- to high-ranking officials from the border agencies of Afghanistan and Tajikistan to discuss challenges.²¹ This was deemed a success, because the human relationships are important to facilitate cooperation. In the New Delhi workshop and related interviews, the issue of border management was key, but there were distinct challenges within and among countries in South Asia to creating more official borders and co-managing these. The UNDP in Afghanistan and Tajikistan could be replicated to do the same in South Asia.

18. Sarah Lain, 'China's Silk Road in Central Asia: Transformative or Exploitative?', *Financial Times*, 27 April 2016.

19. Matthew Pennington, 'Myanmar, Having Warmed to the West, Turns to China Again', *Associated Press*, 27 May 2017.

20. Pye, 'The Dark Shadow of Myanmar's Jade Trade'.

21. UNDP, 'Border Management in Northern Afghanistan II (BOMNAF II)', <http://www.tj.undp.org/content/tajikistan/en/home/operations/projects/democratic_governance/bomnaf.html>, accessed 20 October 2017.

Knock-On Effects

An additional complexity is that there is evidence that any attempts to curb illicit activities in economically deprived areas, including drug trafficking, can have negative unintended consequences. In some places, illicit trade contributes to the sustenance of the local population. According to one interviewee on Myanmar, a heavy-handed criminal justice response to illicit trade might harm only local communities, and curbing illicit trade will require cooperation between the government and non-state armed groups.²²

This tension between IFFs and the realities of economic development are also present in India. Two examples from the workshop in New Delhi were the smuggling of cattle from Bengal to Bangladesh and the drug trade on the India–Pakistan border in Punjab. In both cases, local authorities are reportedly wary of clamping down on the traffickers, due to the fear that doing so may jeopardise the local economy.²³ These comments echo the criticism that is often made of the US-led poppy eradication campaigns in Afghanistan, which wiped out the livelihoods of local farmers.²⁴ The issue is not limited to drugs. One interviewee from Afghanistan stated that, in such a precarious political and economic environment, attempting to take money from warlords and senior officials may undermine their loyalty to the central government if not attempted in a delicate way.²⁵

Understanding how illicit activities can be curbed without jeopardising the local population's livelihood is therefore of crucial importance. The UNODC is currently carrying out work on 'alternative development' (substituting drug production with other economic activities) in Afghanistan, Bolivia, Colombia, Lao People's Democratic Republic, Myanmar, and Peru.²⁶ Whenever politically feasible, similar initiatives may prove valuable in other countries, especially in border areas where illicit trafficking is known to take place. Moreover, the logic of 'alternative development' can be usefully extended to all illicit economies, not only the production and trafficking of drugs.

Another facet to the interaction of illicit activities and development is the need to ensure that well-meaning initiatives do not facilitate criminal activity. Taking another Afghanistan-related example, it has been suggested that building roads or improving irrigation in some areas can inadvertently make drug production and trafficking easier still.²⁷ This is not to say that such initiatives should not be attempted, but rather that their consequences should be considered.

22. Authors' telephone interview with Myanmar expert, 21 April 2017.

23. Authors' interview at New Delhi workshop, 11 April 2017.

24. Felbab-Brown, *Afghanistan Affections*, p.18.

25. Authors' telephone interview with expert on anti-corruption initiatives in Afghanistan, 25 May 2017.

26. UNODC, <<https://www.unodc.org/unodc/en/alternative-development/our-work.html>>, accessed 12 October 2017.

27. David Mansfield and Paul Fishstein, 'Eyes (Still) Wide Shut: Counternarcotics in Transition in Afghanistan', in Gutierrez, 'Drugs and Illicit Practices', p. 18.

Conclusion

IT IS CLEAR that IFFs in the Asian focus countries studied in this paper have a real impact on the economic development of these states. Numerous stakeholders are involved in generating these IFFs, including criminal groups, political players and private sector actors, as well as parts of the general population – often out of economic necessity rather than criminality. IFFs are clearly complex and interact with the political economy of the focus countries, making it difficult to determine effective interventions that avoid exacerbating economic problems or simply dispersing the illicit activity elsewhere.

Corruption is a key enabling feature at the heart of IFFs. It is difficult to combat corruption because there is significant abuse by those in power, as well as collusion with criminal elements. Blurred lines between public responsibilities and personal incentives facilitate the movement of money, and bribery incentivises those in a position of power to ‘turn a blind eye’ to money flows, if not fully collude. A large part of this relates to the inability of outside forces to mobilise the political will – either by carrot or stick – to sincerely address corruption or conflicts of interest. This is further complicated by certain decentralised political governance structures, as demonstrated in Afghanistan, that produce multiple power bases often with conflicting economic agendas. Corruption also weakens the effectiveness of governance initiatives in formal financial institutions, further pushing legitimate business into the shadow economy.

That is not to say that interventions against IFFs are fruitless; but it is clear that they are fragmented and tend to deal only with certain aspects of the problem, such as corruption. A more comprehensive understanding is required of each focus country’s role in IFFs, as well as the domestic and cross-border factors that enable them. This will not only help to further identify the facilitating factors but also allow the study of potential knock-on effects of certain interventions. Money laundering and the shadow economy should form key focuses to help shape interventions.

While the countries studied in the report are linked in many ways, inter-regional initiatives are not always successful, in part because many of the countries suffer from similar systemic problems that do not necessarily get addressed through such initiatives. Corruption in these countries also increases the risk of making regional or international initiatives to tackle IFFs merely a ‘box-ticking’ exercise. Most of those interviewed for this paper felt some form of conditionality for assistance – transparency or independently audited financial reporting – is a necessity.

Research for this paper has found that if aid organisations and international donors are to make a positive impact and address the root causes and symptoms of IFFs, there must also be better coordination between donors. The duplication of projects within countries is wasteful and corrupt actors can leverage this to their own advantage. Tackling fewer issues, but tackling them

more effectively, was also a recommendation from some international financial institutions in Central and South Asia.

Ultimately, long-term relationship-building and trust are key to successful interventions in this policy area. If donors are seen to be unengaged, short-term or, most importantly, uninformed about the local environment and people, they will be unlikely to have a long-term impact.

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