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Illicit Financial Flows and their Impact on Domestic Resource Mobilization in the Arab Region

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Received: 15 Jan 2021, Revised: 3 Feb 2021, Accepted: 27 Feb 2021, Online: 4 Mar 2021

Abstract

Illicit financial flows are one of the challenges facing economic development in developing countries. They prevent infrastructure development and economic growth by depriving the national economy of financial resources for investment in the public and private sectors. This is directly reflected in the increase in unemployment rates and the associated social and economic problems. In addition, the phenomenon of illicit financial flows contributes to the strengthening of criminal and terrorist activities. The paper discusses the general framework of illicit financial flows, the reasons for the spread of this phenomenon and its role in the decline in levels of economic development, especially in developing countries. The country of Iraq, Algeria and Egypt were selected as a sample to arrive at the results during the period (2010-2015), and the research found that the more illicit financial flows, the greater the negative impact on the economy, development indicators such as average per capita Gross Domestic Product (GDP), unemployment and the government's total debt index on Gross Domestic Product, as well as an index of government spending on health.

Keywords: Financial Flows, Gross domestic product, Development Goals, Indicators.

1. Introduction

The international community agrees that Illicit Financial Flows are a major problem facing the world economy for decades, this phenomenon has led to massive leakage of financial resources outside developing countries, which has weakened the capacity to mobilize domestic financial resources for economic development, Illegal financial flows are not limited to the illegal transfer of funds across borders,

but also to money laundering and tax evasion by national companies. Developing countries lost about 7.8 trillion dollar in illicit financial flows between 2004 - 2013, Official reports confirm that these losses are increasing at a rate of (6.5%) annually, almost twice the rate of global economic growth, For the Arab region, the impact of this phenomenon is compounded by political conflicts and civil wars, as well as the accumulated needs of financial resources

for reconstruction and the challenges of economic development. Stripping Arab governments of legitimate sources of funding from direct and indirect taxes and customs duties compounds the difficulties and obstacles that hinder the achievement of economic development goals.

The negative effects of illicit financial flows are difficult to quantify because of the nature and confidentiality of this type of activity, whether these flows are due to crimes (money laundering, stolen assets, criminal offenses), corruption (illegal capital smuggling, abuse of public office) or irregularities associated with foreign trade (external transfer, non-disclosure of real data for tariff purposes) All represent secret transactions that are difficult to quantify.

2. Research Methodology

A. Research Problem

Current literature indicates that illicit financial flows involve the following practices: money laundering and bribery by international companies, tax evasion, and commercial mispricing. Therefore, illicit financial flows deprive countries of the resources that can be used in financing basic public services such as security and justice, and basic social services such as health and education, and this leads to weak financial systems and the economic potential of countries. In addition, increasing illicit financial flows drains foreign financial reserves, increases inflation, reduces tax collection, eliminates investment, and reduces countries' ability to mobilize domestic resources and obtain foreign capital to finance economic growth and development.

B. Objectives of Research

The objectives of the study were the following points:

- 1- Study the impact of illicit financial flows on the GDP per capita dollar.
- 2- Study the impact of illegal financial flows on the Unemployment% rate.
- 3- Study the impact of illegal financial flows on the Total government public debt of GDP%.
- 4- Study the impact of the health spending rate of GDP%.

C. The Research Hypotheses

The main hypothesis of the study is that illicit financial flows affect the domestic resources in the sample countries. There are four specific sub-hypotheses that will be investigated.

- 1- Illicit financial flows correlated with GDP per capita dollar.
- 2- Illicit financial flows correlated with% Unemployment rate%.
- 3- Illicit financial flows correlated with Total government public debt of GDP%
- 4- Illicit financial flows correlated with Health spending rate of GDP%

D. Society and Sample

The sample was represented by selecting three Arab countries (Algeria, Iraq, and Egypt) from a total of 22 Arab countries. It was studied according to available data for the period 2010 to 2015, as these countries are characterized by the availability of natural resources that create a suitable environment for investment.

3. Theoretical Framework

A. Illicit Financial Flows

The term Illicit Financial Flows are a relatively new concept on which no consensus has been reached, it relates to issues relating to criminal methods and breaches of international laws on the one hand, and funding and leakage of financial resources on the other. In recent years the World Bank has defined illicit financial

flows as those illegally acquired funds that are used or transferred across borders. The sources of such funds vary between criminal activities, tax evasion, or any money obtained illegally, Such as illegal business practices and tariff manipulation. In another definition, Illicit Financial Flows can be defined as transactions that cause damage to the national economy, However, this definition is broad and indefinite because it encompasses many legal and illegal activities, such as tax avoidance (Tatiana , 2016) . In another definition, it is defined as funds transferred illegally, illegally acquired or used illegally to include all unregistered financial flows that result in the accumulation of foreign assets by residents due to violation of the laws in force in the countries (Hare , 2014) , this occurs primarily through the economic drivers of individuals and companies when the rate of return on investment is higher than the rate of return based on local risk (O'hare ,2014).

B. Most Important Channels Of The Flow Of Illicit Financial Flows

There are many tools through which money can be smuggled out of the country, it may be direct or indirect, as it may be between two or more countries. Illegal cash flow can be in the form of cash, goods, bribes or commissions for transactions that may be huge, or through the forgery of invoices, through mutual agreements between residents, from the importation of luxury and durable goods, or through practices that multinationals may undertake by pricing transfers or transferring profits between countries, Or through the banking sector. In general, there are three main channels through which illicit financial flows can be achieved:

1. Business activities

Illegal financial flows arise in business activities for several purposes, the most

important of these are concealing wealth, tax evasion and avoiding customs duties. The OECD classifies these activities as "erosion, of the tax base and the transfer, of profits"(Chowla & Tatiana,2016). Illegal financial flows under business include manipulating billing prices by lowering export prices and increasing import prices, as well as shadowing the prices of intangible services and the illegal export of currencies, Illicit financial flows range from something as simple as individual transfers of funds to private accounts abroad without taxes, or very complex schemes involving criminal networks that create multilayered structures and jurisdictions to conceal illicit ownership (Oecd , 2014).

2. Corruption and embezzlement

From the World Bank's point of view, it is an abuse of the job for private gain, this phenomenon occurs when an employee accepts or requests bribes to facilitate the execution of a contract or public tender, or when agents or brokers of companies offer bribes to take advantage of the procedures or overcome competitors or to make profits outside the framework of the laws imposed, or happens by exploiting public office without resorting to bribes by employing relatives to steal public money, In general, corruption and embezzlement weaken the state's ability to meet its financial obligations, and contribute to creating an environment conducive to the continuation of illicit financial flows abroad (Odida & Hon ,2019).

3. Criminal activities

These activities include fraud and fraud within the financial sector, such as money laundering operations, which have taken great interest by researchers in the present day, or Illegal issuance of loans or manipulation of financial statements within financial institutions, which hinders the work of financial analysts in the country, as well as trade in persons, human

organs, drugs, weapons and the like (Wekwete ,2014) .

C. The Economic Effects Of Illicit Financial Flows

Both developed and developing countries lose significant financial resources due to illicit financial flows , these flows deplete financial resources, tax revenues and foreign reserves, causing a host of problems and preventing economic development in these countries, especially developing countries. The Illicit Financial Flows distort the levels of private and public investment due to the flow of capital and transfer to other countries, making it unavailable for investment in the real economy (Ritter,2015) . Illegal money leads to crowding out other companies and Access to significant investment opportunities due to high returns resulting from illicit financial flows , Illegal financial flows also hinder governments from fulfilling their social, economic and cultural obligations, even to health, education, infrastructure, roads, bridges and other important services. This makes countries rely on borrowing from foreign countries, requesting foreign aid, entering into agreements with other parties and thus falling into the loan trap. The Ndikumana study (Ndikumana ,2014) showed that developing countries achieve economic growth of 3%, while the rate would increase to 3.9% if Illicit Financial Flows were stopped (Herkenrath ,2014). Despite the presence of Illicit Financial Flows in various economic sectors, but they are concentrated in the natural resources and extractive sector, and attributed to a combination of factors, the most important of which are the following (Kar & Spanjers ,2019), (Kar , et al. ,2015)

- These resources are usually owned by the public sector and therefore no individual or organization ensures that they are properly managed.

- Natural and strategic resources have a high capacity to generate huge financial flows and this makes them vulnerable to abuse by the weak in power and the issuance of licenses, privileges and rights in exchange for re-ceiving bribes from companies and large investors.

- Geographic locations where natural resources are located are often far from city centers, which makes them far from government surveillance.

- Lack of credibility among officials to report on the quality and quantity of natural resources produced and exported, allowing money to be smuggled out easily.

- The authorities in countries rich in natural resources finance their public expenditures from the natural resources available to them without relying on other funding sources such as taxes.

D. Domestic Resource Mobilization and Economic Development

Mobilizing domestic resources means working to develop resources and re-prioritize their employment in such a way as to ensure their future growth, as well as the elimination of squandering in the use of them, which will greatly promote the achievement of economic development and thus strengthen the economy of the State. Arthur Lewis was the first to point to the need to mobilize domestic resources for economic development through his famous article "Economic Development with Unlimited Supplies of Labor " In 1953, it won the Nobel Prize for Economics, best known as the "Dual Economy Model" and became the mainstay of several decades of research in economic development (Chiswick,2018) . The term economic development revolves around exploiting competitive advantages and comparing economic sectors and regions in terms of the final results achieved with the aim of increasing GDP, living standards, increasing employment

and reducing unemployment, as well as attracting domestic and foreign investments while retaining existing industries and expanding their work internationally (Wekwete,2014) .In 2003, the World Bank defined economic development as a process involving the public and private sectors collectively ,to create conditions for ,growth and employment generation, which positively impact the public life of the population and the economy. The concept of economic development has become a global concept used to address poverty and create employment opportunities for the population, both urban and rural (Meyer ,2014) .

E. Economic Development Goals

For more than half a century, developing countries have relied on economic development to achieve a range of objectives, the most important of which are:

1. Making fundamental changes in the economic structure.
2. Achieving justice in the distribution of income.
3. Improving the quality of goods and services.
4. Achieving the increase in the share of individuals, in the national income.
5. increase in the share of individuals of the national income real and not cash.
6. increase the share of individuals in an investment capacity.

Development goals are closely linked to their concept, so another goal is to preserve the environment and natural resources for the well-being of current generations and not to deplete them, as this would prejudice the rights of future generations.

F. Indicators For Measuring Economic De-velopment

The development includes four main dimensions. The first is the economic dimension which includes a set of indicators, the most important of which are (per capita to GDP), the ratio of gross investment to GDP, the ratio of external debt to GDP, ratio of official aid to credit ratio to GDP). The second is the social dimension, which also includes a set of indicators (public health index, education index, unemployment index, consumption index, public safety index, population growth index). The third dimension includes the most important environmental indicators (average per capita water resources index, average per capita total land index, environmental pollution ratio index, climate change index, desertification index), and finally the institutional dimension which includes the most important indicators (global partnership index, Policy coherence and effectiveness, Citizen Activity Index, Access to Information Index, R&D Expenditure Index).

4. Methodology

The main of this research was to explore the relation-ship between illicit financial flows and local resources in the Arab region, and to achieve this goal the study used a quantitative analytical approach to explore the relation-ship between research variables by analyzing data for a group of countries (Iraq, Algeria, Egypt) for the time period 2010 - 2015. According to official statistics, UNDP Human Development Reports and the World Integrity .

A. Result Analysis

Evolution Of Illegal Financial Flows And Their Re-lationship With Development For Some Arab Countries To The Period (2010-2015). Estimating the Illicit Financial Flows held by foreign countries

is not an easy process, because the nature of these activities is confidential and not explicitly disclosed, Therefore some international organizations, such as the Global Integrity Organization, have taken to estimate such flows because of their magnitude and what may harm the economies of the world, and Issuing special reports, On the basis of these reports, it was found that most Arab countries illegally smuggle funds abroad, due to the weakness in the control role of States on their trade operations or the presence of administrative corruption among officials or may be due to political or financial instability in them. Global Integrity statistics show that Arab countries illegally lost more than US 77 billion \$ to 2015, This is really a huge amount that could be used to cover expenses or invest in order to achieve an increase in economic growth rates, because

capital flight abroad is a missed opportunity that negatively affects economic development and not invested to create opportunities to achieve profits and thus alleviate poverty in some Arab countries.

B. Analysis of Data On Illicit Financial Flows For Some Arab Countries

From table (1) we note that the average flows of illicit funds out of the Arab countries selected for the period 2010-2015 is (21753) million US dollars, we note that Iraq is ranked first with an average of these flows (14838) million US dollars, while Egypt topped the second place With an average of (4802) million US dollars, followed by Algeria in the third place with an average of (2113) million US dollars.

Table 1. shows the illicit financial outflows of some Arab countries for the period 2010-2015 (million US dollars).

Country Years	Algeria	Iraq	Egypt
2010	1406.04	21115.33	2145.40
2011	187.18	14177.05	5245.94
2012	2586.17	14422.21	5007.37
2013	1043.13	15993.99	3618.81
2014	5706.00	13317.00	5962.00
2015	6971.00	10000.00	6833.00
Avg.S.US	2113	14838	4802

C. Analysis of Economic Development Data for Arab Countries

Through this paragraph, the researcher focused on four main indicators (per capita GDP, unemployment rate, total government public debt of GDP, health expenditure of GDP) because of its

important role in our daily life, These indicators were analyzed for some Arab countries represented by (Algeria, Iraq, Egypt) as in (table 2) (Arab Development Portal, 2014), (Arab Monetary Fund Reports, 2015), (Central Statistical Office Statistical, 2011), (Human Development Reports, 2015).

Table 2. Economic Development Indicators of Some Arab Countries for the Period (2010-2015)

Indicators Period	GDP per capita \$	Unemploy- ment %rate	Total government public debt of GDP %	Health spending rate of GDP %
2010	4480.79	10.00	10.49	3.6
2011	4524.35	10.00	9.26	3.7
2012	4586.65	11.00	9.33	4.4
2013	4620.13	9.80	7.6	4.3
2014	4698.66	10.60	7.67	4.7
2015	4776.79	11.20	8.75	4.9
Average	4614.56	10.43	8.85	4.27
Indicators Period	GDP per capita \$	Unemployment rate	Total government public debt of GDP%	Health spending rate of GDP %
2010	4657.28	12.00	53.53	2.4
2011	4848.44	11.00	40.72	2.1
2012	5322.39	11.00	34.78	1.0
2013	5508.04	12.00	31.99	1.1
2014	5344.33	12.70	32.86	1.0
2015	5298.1	13.20	56.88	0.7
Average	5163.10	11.98	41.79	1.38
Indicators Period	GDP per capita \$	Unemployment rate	Total government public debt of GDP%	Health spending rate of GDP %
2010	2644.82	9.00	69.59	1.4
2011	2635.19	12.00	72.83	1.5
2012	2634.85	12.70	73.8	1.4
2013	2632.06	12.70	84.02	1.4
2014	2648.29	13.40	85.13	1.5
2015	2703.74	12.80	88.46	1.6

We can see from the table (2) that the indicators vary among the selected countries, in Algeria, the average per capita GDP (4614.56) US dollars, Iraq (5163.10) US dollars, Egypt (2649.83) US dollars, which shows that Iraq has the highest GDP among countries over the period, resulting in an increase in per capita funds. As for the unemployment rate, it reached the highest rate in Egypt with an average of (12.1%), then Iraq with an average of (11.98%) and Algeria with an average of (10.43%). As for the total public debt index of the government of GDP, it was the highest rate in Egypt with an average (78.97%), Iraq ranked second with an average (41.79%) and Algeria (8.85%), This shows that the Egyptian government has focused on the public debt of GDP more than other countries. As for the rate of expenditure on health from the GDP, the average expenditure was weak for the countries of the study sample, the

rate was in Algeria (4.27%), Egypt (1.47%) and Iraq (1.38%).

D. Analysis of the relationship between illicit financial outflows and economic development of some Arab countries for the period (2015-2010)

In this section, we will examine, the extent to which the illicit, financial outflows of a group of Arab countries (Algeria, Iraq, and Egypt) are linked with the economic development indicators (GDP per capita, unemployment rate index, total debt index). Through the use of the statistical program SPSS.V25) to analyze the correlation between them using simple correlation (Person) and give a decision on the main hypotheses as follows:

1. The first main hypothesis:

H0: There is no statistically significant, correlation between the Illicit Financial

Flows out of Algeria with the indicators of economic development in Algeria.

H1: There is a significant correlation between the Illicit Financial Flows out of Algeria with the indicators of economic development in Algeria.

2. *The second main hypothesis:*

H0: There is no statistically significant, correlation between the Illicit Financial Flows coming out of Iraq with the indicators of economic development in Iraq.

H1: There is a significant statistical correlation between Illicit Financial Flows out of Iraq with the indicators of economic development in Iraq.

3. *The third main hypothesis:*

H0: There is a significant, correlation between the Illicit Financial Flows out of

Egypt with the indicators of economic development in Egypt.

H1: There is a significant statistical correlation between illicit financial outflows from Egypt with economic development indicators in Egypt.

Before testing the hypotheses, the researcher considered testing the data subject to the normal distribution (Normality test) because it is very important in determining the type of statistical test that will be used to test the hypotheses of the research, when the data subject to the normal distribution will use the methods of parameter testing (Parametric Test). In the case of abnormal distribution of normal distribution, non-Parametric Test methods will be used. The researchers used two types of tests: the first test (Kolmogorov-Smirnov), and the second test (Shapiro-Wilk), and the (table 3) shows, the results of those tests.

Table 3. Results of the test of the normal distribution of the study variables

		"Tests of Normality"					
		"Kolmogorov-Smirnov ^a "			"Shapiro-Wilk"		
		Statistic	df	Sig.	Statistic	df	Sig.
Illicit Financial Flows	Algeria \$.254	6	.200*	.820	6	.088
	GDP per capita \$.146	6	.200*	.974	6	.918
	Unemployment rate	.254	6	.200*	.900	6	.373
	Total government debt to GDP	.208	6	.200*	.966	6	.866
	General rate of expenditure on health to GDP	.194	6	.200*	.922	6	.522
Illicit Financial Flows	Iraq\$.212	6	.200*	.935	6	.621
	GDP per capita \$.153	6	.200*	.984	6	.970
	Unemployment rate	.314	6	.066	.748	6	.019
	Total government debt to GDP	.244	6	.200*	.909	6	.427
	General rate of expenditure on health to GDP	.269	6	.200*	.889	6	.313
Illicit Financial Flows	Egypt \$.215	6	.200*	.963	6	.839
	GDP per capita \$.299	6	.101	.860	6	.188
	Unemployment rate	.333	6	.036	.798	6	.056
	Total government debt to GDP	.253	6	.200*	.894	6	.342
	General rate of expenditure on health to GDP	.293	6	.117	.822	6	.091

*. "This is a lower bound of the true significance".

From (Table 3) shows that all test values were greater than (0.05), This means that the study data is subject to normal distribution and the parameter test

condition is met. Therefore, a simple correlation coefficient (Pearson) test will be conducted for the main hypotheses, as in the (table 4).

Table 4. Results of the correlations between the illicit financial outflows and the development indicators of the study sample

Algeria					
		GDP per capita \$	Unemployment rate	Total government debt to GDP	General rate of expenditure on health to GDP
Illicit Financial Flows Algeria	Pearson Correlation	-.889*	.817*	.830*	-.843*
US.\$	Sig. (2-tailed)	.018	.047	.041	.035
Iraq					
		GDP per capita \$	Unemployment rate	Total government debt to GDP	General rate of expenditure on health to GDP
Illicit Financial Flows Iraq	Pearson Correlation	-.866*	.817*	.893*	-.820*
US.\$	Sig. (2-tailed)	.026	.047	.016	.046
Egypt					
		GDP per capita \$	Unemployment rate	Total government debt to GDP	General rate of expenditure on health to GDP
Illicit Financial Flows Egypt	Pearson Correlation	-.843*	.859*	.813*	-.824*
US.\$	Sig. (2-tailed)	.035	.029	.049	.044

* "Correlation is significant at the 0.05 level" (2-tailed).

From the table (4) we note that all correlations between the variables of the research sample for the period (2010-2010) were strong and statistically significant at the level (0.05), and this indicates that the more illegal financial outflows will have an impact on economic development indicators, From the results, we note that there is a significant and inverse correlation with significant statistical significance between the illicit financial outflows and the GDP per capita index of the research sample, This indicates that the more illicit financial outflows the less per capita GDP. As for the unemployment index, the results, showed that there is a, positive and strong, correlation with the illicit financial outflows. This indicates that the more Illicit Financial Flows will increase the

unemployment rates in the sample countries. As regards the total government public debt index of GDP, there was also a positive correlation and statistically significant correlation with illegal flows. This indicates that the more illegal flows, the greater the total government public debt of GDP. As for the public health expenditure index, the results showed that there is a strong inverse correlation with the illicit financial outflows from the study sample. This indicates that the more illicit financial outflows the less the government spending on health than the GDP. Accordingly, the three alternative hypotheses, which provide a significant correlation between the illicit financial outflows and the economic development indicators of the sample countries, cannot be rejected.

5. Conclusions

The phenomenon of Illicit Financial Flows is one of the serious economic phenomena that threatens both developed and developing economies. Illicit Financial Flows have negative effects on economic development indicators, particularly in developing countries. Iraq ranked first among the selected countries in terms of the volume of illicit financial flows, with an average of (14838) million for the period 2010-2015, due to financial corruption and weak regulatory bodies, as well as political instability in the country. Egypt ranked second after Iraq in the average illicit financial outflows, averaging 4802 million \$ annually for the period 2010-2015. Algeria ranked third among the selected States for illicit financial flows, with an average of 2,113\$ million per year for the period 2010-2015. Although Iraq was at the forefront of the sample countries in illicit financial flows, it ranked first in the average per capita GDP and 5163\$ per year for the period 2010-2015, due to the presence of significant economic and natural resources in Iraq. Egypt, Iraq and Algeria recorded high unemployment rates of 12.1%, 11.98% and 10.43% respectively, which are high rates that directly affect economic and social stability. Iraq recorded the lowest level of health expenditure as a percentage of GDP with an average of 1.38 billion \$ for the period 2010-2015, then Egypt with an average of 1.47 billion, and Algeria with an average of 4.27 billion \$.

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