

## Locating tax risk - the way to tackle illicit financial...

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These are the slides for the talk I presented in Beirut this afternoon:

### **Locating tax risk - the way to tackle illicit financial flows**

#### 1 There are illicit financial flows

- \* This is a fact
- \* It's also true we will never stop them entirely
- \* This means everything we say today is about risk mitigation

#### 2 The questions we need to address

- \* What are the risks?
- \* How do they arise?
- \* What can actually be done about them?
- \* Why is it worth tackling them?
- \* Why is it worth expending political capital on this?
- \* What are the tools we need to use?

#### 3 What is tax for?

- \* It is assumed that pays for government expenditure.
- \* This is at best only partly true
- \* Government spending can also be funded by:
  - \* Borrowing
  - \* Aid

- \* Local currency creation
- \* So while may have an important role in the funding cycle of government that is not its only use

#### 4 Tax has other uses:

- \* Creating macroeconomic control of an economy
- \* This is through fiscal macroeconomic management
- \* Underpinning the value of the local currency by requiring its use to settle tax liabilities
- \* Income and wealth redistribution
- \* Repricing market failure
- \* Incentivising socially beneficial activities

#### 5 The Joy of Tax

- \* Put all these facts together and you have what I call ***The Joy of Tax***
- \* Tax is the single most powerful peaceful instrument a government has to shape the society that it controls
- \* The challenge of illicit financial flows is that they undermine any government's chance of achieving that goal
- \* The big challenge of illicit financial flows is not then the money alone - however important that is
- \* The big challenge of illicit financial flows is that they challenge the ability of the state to deliver a whole range of policy options that it wants to create on behalf of those who live in the jurisdiction for which a government is responsible

#### 6 How to tackle this?

- \* The choice to date has been to blame some now familiar villains
- \* Organised crime
- \* Those who are corrupt
- \* Multinational corporations
- \* Tax havens

- \* The response is
- \* Anti-money laundering measures
- \* OECD BEPS
- \* Country-by-country reporting
- \* Calls for unitary taxation

- \* Trust me, I buy them all
- \* But the time has come to go further

## 7 We need new tools to identify and tackle tax abuse

- \* There are two key new tools:

### **1. *Measuring tax gaps***

### **2. *Undertake tax spillover assessments***

- \* These require political will
- \* And they require funding - if necessary from the IOs to help achieve this — which is something I am explicitly calling for

## 8 The tax gap (1)

- \* The tax gap is a measure of the tax that could be but is not collected by a government
- \* All countries have a theoretical tax yield they could collect based on current GDP and law
- \* They don't get it because of the tax gap, which comes in five parts

### 1 The cost of tax bases not taxed, such as wealth (A)

### 2 The cost of tax allowances and reliefs a government grants (B)

- \* Take these two off the theoretical tax base calculated on GDP and you get the technical tax yield. Then deduct

### 3 Tax evasion (C)

#### 4 Tax avoidance (D)

#### 5 Tax bad debt (E)

- \* And you get to tax actually paid

#### 9 The tax gap (2)

- \* The tax policy gap is
- \* Tax bases not taxed + tax reliefs given away
- \*  $= A + B$
- \* The tax compliance gap is
- \* Tax evasion + tax avoidance + tax evasion
- \*  $= C + D + E$
- \* The total tax gap is:
- \* Theoretical tax base based on GDP
- \* Take away  $A + B + C + D + E$
- \*  $=$  Tax actually paid
- \* Every government had to know these figures, I suggest, or they're not in control of their economy

#### 10 Tax spillovers

- \* Tax spillovers assess the likelihood that one part of a tax system causes harm to another part of a tax system, either domestically or internationally
- \* Tax spillovers happen domestically and internationally
- \* They involve all taxes, but especially direct ones
- \* And they involve the administration of tax as well as the taxes themselves
- \* The IMF has tried to appraise them quantitatively but this has proved to be very hard
- \* Professor Andrew Baker of Sheffield University and I now propose a qualitative measure

#### 11 Qualitative tax spillovers - the assessment grid

## **12 Qualitative tax spillovers - the process**

- \* Four domestic taxes and four tax admin systems are marked for the risk that they create domestically first and internationally second**
- \* Then the domestic tax system is appraised for the risks imposed on it from elsewhere**
- \* The higher the score the bigger the risk**
- \* The colour coding simply helps identify the big risks — they are in red**
- \* The process is designed to identify the biggest targets for reform**

## **13 Qualitative tax spillovers —our suggestion**

- \* It's our suggestion every country could and should do a qualitative tax spillover assessment**
- \* Then they will know what reform is really needed**
- \* And how effective it might really be**
- \* This is the way for all countries — and not just OECD ones — to reclaim the agenda on this issue**
- \* We think it's time to use a systematic tool for each country to create its own demands for reform**