ILLICIT FINANCIAL FLOWS AND ASSET RECOVERY
In The Republic of Azerbaijan

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Foreword

Illicit Financial Flows (IFFs) impact a country's economic and social development in a myriad of ways. Undocumented flights of wealth to and from - as well as within - a country have severe repercussions on government revenues, wealth that could otherwise be invested in public spending and other forms of economic and social reforms. Illicit financial flows, particularly those related to organised crime, also withdraw funds from the legitimate economy and may force the State to divert more resources to prevent and respond to criminal activity or to treat or compensate victims. The drain on resources and tax revenues caused by IFFs blocks the expansion of basic social services and infrastructure programs that are targeted at improving the wellbeing and capacities of all citizens, in particular, the very poor.

IFFs in many developing countries mean fewer hospitals, schools, police, roads and job opportunities, as well as lower pensions. It is for these reasons that States must place significantly higher priority on seizing and confiscating illicitly-obtained assets, and to channel such recovered assets to high-priority development needs.

New paradigms and policies to counter IFFs must be established to produce an unbroken chain of work from tracing, freezing, seizure, confiscation and recovery of illicitly-obtained assets, through transparent management and liquidation of such assets, to distribution of the proceeds to high-priority development needs. It is this mechanism and paradigm that will enable countries to capture billions in assets and to directly channel them into, for example, more schools, hospitals, community clinics and infrastructure, as well as the much-needed payment of salaries for teachers, nurses and doctors. Such policies also can enable States to significantly reduce youth unemployment. All of these are key factors to a country's development.

In light of the above, the European Union and the United Nations Interregional Crime and Justice Research Institute (UNICRI) are proud to launch a series of studies on Illicit Financial Flows and Asset Recovery. These studies shed light on the significant damage being caused to States as a result of unchecked IFFs, and on the significant value of prioritising the capture of illicitly-obtained assets linked to such IFFs. The EU and UNICRI are committed to providing key support and expertise needed by States to more effectively respond to IFFs. In creating and implementing more effective responses, many of which are identified in the recommendations of these reports, States will be able to weaken the influence of organised crime, as well as inject significantly greater funding into high-priority development needs.

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RESEARCH PAPER

ILLICIT FINANCIAL FLOWS AND ASSET RECOVERY

In the Republic of Azerbaijan

Executive Summary:

Organised crime produces significant amounts of illicit revenue and proceeds globally. Azerbaijan's strategic position at the crossroads of trans-regional and trans-continental trade is particularly attractive to organised criminal groups motivated to carry out smuggling operations and other illicit activity. Azerbaijan's crime areas of priority concern include drug trafficking, human trafficking and migrant smuggling, and the smuggling of counterfeit goods. In general, the major source of criminal proceeds in Azerbaijan continues to be public corruption across multiple sectors and agencies within the government.

Combating organised crime and Illicit Financial Flows (IFFs), and recovering illicitly-obtained assets, requires multiple policy areas and transnational cooperation. Azerbaijan has invested substantially in measures to combat the nexus of corruption, organised crime and IFFs. Progress has been made in meeting anti-money laundering global standards to ensure adequate safeguards in commercial banks, and to inhibit the proceeds of illicit activities from flowing through the financial sector. Azerbaijan is now considered to be fully in line with the key UN conventions, the Financial Action Task Force (FATF) 40 recommendations, and significant relevant EU directives. However, there are still significant opportunities to strengthen and streamline capacity (and results) in the seizure and confiscation of assets linked to illicit activities. Channelling such recovered assets to high-priority development needs would benefit the fulfilment of Azerbaijan's economic development plan aiming to improve the well-being of the country's population.

Key Findings:

- If Azerbaijan were to prioritise the seizure and confiscation of only 10% of the IFFs estimated to be circulating within the country, this could enable the country to cover the annual salary costs of over 10,000 nurses. As well, such recovered assets could be used to cover the cost to build more than 40 120-bed hospitals (with standard medical equipment) throughout the country, at an average cost of USD 700 per square meter – each 120-bed hospital costing an average of USD 20 million.
- Similarly, if Azerbaijan were to prioritise the seizure and confiscation of only 10% of the IFFs estimated to be circulating within the country, this could enable the country to cover the annual salary costs of over 10,000 teachers for a period of five years, at a monthly average salary of AZN 2,460 (or approximately USD 1,448).
- The Government of Azerbaijan may wish to consider further strengthening of the Department for Coordination of Special Confiscation Issues (within the General Prosecutor's Office) with support from international experts, to help ensure that this unit houses under one roof, officials with access to databases of, for example, the taxing authority, vehicle registry authority, land registry authority, business records authority, criminal records authority and related entities; as this would allow for the production of single, consolidated reports on the assets held by those suspected of serious criminal activity, as well as assets in the possession of their family members and/or possible associates.
- Consideration should also be given to coupling the above-mentioned unit with an Asset Management Office, for the transparent management of seized and confiscated assets, as well as the public liquidation and distribution of confiscated assets, ideally to high-priority development needs.
- Given that money laundering cases often take years to adjudicate, and thus to produce a final order for confiscation of assets linked to organised criminal activity and corruption, and given that this produces an inherent, and often justified, perception by the public that the criminal justice system is too slow in the recovery of assets, strong consideration should be given to the establishment and/or strengthening of non-penal mechanisms for the seizure and confiscation of assets – once such mechanisms are in place, and are being implemented (still, with due process for any individual seeking to claim title over such assets), this can reduce the time to confiscate assets from a period of years to a period of several months.

Acronyms and Abbreviations

ACD	Anti-Corruption Department with the Prosecutor General of the Republic of Azerbaijan
AML/CFT/CFP	Anti-Money Laundering/Countering Financing of Terrorism/Combating the financing of proliferation
AROs	Asset Recovery Offices
AZN	Manat (Azerbaijan's currency)
CARIN	Camden Asset Recovery Inter-Agency Network
CBRN	Chemical, Biological, Radiological and Nuclear
CHFIU CIS	Council of Heads of Financial Intelligence Units of the Commonwealth of Independent States
CIS	Commonwealth of Independent States
CoE	Council of Europe
CPT	Council of Europe's Committee for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment
CPS	Country Partnership Strategy
DFM	Department of Financial Monitoring
EaP	The Eastern Partnership
EU	European Union
EUR	European Union Euro
Eurojust	The European Union Agency for Criminal Justice Cooperation
Europol	The European Union Agency for Law Enforcement Cooperation
FATF	Financial Action Task Force
FMS	Financial Monitoring Service
GDP	Gross Domestic Product
GFI	Global Financial Integrity
HDI	Human Development Index
IBA	Bank of Azerbaijan
IFFs	Illicit Financial Flows
ICT	Information and Communication Technology
Interpol	International Criminal Police Organization
Moneyval	The Council of Europe's Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism
NRA	National Risk Assessment
OECD	Organisation of Economic Cooperation and Development
OGP	Office of the General Prosecutor
OSCE	Organisation for Security and Cooperation in Europe
SDGs	Sustainable Development Goal
UN	United Nations

UNCAC	United Nations Convention Against Corruption
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNECA	United Nations Economic Commission for Africa
UNICEF	United Nations Children's Fund
UNICRI	United Nations Interregional Crime and Justice Research Institute
UNTOC	United Nations Convention Against Transnational Organised Crime
USD	United States Dollar
USSR	Union of Soviet Socialist Republics
WHO	World Health Organization

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1. Overview of Illicit Financial Flows and the Recovery of Illicitly-Obtained Assets

1.1 Introduction

This study examines illicit financial flows (IFFs) generated from organised criminal activity in Azerbaijan. It provides an overview of organised crime and assets linked to organised crime in the country and outlines the legislative and operational frameworks in place to combat IFFs and to recover illicitly-obtained assets. Effective asset recovery policy is a fundamental component of combating IFFs and mitigating the harm produced by IFFs.

This study's main objective is to provide targeted recommendations to national authorities, as well as other key stakeholders, in order to create and strengthen mechanisms for the effective and efficient seizure and confiscation of assets linked to organised crime (and, where appropriate, high-level corruption). The study also provides recommendations to strengthen the effective and transparent management of any recovered assets, including recommendations with respect to directing such assets to high-priority development needs. High-priority needs in Azerbaijan include the employment, health, and infrastructure sectors.

The data collection for this study was undertaken from May through October of 2020 through open-source desk research, as well as feedback from public officials, members of civil society and other key stakeholders.

Definition of Illicit Financial Flows

There is no consensus regarding the definition of IFFs, as it covers a diverse set of activities and behaviours, reflecting the complex and multifaceted nature of illicit international trade and finance.[1] The absence of a comprehensible and universally adopted definition explains the difficulty in analysing it and, therefore, producing targeted responses. The United Nations Economic Commission for Africa (UNECA) stated that this lack of terminological clarity limits the emergence of effective policy measures.[2] Another reason for this struggle concerns the statistical feasibility of quantifying IFFs, which is extremely challenging. This is because IFFs, and related crimes, are purposefully hidden or disguised by criminals who are seeking to protect themselves from the interventions of law enforcement agencies. Consequently, attempting to gather reliable information to model criminal actions and the requisite data through which to produce accurate responses is also challenging.[3]

Notwithstanding these limitations, for purposes of this study and to assist States in developing holistic and useful responses to the threat, IFFs are defined broadly as the revenue, proceeds and any other assets generated by the following activities:

- Corruption, including the proceeds of theft, bribery, graft and embezzlement of national wealth by government officials;
- Illicit Commerce, including the proceeds of tax evasion, misrepresentation, misreporting and mis-invoicing related to trade activities, and money laundering through commercial transactions; and
- Other Serious Crime, including the proceeds of criminal activities, including human and drug trafficking, smuggling, counterfeiting, racketeering (also known as criminal protection or extortion) and terrorist financing.[4]

This classification, which is a slight alteration from that used by UNECA in 2013, highlights not only the diverse and evolving nature of illicit financial flows but also the need for multifaceted (holistic) responses that tackle the threat from various angles – e.g., not just a criminal justice response.[5] The classification also disregards the characterisation that IFFs should only be international in nature – significant losses and harms can occur to national economies, healthcare and education systems, and employment opportunities, even if IFFs occur within a specific country. The dynamic of the forms of IFFs differs from country to country, depending on the illicit flows transiting into, through and out of the country. Still, higher-value illicit flows, such as the trade of narcotics, tend to correlate with higher levels of other criminality, such as corruption.[6]

This study concentrates on the revenue, proceeds and other assets generated from organised criminal activities in Azerbaijan. Due to the interdependent nature of IFFs, this study also examines assets generated from corruption and commerce to provide a useful framework on IFFs in Azerbaijan. Money laundering is a crucial tool used by organised criminal groups to move illicitly-obtained revenue and to fund criminal activity. There is also a strong link between corruption and organised crime as both are propelled by the same limitations of governance and the law.

Recovery of Illicitly-Obtained Assets

The recovery of illicitly-obtained assets is essential to combating organised crime and IFFs as it deprives criminals of their financial gains and can act as a deterrence against future crimes (by removing the financial motivation of crimes). The recovery of illicitly-obtained assets can also help mitigate the harmful impact of IFFs through the liquidation and reinvestment of those assets into public welfare and high-priority development needs. For the purposes of this study, the asset recovery process includes the tracing, freezing, seizure, confiscation, and management of illicitly-obtained assets.

Worldwide progress in the recovery of illicitly-obtained assets has been, at best, modest. In 2012, the OECD launched a survey measuring assets frozen and returned between 2010 and June 2012. In this time period, a total of approximately USD 1.4 billion of corruption-related assets had been frozen. In terms of returned assets, a total of USD 147 million were returned to a foreign jurisdiction in the 2010-June 2012 period. These figures pale in comparison to the widely quoted estimate that the aggregate size of money laundering in the world could be somewhere between two and five per cent of the world's GDP. In 2009 alone, criminal proceeds were estimated to be at 3.6% of global GDP, with 2.7% (or USD 1.6 trillion) being laundered.[7] For scale, this latter figure represents the combined 2019 GDP of Spain, Australia, Mexico and Colombia.

European Union (EU) progress in the recovery of illicitly-obtained assets has also been modest. Europol estimates organised criminal groups have a profit of EUR 110 billion annually in the EU.[8] Corruption is estimated to cost the EU economy some EUR 120 billion per year.[9] Europol estimates that about EUR 1.2 billion is confiscated each year in the EU, which represents 0.009% of EU GDP. For a country with a GDP of EUR 200 billion (e.g., Finland in 2014), this amounts to about EUR 17.7 million; for a country with a GDP of EUR one trillion (e.g., Spain in 2014), the figure is about EUR 88.7 million; for a country with a GDP of about EUR 2.2 trillion (e.g., France in 2014), it is about EUR 195.2 million.

The most widely accepted estimate of global bribery puts the total at around USD 1.5 to 2 trillion each year.[10]

Corruption, bribery, theft and tax evasion, and other illicit financial flows cost developing countries USD 1.26 trillion per year. That is roughly the combined size of the economies of Switzerland, South Africa and Belgium, and enough money to lift the 1.4 billion people who get by on less than USD 1.25 a day above the poverty threshold and keep them there for at least six years.[11]

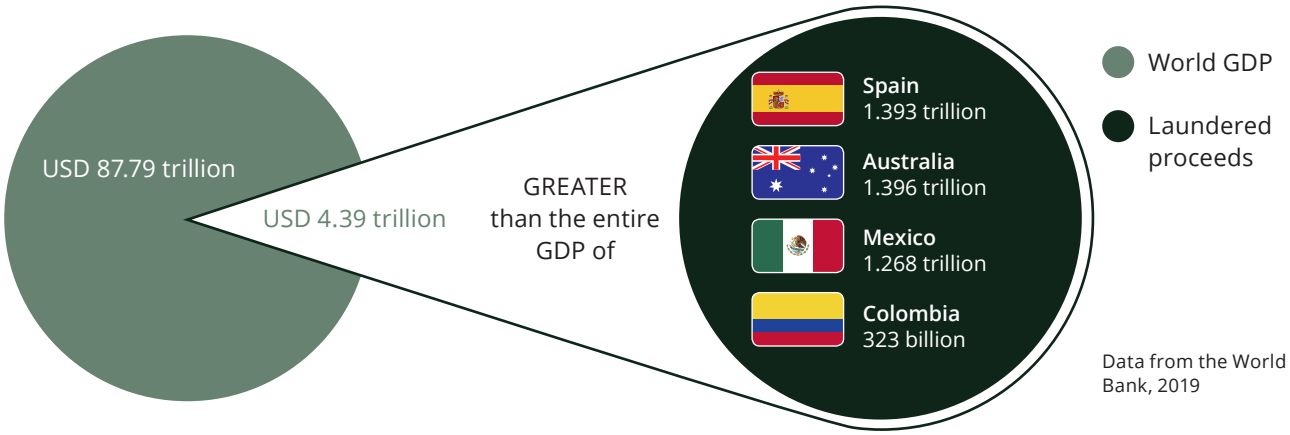
A USD 1 million bribe can quickly amount to a USD 100 million loss to a poor country through derailed projects and inappropriate investment decisions which undermine development.[12]

Notwithstanding the above, such estimates should be treated with caution. They are intended to give an idea of the magnitude of money laundering, which represents only a portion of IFFs. Due to the illegal nature of the transactions, precise statistics are not, nor likely ever will be, available and it is therefore impossible to produce a definitive estimate of the amount of money that is globally laundered every year. The Financial Action Task Force (FATF) therefore does not publish any figures in this regard. Still, there is near universal consensus that money laundering and IFFs worldwide undermine most economies as well as development

Just as IFFs weaken development, the recovery of assets linked to IFFs can enhance development. The recovery of only a small portion of illicitly-obtained assets linked to serious criminal activity – both from abroad and from within a country – can provide developing countries with much-needed additional resources. In this context, prioritising the tracing, seizure, confiscation and recovery of illicitly-obtained assets can, aside from providing a useful deterrent to criminality, fund high-priority development needs, such as those in the health, education or infrastructure sectors.

Many obstacles, particularly in cross-border cooperation to recover assets, have allowed criminal organisations and corrupt officials to take advantage of such weaknesses. Proving that assets are linked to criminal conduct can be a complex and lengthy process, ultimately producing a lack

Estimated annual amount of global laundered proceeds is greater than the entire GDP (2019) of the following countries combined



of public confidence in state institutions. Nevertheless, countries that have had the most success in the tracing, freezing, seizure and confiscation of illicitly-obtained assets (whether located abroad or within that particular country) are those that have adopted mechanisms that can accelerate criminal justice processes for confiscation,[13] as well as mechanisms for non-conviction-based forfeiture of assets.[14]

An increasing number of jurisdictions have adopted mechanisms for initiating proceedings for unexplained wealth or illicit enrichment.[15] Many countries now recognise the value of establishing dedicated Asset Recovery Offices (AROs), essentially offices that house officials with access to multiple databases (e.g., vehicle registry, business registry, tax information, customs database, criminal records). Such AROs, once in place, can take a cross-institutional view of one's assets, as well as the assets held by family members or associates of those suspected of being involved in serious criminal activity – more often than not, when one launders illicitly-obtained assets, he or she does not place them in his or her own name.

Additionally, the establishment and training of specialised forensic financial analysts, who support the role of prosecutors in proving financial crimes, have proven to be beneficial in both criminal proceedings as well as in civil confiscation proceedings. States that have developed strong inter-institutional cooperation mechanisms also have shown greater success in the recovery of illicitly-obtained assets.[16]

Mechanisms for Accelerated Conviction and Non-Conviction-Based Forfeiture

- Plea bargaining, reconciliation or other expedited settlement of criminal proceedings requiring the defendant to return illicitly-obtained assets in exchange for a reduced sentence (or information regarding assets illicitly-obtained by others);
- Mechanisms that allow courts to impose orders for extended confiscation
  Example: *issuing an order stating that all assets acquired, say, over the past five years by a defendant convicted of a serious crime, are presumed to have been illicitly-acquired, unless the defendant can rebut this presumption;*
- Orders for the confiscation of legally-acquired assets of the defendant, where the State demonstrates that it has taken every reasonable measure to locate the illicitly-acquired assets, but has been unable to do so.

Additional valuable mechanisms may include a separate civil confiscation proceeding against assets that are considered to be illegally-acquired – such proceedings still place the initial burden on the State to prove that certain assets are the product of illicit activities, albeit at a lower burden of proof; civil confiscation proceedings, while they do not adjudicate the criminal culpability of any particular individual, or allow the judge to deprive anyone of their liberty, have the advantage of being able to be adjudicated over a span of months, and to recover assets more quickly, in stark contrast to, say, a criminal money laundering case, which typically takes several years. The initiation and adjudication of a civil confiscation case (against illicitly-acquired assets) does not necessarily preclude the initiation and adjudication of a parallel criminal case (against an individual).

1.2 International Regulations and Recommendations

A broad set of international conventions, standards, and bodies have been developed in order to combat IFFs. These include UN conventions which establish standards that all countries are expected to meet in order to avoid providing a safe haven for various kinds of IFFs. They also include treaties or organisations with narrower membership, but which set out more detailed measures to be applied by their member countries; a number of these treaties allow for useful peer reviews to ensure adequate compliance.

In 2015, the General Assembly of the UN adopted the Addis Ababa Action Agenda which invites "appropriate international institutions and regional organisations to publish estimates of the volume and composition of illicit financial flows".[17] Similarly, the 2030 Agenda for Sustainable Development and the Sustainable Development Goals (SDG) call on countries to:

- significantly reduce illicit financial and arms flows by 2030;
- substantially reduce corruption and bribery in all their forms;
- develop effective, accountable and transparent institutions;
- strengthen domestic resource mobilisation, also by supporting developing countries;
- enhance global macroeconomic stability;
- strengthen the recovery and return of stolen assets and combat organised crime.[18]

Key International Parameters Regarding Illicit Financial Flows

- 1988 UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances
- 1999 UN International Convention for the Suppression of the Financing of Terrorism
- 2000 UN Convention against Transnational Organised Crime
- 2003 UN Convention against Corruption
- FATF 40 Recommendations

The UN also highlights the need for a methodology to estimate IFFs in order to comply with the data requirements stemming from the global SDG indicator framework.[19]

The EU and the OECD have also played key roles in defining priorities that countries need to consider to better address the threats of money laundering and IFFs, as well as the need to strengthen mechanisms for the seizure and confiscation of assets, and the need to tackle tax evasion.[20] Additional mechanisms such as the Camden Asset Recovery Inter-Agency Network (and similar networks) provide much-valued support and cross-border dialogue for police and prosecutors to better capture assets linked to organised crime and high-level corruption.[21]

2. Overview of Illicit Financial Flows and Organised Crime in Azerbaijan

2.1 Overview of Azerbaijan

- Population: over 10 million[22]
- Official language: Azerbaijani
- Currency: Manat (AZN)[23]
- Member of UN, OSCE, WTO, CoE, EaP
- 30 August 1991: independence from USSR
- Attractive transit country for organised crime due to its geographical position

Economic Context

Azerbaijan was under Soviet control from 1920 until 1991 when it declared its independence. Since then, the economic development of the country can be divided into two main stages: first, the period of economic collapse or recession, among the worst in the region, covering the years 1991-1995; second, a period of macroeconomic growth and stability that began in 1996 with the commencement of oil revenue windfalls. Rapid increases in oil production caused the Gross Domestic Product (GDP) growth to surge from 2005 to 2007. The effect of the 2008-2009 global crisis was mitigated by the increased oil production and a strong fiscal stimulus for the non-hydrocarbon sectors.[24]

The rapid economic growth resulted in a sharp decline in poverty, falling from 68% in 1995 to only 5.1% in 2018. The unemployment rate has remained stable at five per cent since 2017, with identical expectations for the coming years.[25] In 2019, the country's GDP grew 2.3% and was around USD 48 billion, while the GDP per capita was USD 5,880.[26] However, the GDP was projected to fall to -2.2% in 2020 due to the COVID-19 pandemic and increase to 0.7% in 2021.[27]

The country's economy is greatly reliant on natural gas and oil, with hydrocarbon production and related services accounting for about 60-70% of GDP. Agriculture accounted for 5.2% of GDP as well as the employment of 35.8% of the population.[28] The country has benefited from high oil prices and increased gas production, and other sectors (e.g., steel, iron, chemical and petrochemical products, and textiles) have also shown improvement. Other strengths include a strong sovereign fund, an increase in exports to Turkey and Europe, serving as a geographic liaison between China and Europe, and a positive general business environment. On the other hand, economic challenges in Azerbaijan include a heavy reliance on hydrocarbons, declining oil production (25% lower since 2014), and a weak banking system that refuses to offer loans in local currency to avoid exchange rate risks.[29]

Foreign trade is a key factor for the economy of Azerbaijan. Given the high degree of control exercised by the state over the hydrocarbon sector, its export revenues have enabled the government to substantially increase budget revenues and expenditure. This has boosted growth in other sectors of the economy and created business opportunities for financial institutions.[30]

Various fiscal reforms and governance improvements have been launched, but the pace of implementing these measures has lagged. The lack of urgency in devising stronger fiscal tools and governance measures is likely caused by the lack of fiscal pressure on the government due to its significant oil revenue. Large amounts of oil revenue result in the government taking a less conservative fiscal policy, with investment in infrastructure multiplying nearly six-fold over the last ten years (2010-2020).[31]

Despite the economic growth and improvements in social assistance, Azerbaijan's institutional capacities have not developed rapidly enough compared to socio-economic development. Administrative and planning capacities remain limited, and there is a general lack of coordination in planning and implementation among ministries and agencies. Furthermore, macroeconomic policies have lacked predictability of expenditures framework. The inadequate setting of priorities and the lack of sequencing of reforms hinder further development of the non-oil economy.[32]

Political Context

Azerbaijan is a presidential republic. The President acts as Head of State. The Prime Minister and head of the government of Azerbaijan are appointed by the President. The President and the government exercise executive power, and legislative power is vested in both the government and parliament.

Since the presidential election in April 2018, the Government of Azerbaijan has undergone significant changes, including the appointment of several key ministers in charge of education, tax reforms, the environment and energy, as well as agriculture and rural development. The new Government has been tasked with continuing reforms in key sectors to recover economic growth. The notable increases in the 2019 budget allocations for education (up by 13%) and health care (by 44.5%) are important in terms of improving human capital. Still, further efforts are needed to align budget spending with development needs, including strengthening medium-term budgeting and the public investment management system.[33]

2.2 Overview of Organised Crime and IFFs in Azerbaijan

Azerbaijan's strategic position at the crossroads of trans-regional and trans-continental trade is particularly attractive to organised criminal groups motivated to carry out smuggling operations and other illicit activity. Azerbaijan's crime areas of priority concern include drug trafficking, human trafficking and migrant smuggling, and the smuggling of counterfeit goods; money laundering often flows from these as well as other serious crimes, including violent crime.[34]

In general, the major source of criminal proceeds in Azerbaijan continues to be public corruption across multiple sectors and agencies within the government. In addition, the Afghan drug trade generates significant illicit funds, some of which transit Azerbaijan. Tax evasion, the smuggling of counterfeit goods, trafficking, and organised crime also generate illicit funds. Additional money laundering likely occurs in the financial sector, including in non-bank financial entities and alternative remittance systems. Azerbaijan possesses a significant black market for smuggled and/or counterfeit goods for sale in-country and is also a transit point for smuggled cargo.[35]

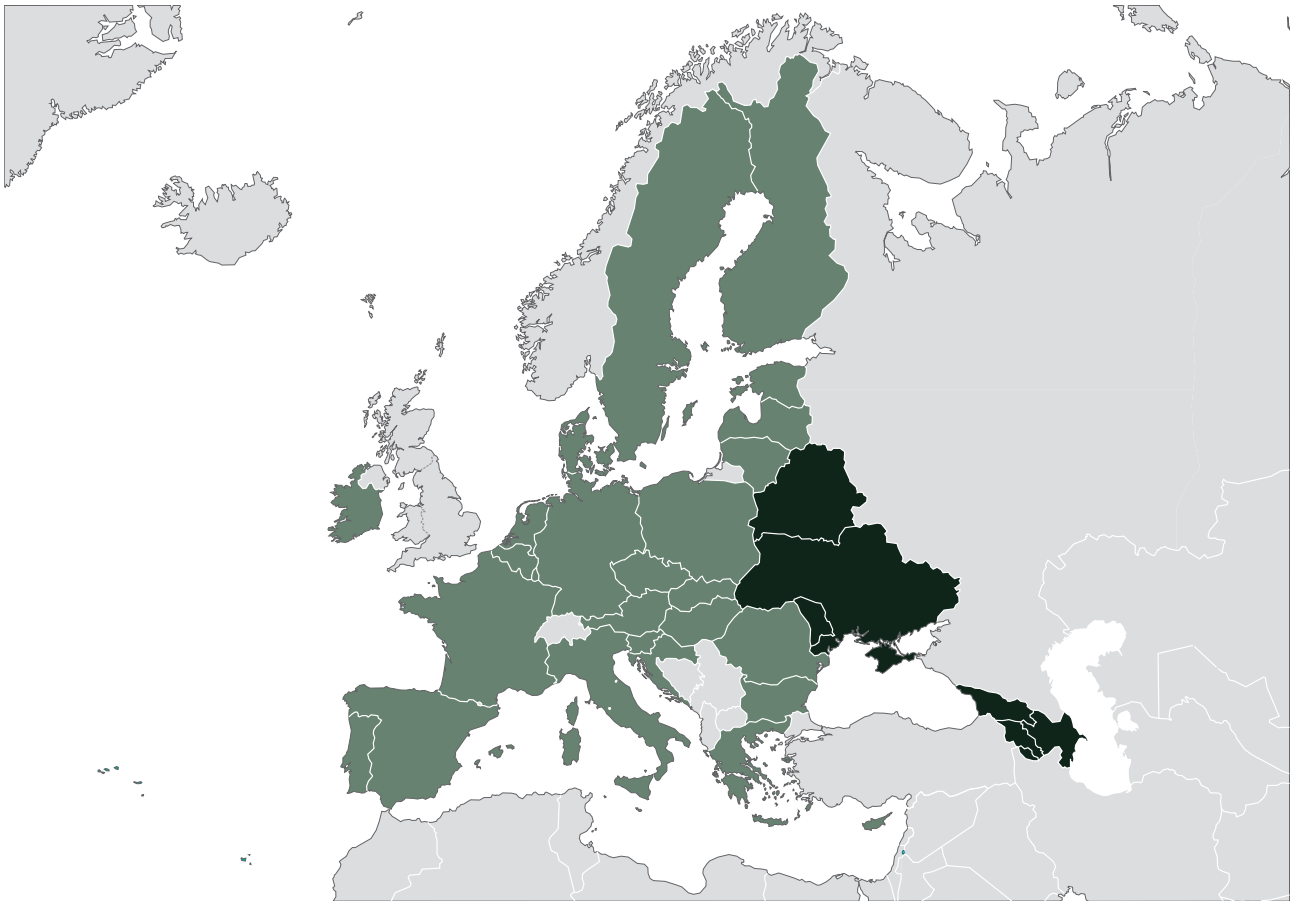
Drug Trafficking and Human Trafficking

Illicit narcotics trafficking through Azerbaijan remains a significant concern, exacerbated by the country's location along major drug trafficking routes from Afghanistan and Iran to Europe and Russia, although it is considered that the proceeds from these crimes are not normally laundered through Azerbaijan. Drug use and cultivation exist on a relatively small scale in Azerbaijan and are less significant problems. There is limited illicit cultivation of cannabis and opium poppy in Azerbaijan, mostly for consumption within the former Soviet sphere.[36] Azerbaijan is a transit point for Southwest Asian opiates bound for Russia and to a lesser extent the rest of Europe. In 2019, national authorities identified 69 criminal groups specialising in narcotics and seized over 1,231 kg of narcotics, including 327 kilograms of hard drugs such as heroin.[37]

Azerbaijan is also a source, transit, and destination country for people subjected to forced labour and sex trafficking. Azerbaijani people are reported to be subjected to forced labour in Turkey, Russia, United Arab Emirates, and Azerbaijan.[38] Women and children from Azerbaijan are subjected to sex trafficking within the country and in Turkey, Russia, and the UAE.[39] Azerbaijan is a destination country for sex and labour trafficking victims from Turkey, Uzbekistan, Turkmenistan, Ukraine, and, in previous years, China and Russia.[40]

The Government of Azerbaijan does not fully meet the minimum standards for the elimination of human trafficking; for instance, it has not yet[41] adopted a proposed 2019-2023 National Action Plan. Still, in 2016, the government increased the number of trafficking investigations, maintained strong prosecution and conviction rates, and handed down severe sentences for labour and sex traffickers.[42] In 2019, national law enforcement investigated 25 cases with 27 suspects (compared with 28 cases with 34 suspects in 2018) and prosecuted 30 defendants (34 in 2018). Courts convicted 42 traffickers (23 in 2018), of which 14 received one to ten and half years' imprisonment. However, there was a slight increase in suspended sentences, compared with 2018.[43] Given the significant trauma experienced by victims in the course of human trafficking, and given that this requires even higher emphasis on measures to prevent victimisation, it was unknown at the time of drafting of this study the extent to which the Government of Azerbaijan is succeeding in preventing human trafficking and other forms of exploitation.

Organised crime and the Eastern Partnership



Azerbaijan is a member of the Eastern Partnership (EaP), a joint policy initiative between the EU, its member states, and six eastern neighbouring countries: Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine.

During the 2017 EaP Summit, the partnership countries reiterated their commitment to the establishment and further development of sustainable structures to prevent and fight corruption, strengthen transparency, and combat money laundering. A Joint Declaration from the Summit established as key priorities 'effective systems of declaration of assets and of conflict of interest with easily searchable databases' and 'development of a legal framework and mechanisms for the recovery and management of assets and effective tools for financial investigations'.

Often serving as transit points for trafficking and smuggling, all six EaP countries are threatened by organised criminal groups in the region. These criminal groups and the illicit revenue generated from their crimes have a detrimental impact on the development and stability of the EaP region, the EU, and the Europe generally. It is imperative to implement a common strategy and operational responses between the EU and EaP countries, particularly on the issues of tracing, freezing, seizure, confiscation and return of illicitly-obtained assets.

Money Laundering

National authorities reported that the number of money laundering cases has increased in recent years. In contrast to 2015-2016, when two stand-alone criminal cases on money laundering were opened, in 2017-2018, nine money laundering-related convictions (regarding 12 persons) were handed down by courts of first instance. However, the adjudication of money laundering has not been effectively applied, resulting in a low number of convictions.[44]

The FMS has identified several means used by criminals to launder the proceeds of criminal activities. This includes suspicious transfers of funds from various persons to a single person, large-value fund transfers from a legal person to a natural person, and the use of false documents to open accounts and transactions that seem obscure and do not match the customer's profile. These examples all show that the main cases of money laundering in Azerbaijan are usually at some point connected to the official banking sector.[45]

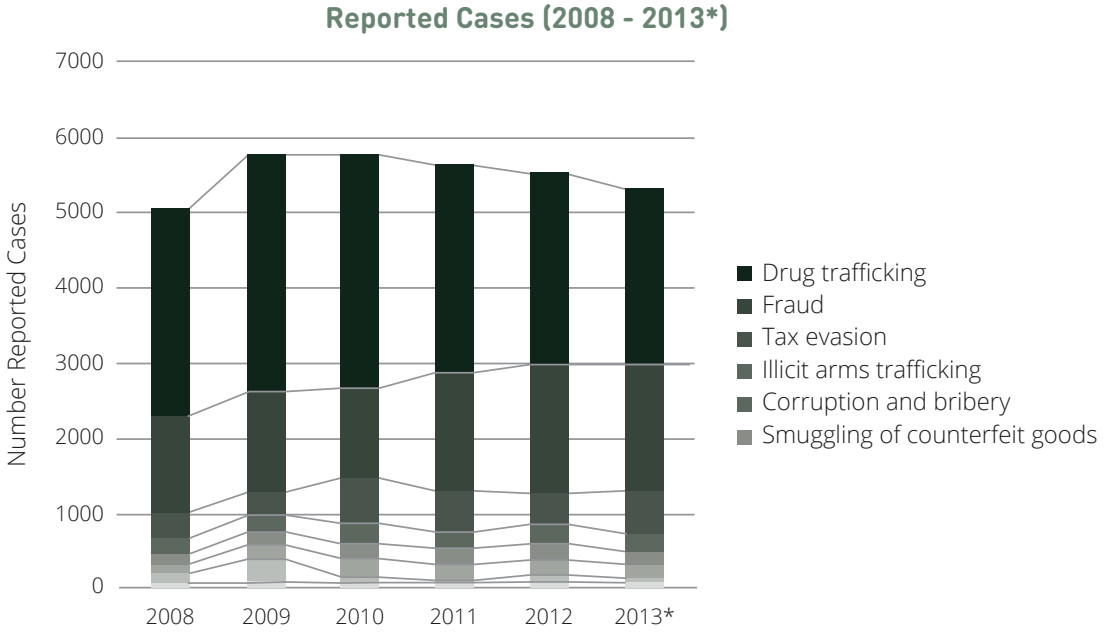
In September 2013, there were 43 banks operating in Azerbaijan, with the majority being relatively small. The exception was the International Bank of Azerbaijan (IBA), which accounted for about 34% of banking sector assets. Today, however, there are reportedly 26 banks operating in the country.[46]

Azerbaijan's close geographic proximity to Iran, which remains listed by the FATF as a high-risk and non-cooperative jurisdiction, presents a potential money laundering and terrorist financing threat, particularly in light of the important reports of terrorist networks in Iran. The FMS under the Central Bank of Azerbaijan conducts research in relation to transactions received into its database that relate to Iran. This service confirms that transactions with Iranian nationals are closely supervised and transfers of funds to Iran are prohibited.[47]

Financing of Terrorism

Authorities in recent years investigated several cases involving actual or attempted attacks. Shortly after the 2008 terrorist attack in the Abu-Bakr mosque in Baku, 26 members of a terrorist group were detained and sentenced to imprisonment.[48] At the beginning of 2012, several investigations and arrests took place in relation to a number of planned attacks.[49] The capital city Baku was identified as a high-threat location for terrorist activity.[50]

In 2019, the Azerbaijani government actively worked to deter, detect, and thwart terrorist efforts to move people, money, and materials across its land and maritime borders and within the South Caucasus. Azerbaijani law enforcement and security services conducted operations to disrupt and prevent terror attacks, arrested and



*Data available until November 2013

Source: elaborated by the author based on the most recent Moneyval Report (2014), p. 22

prosecuted suspected terrorists, and prosecuted returning Azerbaijanis suspected of having joined or having financed terrorist groups fighting outside Azerbaijan.[51]

Azerbaijan maintains counterterrorism cooperation with other countries and actively opposes terrorist organisations seeking to move people, money, and materiel through the Caucasus region. The country remains focused on counterterrorism efforts to include prosecuting individuals under statutes related to terrorism, arresting foreign terrorist fighters returning to Azerbaijan from conflicts abroad, and conducting special operations against those the government has suspected to be planning terror attacks.[52]

Due to the COVID-19 pandemic, the United Nations[53] warned that threats related to terrorism remain and that terrorist groups may see opportunities for increased terrorist and terrorist financing activity while government attention is focused on dealing with the pandemic and its consequences.[54]

Corruption

Corruption increases business costs and represents a significant challenge for investment by foreign companies; patronage is considered to be particularly prevalent in the oil industry, which yields the state's largest revenue.[55] According to Transparency International, a weak judiciary and insufficient regulatory enforcement allow many government officials to act with impunity.[56]

In 2017, a massive leak of bank records from 2012 to 2014 showed that the ruling elite of Azerbaijan ran a USD 2.9 billion slush fund and an international money laundering scheme.[57] Part of the money was reportedly used to help whitewash Azerbaijan's international image, which had been tainted due to serious human rights violations.[58] European politicians, along with European financial institutions that enabled the scheme, also were implicated.[59]

In 2016, the perceived level of public sector corruption in Azerbaijan was very high, with a score of 30 on a scale of 0 (highly corrupt) to 100 (very clean).[60] Some 58% of people in Azerbaijan indicated that corruption in the public sector is a problem or a serious problem, with health services and the judiciary perceived to be the sectors most affected by corruption.[61] Additionally, 15% per cent of public service users admitted they have paid a bribe in the previous 12 months.[62]

3. Combating IFFs and Organised Crime in Azerbaijan

3.1 Introduction

Combating IFFs involves multiple policy areas, within and outside the criminal justice system. From crime control to regulations in the financial sector, and tax regimes, its implications require cross-sectoral and cross-national responses. This contemplates a wide range of actors to design and implement different, albeit mutually reinforcing, policies and actions at different levels of government. Law enforcement and customs authorities need to increase awareness and operational actions, and the financial sector and vulnerable professions need to implement preventive measures. Transparency in corporate structures is also essential and steps must be taken to promote public sector integrity and support widespread focus on the seizure, confiscation and recovery of illicitly-obtained assets (through penal and non-penal mechanisms). Further, reinvesting recovered assets into high-priority development needs is essential for overall socio-economic development. Policy coherence for sustainable development will be instrumental for reducing illicit financial and arms flows, with inter-agency and international cooperation at the heart of the solution.

The need to reduce IFFs is at the forefront of the international agenda of development policy. The aim of curbing IFFs is strongly linked to the post-2015 agenda by its incorporation into the SDGs of the UN in Target 16.4: "By 2030, significantly reduce illicit financial and arms flows, strengthen the recovery and return of stolen assets, and combat all forms of organised crime".[63]

3.2 Azerbaijan's Legal and Institutional Framework

Legal Framework

On 27 February 2020, President Aliyev signed a decree approving the 2020-2022 National Action Plan (NAP) on the Promotion of Open Government. The overall aim of the NAP has been to improve greater transparency in governmental operations, and to reduce corruption, as well as to strengthen anti-money laundering and terrorism financing measures.

As per a December 2020 Cooperation Implementation Report on Azerbaijan,[64] a presidential decree strengthening reforms in the judicial-legal system was adopted on 3 April 2019, with the goal of increasing the independence, efficiency and transparency of the judiciary; and some 40 implementing acts have been drafted with the aim of creating, where needed, specialised courts, preventing interference in court affairs, and strengthening the enforcement of judicial decisions.

Additional key metrics under the NAP include:

- Implementing measures on submission of financial declarations by public officials;
- Developing cooperation with international organisations specialised in the areas of open government and anti-corruption;
- Improving legislation and establishment of mechanisms for periodic risk assessments of systems to combat money laundering and terrorism financing;
- Conducting annual analyses for determination of the risks, trends and typologies of using transactions and operations with cash, securities, real estate, vehicles and legal entities, as well as import-export transactions for money laundering and terrorism financing; and
- Improving cooperation with international organisations specialised in AML/CFT and developing related action plans.[65]

The Law on Courts and Judges was also amended to increase the wages of judges. Equally, improvements have been made with respect to improving the evaluation of judicial performance. Progress is also expected with respect to the country's asset declaration system for public officials, including parliamentarians, judges and prosecutors, although, at the time of drafting of this report, no additional progress was yet noted in this area.

In 2020, a new Department for Coordination of Special Confiscation Issues was established under the General Prosecutor's Office. This unit's main tasks include facilitating compensation to victims of crime, ensuring that special confiscation measures are applied, detecting and tracing assets that may be subject to confiscation, maintaining records of evidence subject to confiscation, and providing investigating authorities with practical assistance regarding the seizure and confiscation of assets.

In November 2016, the Government of Azerbaijan also adopted a National Action Plan on combating legalisation

of criminally obtained funds or other property and financing of terrorism for 2017-2019.[66]

Pursuant to the National Action Plan, the FMS has facilitated the drafting of a proposed new AML law ("Law on Targeted Financial Sanctions"), which includes various amendments concerning beneficial owners, to better regulate the transparency of legal entities.[67] This, and other amendments to existing law, was – at the time of drafting of this study – in the phase of discussion with other state bodies, with the aim of presenting such amendments to the legislative body in 2021. Additionally, the FMS reportedly was providing inputs, in coordination with law enforcement bodies, on key amendments to the Criminal Procedure Code regarding asset recovery and parallel financial investigations. These amendments were expected to be submitted to the legislative branch in the Fall of 2021.

To prevent illegal drug consumption and trafficking, targeted legal and institutional measures were implemented and relevant authorities in the Republic of Azerbaijan instituted a risk-based approach. The Program against Illegal Trafficking of Drugs, Psychotropic Substances and their Precursors and Spreading of Drug Addiction for the years 2013-2018 was approved in June 2013.

Additional previous targets of the Government have been to become a party to the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism (Warsaw Convention), to establish national mechanisms on asset recovery and to set up an integrated AML/CFT statistical database.

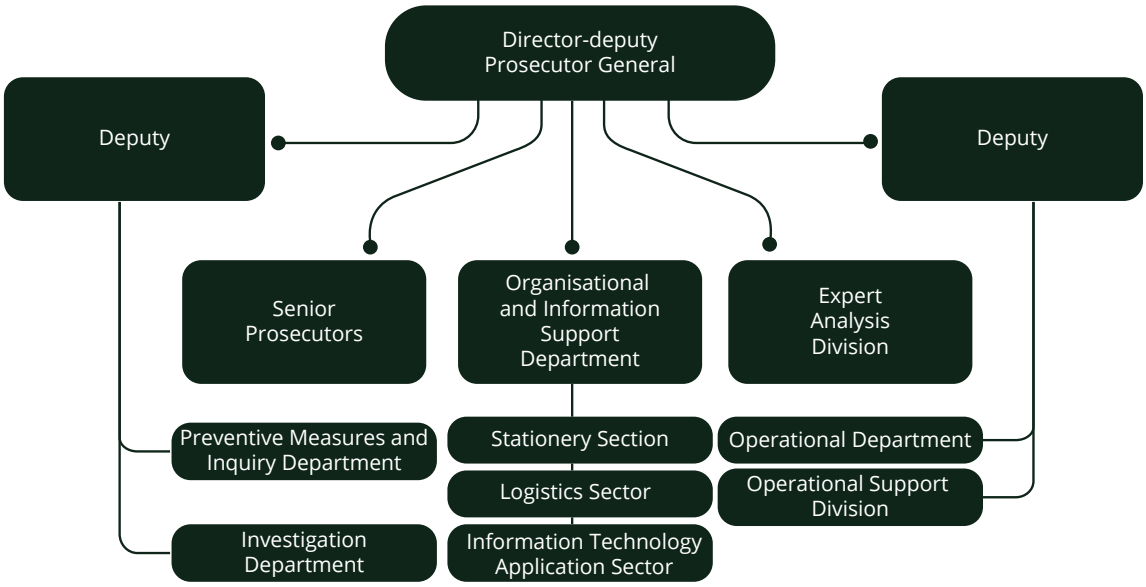
In 2019, the European Union and the Council of Europe, in coordination with Azerbaijani officials, launched a new project to Strengthen Anti-Money Laundering and Asset Recovery in Azerbaijan,[68] designed to respond to the needs of Azerbaijan in the area of the fight against money laundering, terrorist financing and asset recovery, representing a continuation of actions to strengthen capacities to fight and prevent corruption (2015-2017) and to strengthen anti-money laundering (2018). The project has been aligned with cooperation activities identified in the EU-Azerbaijan Action Plan and the Council of Europe Action Plan for Azerbaijan 2018-2021, a strategic programming instrument that aims to bring Azerbaijan's legislation, institutions and practice further into line with European standards in the areas of human rights, the rule of law and democracy.[69]

3.3 Institutional Framework

The following institutions are key bodies and authorities involved in combating organised crime, money laundering or financing of terrorism in the country:

- The Financial Monitoring Service (FMS), which is an operationally independent body under the Ministry of Economy, was established by Decree of the President of the Republic of Azerbaijan numbered 95, dated May 25, 2018. It is a public legal entity funded from the state budget and implements unified regulation and supervision as well as coordination of activities in the field of preventing legalisation of criminally obtained

Structure of Anti-Corruption Directorate, within the Office of the General Prosecutor



funds or other property as well as to prevent the financing of terrorism. The FMS serves as a national centre for receiving, analysis and dissemination of data regarding potential money laundering or terrorist financing. Its tasks also comprise the implementation of State policy, improvement of the supervision system and coordination of the activities of relevant State authorities in the AML/CFT area.[70]

- Office of the General Prosecutor – investigates money laundering cases together with its Anti-Corruption Department (ACD). As of 2020, a specialised unit was created within the OGP to facilitate the tracing, freezing, seizure and confiscation of assets linked to criminality.

- The Ministry of Justice participates in the development of legislation through the formulation of proposals on draft legislation and general legal advice on legislation. According to the AML/CFT Law, the Ministry of Justice is as the supervisory authority for notaries and non-profit organisations.

- The State Tax Service under the Ministry of Economy oversees the implementation of State tax policy. The Ministry is responsible for the registration of commercial legal persons and provides information to relevant State authorities with respect to data in its possession as required by Azerbaijan legislation.

- The State Security Service is granted the authority to investigate terrorism and terrorist financing cases.

- The Central Bank is the central executive authority responsible for the implementation of State policy and supervision in the securities market. It is the supervisory authority for brokers who professionally participate in the securities market and those who are engaged in the management of assets.

- The State Customs Committee monitors physical cross-border transportation of currency and bearer negotiable instruments.

In October 2020, a Coordination Council was established by decree of the Cabinet of Ministers to supervise and direct the execution of the country's National Action Plan (NAP). The Coordination Council is a high-level body that includes several working groups of State officials whose role is to identify ML/TF risks and threats and analyse the legislation of the country to eliminate gaps in AML/CFT regulations that may be used by criminals. The main purpose of the Coordination Council is to enhance the effectiveness of the AML/CFT system of Azerbaijan. The Deputy of the Prime Minister of Azerbaijan leads the Coordination Council and the FMS carries out the general coordination of working groups.[71] As of the drafting of this study, it was unknown as to whether the Coordination Council has facilitated any legislative changes in the country, or whether its work has facilitated any operational increases in seizures or confiscations of assets, although it would be reasonable to assume that such achievements might not have occurred in the short time since the Council's creation.

3.4 Azerbaijan's Compliance with International Measures and Recommendations

Progress has been made in Azerbaijan meeting anti-money laundering global standards to ensure adequate safeguards in commercial banks, and to inhibit the proceeds of illicit activities from flowing through the financial sector. Laundering money or other property derived from illicit activity has been criminalised under the Penal Code, as amended in 2006. In 2009, Azerbaijan further bolstered its legal and institutional framework for AML. The Law on the Prevention of Legalisation of Criminally Obtained Funds or Other Property and Financing of Terrorism (2009) provides for a system of reporting and analysing suspicious transactions in all financial institutions and designated non-financial businesses and professions.[72] In 2012, the Council of Europe's Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (Moneyval) ended the formal reporting regime in Azerbaijan due to the progress made in fulfilling recommendations. Azerbaijan is now considered to be fully in line with the key UN conventions, the Financial Action Task Force (FATF) 40 recommendations, and significant relevant EU directives.[73]

According to information from the now-defunct Financial Markets Supervision Authority (FIMSA), in some 50 cases, banks, insurance companies, the postal office and non-bank organisations were sanctioned for amounts of roughly AZN 75,000. 30 banks were sanctioned in the amount of AZN 45,000; 10 insurance companies were sanctioned in the amount of AZN 15,000; eight non-bank credit organisations were sanctioned in the amount of AZN 12,000; and two postal offices were sanctioned in the amount of AZN 3,000. Additionally, some 37 notaries were subject to disciplinary responsibility for failure to properly identify customers.[74]

In 2021, Azerbaijan was no longer categorised by the US State Department as a Country/Jurisdiction of Primary Concern in respect of Money Laundering and Financial Crimes.[75]

International cooperation is one of the important aspects of the Financial Monitoring Service's activities. Implementing appropriate measures in this field also serves the purpose of effective execution of "Strengthening international and bilateral cooperation" of the "National Action Plan on combating the legalisation of criminally obtained funds or other property and financing of terrorism for 2017-2019". [76]

According to a November 2018 report on progress that the Republic of Azerbaijan has made to remedy the deficiencies identified in its Fourth Round Mutual Evaluation Report (MER), it was concluded that Azerbaijan addressed the vast majority of the deficiencies, and that a very small number of outstanding deficiencies remain.

Source: Mutual evaluation of Azerbaijan –follow-up report, *https://rm.coe.int/4th-round-mutual-evaluation-of-azerbaijan-follow-up-report-submitted-b/1680934a1a*. Nov. 2018,

The Financial Monitoring Service, which is an independent body under the Ministry of Economy, is the country's financial intelligence unit. Its main role includes facilitation of compliance with Azerbaijan's law on the prevention of legalisation of criminally obtained funds or other property and financing of terrorism. The total number of transaction reports submitted by the reporting entities to the FMS in 2018 increased by 17.7% reaching 55,297. Some 63.5% of these reports were currency transaction reports (transactions in cash of AZN 20,000 or more), 31.2% high-risk, 0.3% suspicious, and 5% other transaction reports. In 2018, currency transactions increased by 26.5%, high-risk transactions by 38%, and suspicious transactions by 65% compared to 2017.[77]

Under the previous Action Plan, the Council of Europe provided technical support to the anti-corruption policy process by facilitating public input and expert advice for the development of a national anti-corruption action plan and monitoring of its implementation, and by supporting the development and integration of ethics and anti-corruption training into the civil service and higher education sectors.

Still, consideration should be given to ensuring that Moneyval recommendations are further entrenched into actual practice, and that results should be measured, among other means, by amounts seized and confiscated from those participating in acts of corruption (as well as other forms of serious and organised crime). Further emphasis may also need to be placed on how recovered assets are utilised – e.g., whether policies and mechanisms are in place to transparently liquidate and distribute recovered assets to high-priority development needs.[78]

Although Azerbaijan has considerably improved its position in Transparency International's Corruption Perceptions Index 2019, from 152 to 126 out of 180 countries,[79] the problem of corruption, money laundering and other serious crimes which generate IFFs remains a significant challenge and likely acts as an impediment to the country's development.[80] As of the drafting of this report, it was unknown to what extent issues of former high-level corruption had been addressed in response to multiple press reports regarding this matter.[81]

3.5 Azerbaijan's capacity to freeze, seize, confiscate and recover assets linked to organised criminal activity, corruption and the financing of terrorism

National authorities appear to be improving on the seizure and confiscation of assets linked to criminal offences. Such measures were applied in at least four cases in 2017 and 2018. In 2017, assets valued at USD 106,925, EUR 16,845, and AZN 1,010,062 were the subject of confiscation orders. In 2018, confiscation orders were obtained for assets valued at USD 5,400, EUR 3,215 and AZN 6,687,055. This included jewellery, land, apartments, vehicles and other movable and immovable assets which were seized and later confiscated. In three ongoing money laundering cases, assets – including apartments, vehicles and land – with a corresponding value of AZN 1,361,300 had been reported as seized. These seizures and confiscations represent important steps for Azerbaijan in terms of "going after the money", and suggest more of a seizure and confiscation-oriented approach to addressing serious crime and illicit financial flows.[82] According to the Anti-Corruption Directorate (ACD), assets valued at some AZN 40.3 million were seized in 2019, and at AZN 13.2 million in 2020 as a result of work carried out by that Directorate.[83]

The data above on the amounts of property seized, confiscated and recovered show an improving trend. According to the 2014 Moneyval Report, and subsequent follow-up reports, mechanisms to allow for the confiscation of assets of corresponding value held by a defendant (and which may have been legally obtained), had been deficient, but were largely resolved.[84]

Positive Steps with Respect to Reconciliation, Accelerated Resolution of Cases and Return of Assets

In May 2020, Azerbaijan's Criminal Code was amended (Articles 73-1 and 73-2) as part of broader reforms to encourage individuals accused of certain crimes (such as Fraud, Embezzlement and Plundering of Natural Gas, Water, Electricity and Plumbing, as well as other Economic Crimes) to return assets. Such individuals may be considered exempt if they compensate victims for these crimes. The extent and availability of exemption from criminal liability for these crimes is dependent on whether, for example, such fraud or embezzlement included or not aggravating circumstances, and the amount returned to victims or the State budget.

As of the drafting of this report, no data was available to indicate that long-term sustainable mechanisms were in place (e.g., internal policies within law enforcement institutions, the prosecutorial service or the judiciary) to ensure that extended confiscation – while maintaining due process – is applied as the norm, rather than the exception, in all cases involving serious income-generating criminality, or that sufficient mechanisms are in place for non-penal-forfeiture of assets. Information was also limited with respect to how recovered assets are managed and distributed, if at all, for social re-use or high-priority development needs.

4. Impact and Cost of Illicit Financial Flows and Organised Crime in Azerbaijan

4.1 Introduction

IFFs strip resources that could be used to finance much-needed public services, from security and justice to basic social services such as health and education. IFFs also weaken financial systems and economic potential, slowing down sustainable economic growth. While such practices occur in most countries, the societal and economic impact on developing countries is more severe given their smaller resource base and markets.[85]

IFFs can have a direct impact on a country's ability to raise, retain and mobilise its own resources to finance sustainable development.[86] In addition to discussing the volume of IFFs, it is equally imperative to understand and address the extensive and multidimensional nature of the harms[87] caused by them. When impacts beyond revenue losses are taken into account, it is evident that IFFs have wide-reaching and multifaceted negative impacts on development aims[88] and, more specifically, could directly and significantly impair the ability to achieve the Sustainable Development Goals (SDGs) by 2030.[89]

4.2 Types of harm

IFFs impact a country's economic and social development in myriad ways. Undocumented flights of wealth to and from (as well as within) a country have severe impacts on government revenues, wealth that could otherwise be invested in public spending and other forms of economic reforms. However, the harm provoked by IFFs goes well beyond the mere loss of government revenue. The OECD assesses that IFFs can impact a country through several categories of harm, among them economic, societal, governance and physical.[90]

IFFs and organised crime affect trust in public officials, government institutions, and the rule of law. Low levels of trust, civic engagement, and social capital can impede development and further bolster organised criminal groups.[91] This creates a harmful cycle that increases political instability and weakens governance. The cost of corruption to developing countries is also enormous, with the World Economic Forum estimating an annual USD 1.26 trillion in cost to developing countries.[92]

Corruption not only directly generates IFFs (e.g., banking fraud, embezzlement) but also creates an environment in which organised criminal activity can flourish; the two are mutually reinforcing.[93] Organised criminal groups can exploit the fragility of public authorities caused by corruption, often gaining benefits and access to political power.[94] This creates an environment where organised criminals benefit from corruption, compounding and reinforcing both crime and corruption. Corruption can also weaken the threat of judicial and legal consequences for criminal activity, mitigating any real deterrence effect of the legal system.

What Could be Done with USD 1.26 trillion?

To illustrate the significant cost of corruption, USD 1.26 trillion is enough money to lift the 1.4 billion people living on less than USD 1.25 a day above the poverty threshold and keep them there for at least six years. Additionally, UNCTAD proposed in March 2020 a USD 1 trillion liquidity injection through the IMF to help countries with the COVID-19 crisis, providing money for crucial emergency health services and social relief programs.

Source: Sean Fleming. "Corruption Costs Developing Countries $1.26 Trillion Every Year - yet Half of EMEA Think It's Acceptable." *Word Economic Forum*, 9 Dec. 2019.

Economic Harm

Economic harm is the direct and indirect impact on the country's economy. In the direct form, IFFs withdraw funds from the legitimate economy and may force the State to divert resources in order to prevent and respond to criminal activity or to treat or compensate victims. In the indirect form, IFFs damage the economic climate, competitiveness, investment and entrepreneurship.[95]

Additionally, the drain on resources and tax revenues caused by IFFs have significant effects on the budget and increase the deficit. The loss of financial resources blocks the expansion of basic social services and infrastructure programs that are targeted to improve the wellbeing and capacities of all citizens, including the most vulnerable, such as the very poor.[96]

IFFs also weaken financial systems and allow individuals to hide stolen assets, evade taxes, and avoid the adverse impacts of currency devaluation. Instead of benefiting the people and local economies, the money can end up in offshore tax-havens.[97] In some cases, this produces a minority that has political power and influence over most

of the population, and which has few, if any, incentives to develop the domestic economy and social services.[98]

Societal and Governance Harm

Societal harm creates or exacerbates societal tensions, as well as economic or social marginalisation.[99] IFFs may impact societies by incentivising those in vulnerable groups to participate in, or fall victim to, organised criminal activity. The UN Human Development Report warns that IFFs constitute a roadblock to human development by "weakening governance and reducing consumption, investment and social spending, hurting the long-term construction of collective capabilities and the expansion of human development".[100] For this reason, addressing IFFs can be instrumental in improving societal and developmental needs.

IFFs harm society also by undermining political institutions and therefore reducing public trust in national authorities. This is also known as 'structural / governance harm'.[101] Harm to government reputation occurs whenever a law is broken and the government appears to be ineffective in responding to such criminality.[102] Structural and governance harm concerns the damage done to the quality of governance and the legitimacy of the social contract, the rule of law, and the development process, as a result of corruption, organised crime, IFFs, and impunity.[103]

This type of harm prevents, for instance, the achievement of Goal 16 of the SDGs, of promoting peaceful and inclusive societies for sustainable development, and providing access to justice for all, as well as building effective, accountable and inclusive institutions at all levels.[104] For instance, the combination of high IFFs and high levels of corruption can result in weakened service delivery and the diversion of funds away from Azerbaijan's government programmes, such as those within the health sector. Similarly, the need to increase expenditure on security priorities to control organised crime, such as law enforcement and border control, can divert limited government resources away from investments in social services, such as health and education.[105]

In conjunction with economic and political figures, civil society has a key role to play in terms of defending and cultivating the rule of law. Strong and capable government institutions and civil society discourages many illegal activities and prevents the growth of IFFs. For instance, a transparent tax system and sound public expenditure management can discourage tax evasion, while a strong culture of integrity and accountability within government, along with real sanctions for both criminal and ethical violations, is essential to prevent and manage potential conflict-of-interest situations and can act as a strong deterrent to corruption.[106]

Poverty and inequality are associated with increases in organised crime, not least in relation to human trafficking, smuggling of counterfeit goods and corruption. In Azerbaijan, the combination of drug and human trafficking groups, as well as those involved in money laundering and corruption[107] produces a significant impact on human development, and thus an impact on society and governance.[108]

Physical Harm

IFFs also cause harm to the physical and psychological integrity of individuals.[109] IFFs and organised crime affect, for instance, the achievement of Goal 3 of the SDGs ("Ensure healthy lives and promote well-being for all at all ages)[110] in Azerbaijan in a number of ways that are not at all abstract, including through increased narcotic drug usage as a consequence of drug trafficking, or from the use or threat of violence.[111] Azerbaijani data indicates that the official number of drug addicts is indeed on the rise. According to the Statistics Committee, there were 29,448 drug addicts registered in 2016 in the country, compared to 28,555 a year earlier. Compared to 2000, when 14,010 people were registered, the number of drug addicts in Azerbaijan has more than doubled.[112]

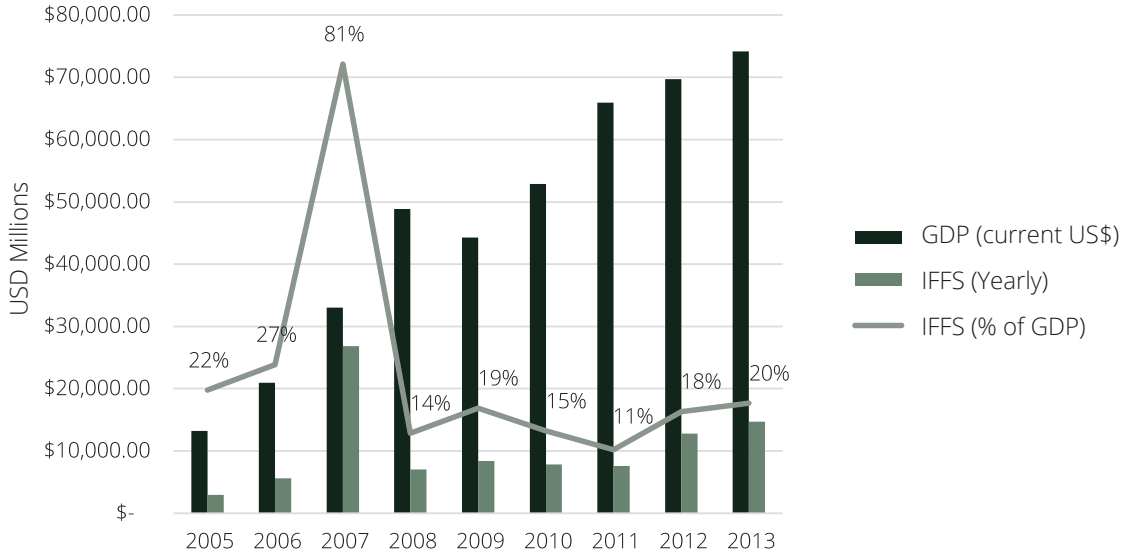
Consequently, the impact of drug use also puts considerable pressure on Azerbaijan's health system, forcing it to deal with the additional economic, but increasingly necessary, burden of drug prevention programmes, as well as treatment and care. Furthermore, drug addiction may also be linked to the recruitment and perpetuation of forms of human trafficking (e.g., for sexual exploitation), which is one of the most prevalent forms of organised crime in Azerbaijan.[113]

4.3 Direct costs of IFFs and organised crime to the State and Society in Azerbaijan

IFFs are by nature intended to be hidden. Therefore, measurements of illicit flows can only be made indirectly using related data, which makes such measurement imprecise. Additionally, there are many forms of illicit flows that cannot be detected using available economic data and methods (e.g., cash transactions).[114] For these reasons, the estimates presented here are likely to be conservative. However, they still provide one measure of the largely unobservable IFFs problem. Moreover, even a conservative estimate of this dynamic indicates a significant degree of impact on Azerbaijani society.

Estimates about IFFs in developing countries vary significantly, and while work has been done by the United Nations to estimate the proceeds of various transnational criminal activities, there remain considerable knowledge gaps, including on the extent to which these proceeds flow through the international financial system.[115] However, because the question is critical to the future of Azerbaijan's population, any indication of the collective significance of IFFs may be helpful in guiding policymakers, citizens, and other stakeholders in the country. In developing countries, total IFFs grew at an average annual rate between 7.2% and 8.1% over the period of 2005 to 2014, reaching estimated levels between USD 620 billion and USD 970 billion in 2014.[116] In Azerbaijan, IFFs grew from USD 7.06 billion in 2008 to USD 14.73 billion in 2013. In this period, the total amount of IFFs in the country reached over USD 94.99 billion, with an annual average of USD 9.50 billion.[117] The analysis of IFF estimates as a percentage of the country's GDP provides a different perspective on IFFs than volume alone, as it indicates the potential impact of this dynamic on the economy.[118] For Azerbaijan, IFFs as a percentage of GDP has remained very high since 2008 (14% of the GDP). Its lowest estimate was in 2011 (11% of the GDP). Nevertheless, estimated illicit flows continued to hover at 20% of Azerbaijan's GDP. Illicit flows are most likely significant inhibitors to country development when their ratio to GDP is greater than 10%.[119]

IFFs in Azerbaijan 2008 - 2013 (Yearly)



Sources: based on data retrieved from World Bank[120] and GFI (2015)[121]

IFFs in developing countries, such as Azerbaijan, mean fewer hospitals, schools, police, roads, and pensions, as well as fewer job opportunities.[122] The OECD and other international entities have indicated that there is clear "collateral damage" of outflows produced by embezzlement, the diversion of public property, and the plundering of the public treasury.[123]

Increased focus on the seizure and confiscation of only a portion of assets linked to IFFs would have a significant impact on accelerating development within Azerbaijan, assuming that recovered assets are liquidated and effectively distributed to high-priority development needs. The following section identifies some development challenges for key sectors, as well as the development opportunities in Azerbaijan in case it would be possible to recover only 10% of assets lost through IFFs in the country.

4.4 Development challenges and opportunities

The goal of Azerbaijan's economic development plan for the future[124] is to improve the well-being of the population, by providing quality health and education services, focusing as the main strategic line on their accessibility for all categories of the population, including for low-income and underprivileged families.

The main priority is to develop social spheres and human capital, improve the quality of education, healthcare, law enforcement, transportation, and strengthen social protection.

Health Care Sector

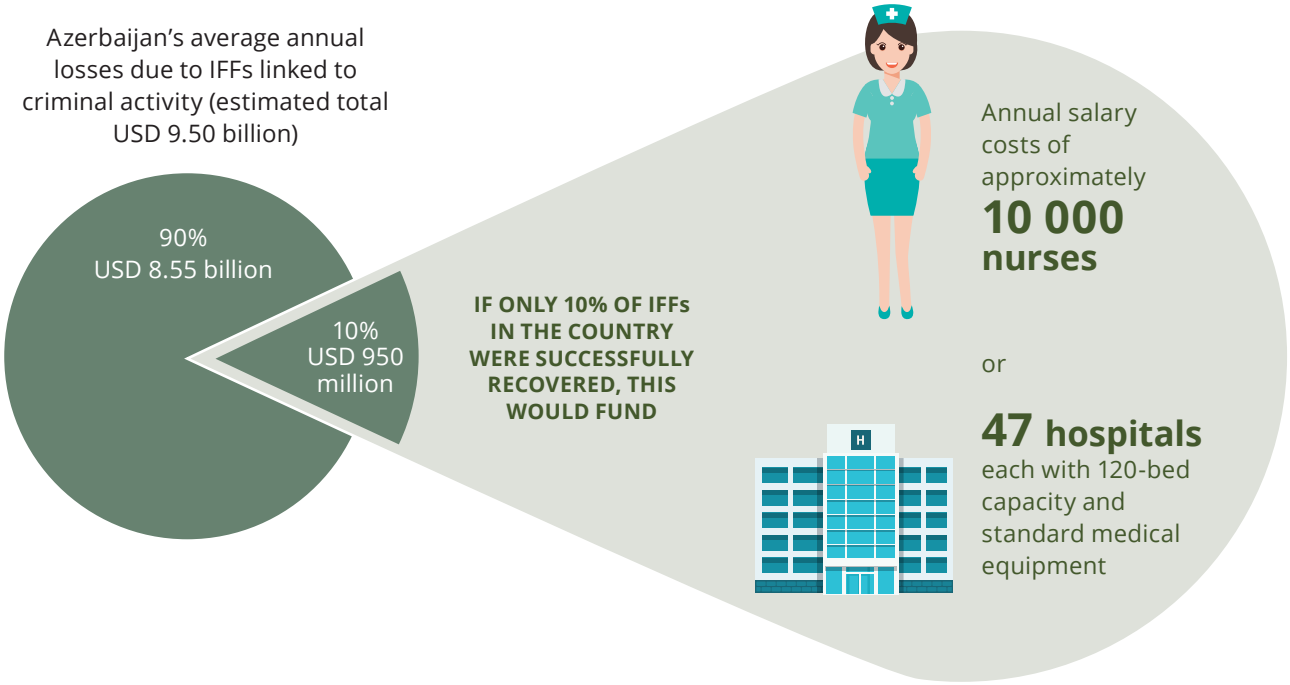
The country's growing economic potential has facilitated the development of the healthcare sector.[125] Budget allocations for public health care have increased substantially since 2007, from 4.7% of the GDP to 6.3% of the GDP in 2017. This resulted in significant progress in building and renovating many medical institutions.[126]

However, many authorities, and the general public, still recognise that a number of healthcare problems need to be addressed. For instance, the country's main cause of premature death in adults is heart disease;[127] the country also faces a high infant mortality rate.[128]

Target 3.2 of the third SDG ("ensure healthy lives and promote well-being") is focused on child mortality, including ending preventable deaths of new-born children by 2030, with all countries aiming to reduce neonatal mortality to 12 deaths or fewer per 1,000 live births.[129] Although the EU-28 infant mortality rate fell from 4.4 per 1,000 live births in 2007 to 3.6 per 1,000 live births in 2017, Azerbaijan was the only European Neighbourhood Policy East country to record an infant mortality rate in 2017 (11.8 per 1,000 live births) that was higher than in 2007 (11.6 per 1,000 live births).[130]

If Azerbaijan were to prioritise the seizure and confiscation of only 10% (approximately USD 950 million) of the IFFs estimated to be circulating within the country, this could, for example, enable the country to cover the annual salary costs of over 10,000 nurses, according to Ministry of Health estimates regarding how much is spent on nurses per year.[131] As well, such recovered assets could be used to cover the cost to build multiple 120-bed hospitals (with standard medical equipment) throughout the country, at an average cost of USD 700 per square meter – each 120-bed hospital costing an average of USD 20 million).[132]

How Recovered Assets Can Strengthen the Health Care in Azerbaijan



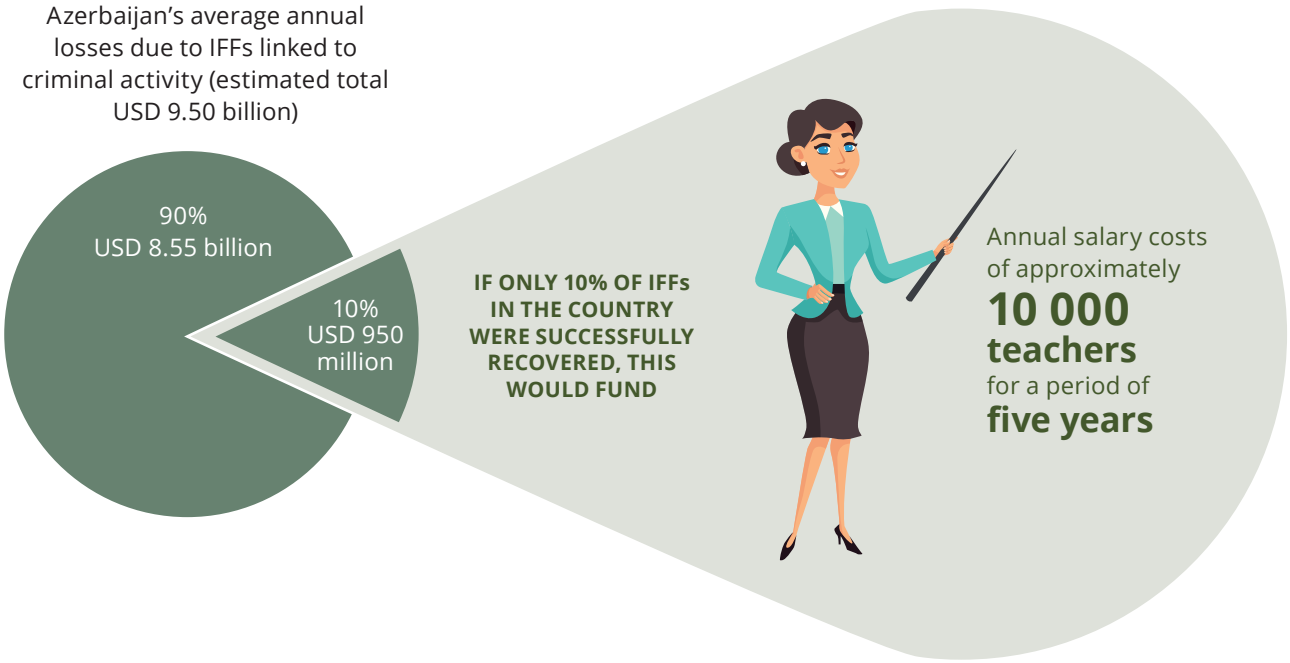
Education Sector

In recent years, Azerbaijan has seen progress in the education sector. For example, the education budget has increased fivefold compared to 2003, reaching AZN 1.5 billion in 2011. This allowed, for instance, 10,700 Azerbaijanis to study in foreign countries between 2007 and 2015.[133] Significant progress has also been made in modernising education. As part of the "People's Computer Project", one in 20 students reportedly now has a computer (compared to only one in 1,063 students in 2004), over 10,000 teachers have been provided with computers, 1,200 educational institutions are connected to the Internet, and 75,000 teaching and technical staff have received ICT training.[134]

Nonetheless, Azerbaijan still faces challenges concerning development in this area, in terms of attracting and retaining qualified teachers, and in terms of the need for many schools and libraries to be built or renovated.[135]

If Azerbaijan were to prioritise the seizure and confiscation of only 10% (approximately USD 950 million) of the IFFs estimated to be circulating within the country, this could, for example, enable the country to cover the annual salary costs of over 10,000 teachers for a period of five years, at a monthly average salary of AZN 2,460 (or approximately USD 1,448).[136]

How Recovered Assets Can Strengthen Education in Azerbaijan



5. Conclusions and Recommendations

This study has examined the severe negative impact of IFFs and related crimes on Azerbaijan and has highlighted some of the sectoral needs that can be significantly addressed if the government prioritises the capture of IFFs and illicitly-obtained assets. Effective asset recovery policy is fundamental to mitigating and preventing future costs of IFFs on the country.

In light of the above, this study provides the following recommendations to national authorities and other key stakeholders to help strengthen the effective and transparent recovery of illicitly-obtained assets, to inhibit IFFs and therefore to facilitate more accelerated development within the country.

1. Identify and Implement Mechanisms that Improve Seizure and Confiscation, as well as Transparent Management of Such Assets

Identify and implement mechanisms that improve efficiency in seizure, confiscation of assets, liquidation of those assets, and the distribution of funds, in a highly transparent manner, to high-priority development needs (needs identified in close cooperation with civil society organisations, and needs identified through regular feedback from citizens).

2. Strengthen Monitoring and Review Mechanisms to Identify and Respond to Illicit Financial Flows in the Country

Consideration should be given to collecting and analysing statistics, and bolstering research, on the level of funds-generating crime together with seizures and confiscations, to perform a strategic assessment of the ML/FT risk, as well as sectors vulnerable to illicit financial flows.

3. Publish Clear and Unambiguous Policy Statements on IFFs/ML and Asset Recovery

Publish clear and unambiguous statements and policies with respect to IFFs / ML and the priority of the Government to seize and confiscate (with due process) assets linked to organised criminal activity.

4. Establish the Use of Extended Confiscation as a Norm Within the Criminal Justice System

Consideration should be given to adopting and implementing, as the norm, not the exception, within the criminal justice system, the use of extended confiscation, which allows a court, once a conviction has been entered for specified serious crimes which can generate significant financial flows, to enter an order that there is then a legal presumption that ALL income and assets of the defendant acquired over, for example, the past five to ten years, shall be deemed to have been illicitly acquired, unless the titleholder can prove that the property was acquired through legal means, with legally-acquired assets, and in good faith.

5. Ensure that the Criminal Justice System can Continue Proceedings against the Assets of Individuals Charged with Serious Income-Generating Crimes, even if:

a. the defendant is a fugitive from justice (as long as the State demonstrates to the court it has done everything reasonable to provide notice to the defendant of criminal proceedings against him or her);

b. the defendant dies prior to the culmination of the criminal proceedings; or

c. the defendant is declared mentally or physically incapable of participating in the criminal proceedings against him or her.

All of the above are consistent with the principle that crime should not pay, even if the assets are found to be in the name or possession of others. An exception here would be those who have acquired such assets in good faith and without any reasonable knowledge that such assets were the product of criminality.

6. Establish the Use of Unjustified Enrichment Proceedings as a Norm Within the Criminal Justice System

As of the drafting of this report, draft laws reportedly had been prepared on unjust enrichment and unexplained wealth. Consideration should be given to adopting and implementing legislation, with international technical advice, regarding unjustified enrichment, or unexplained wealth, where the State can demonstrate to the court that an individual's assets significantly exceed his or her reported or reasonably possible income. Such can be done in criminal proceedings, civil proceedings or both.

7. Adopt more Agile Mechanisms for the Settlement of Criminal Cases

Although legislation does exist in Azerbaijan with respect to reconciliation or plea bargaining (with amendments to the Penal Code in 2017 and 2020), in light of heavy

caseloads of prosecutors and the judiciary, consideration might be given to further bolstering the mainstreaming of settlement of criminal cases, where a defendant agrees to return assets reasonably believed by the State to be the product of serious crime, and/or provides reliable information to the State regarding the serious crimes or illicitly-obtained assets of others, in return for a proportionately lighter sentence. Consideration should be given to not allow such a mechanism for principals in organised criminal syndicates.

8. Adopt and Implement Mechanisms for a Centralised Asset Recovery Office (ARO)

Consideration should be given to strengthening the Department for Coordination of Special Confiscation Issues (within the General Prosecutor's Office) to help ensure that its legal and operational framework are consistent with EU good practices in terms of centralised Asset Recovery Offices (AROs), many of which house under one roof, officials with access to databases of, for example, the taxing authority, vehicle registry authority, land registry authority, business records authority, criminal records authority and related entities, in order to allow the ARO (or similar mechanism) to provide law enforcement (police and prosecutors) with consolidated reports on the assets held by those suspected of serious criminal activity, as well as assets in the possession of their family members and/or possible associates – in light of the fact that most who launder assets do not launder them in their own name.

9. Adopt and Implement Mechanisms for a Centralised Asset Management Office

Consideration should be given to ensuring that a centralized Asset Management Office (which can be combined with the above-mentioned Department for Coordination of Special Confiscation Issues) is in place for the transparent management of seized and confiscated assets, and for the public auctioning off of seized assets which are subject to significant depreciation (with the proceeds from such sales to be held in a State bank account until the case is fully adjudicated), as well as the public auctioning off, as the rule, not the exception, of all confiscated assets, particularly if the State does not have the capacity to effectively optimise the management of such assets. Exceptions may exist, for example, for assets which are businesses in which innocent individuals may lose their jobs if the asset is auctioned off, or where some assets can, in a transparent manner, be distributed to local communities for optimised use, or to State entities (e.g., vehicles to the National Police for undercover operations, as long as checks are in place to avoid corrupt distribution or misuse of such property). Public policies should be put in place to ensure that a significant percentage of the proceeds from the sale of confiscated assets should go to high-priority development needs (e.g., to build schools, clinics, infrastructure).

10. Establish or Strengthen Non-Penal Mechanisms of Civil Confiscation

Given that money laundering cases often take years to adjudicate, and thus to produce a final order for confiscation of assets linked to organised criminal activity and corruption, and given that this produces an inherent, and often justified, perception by the public that the criminal justice system is too slow in the recovery of assets, strong consideration should be given to the establishment and/or strengthening of non-penal mechanisms for the seizure and confiscation of assets (civil confiscation) – once such mechanisms are in place, and are being implemented (still, with due process for any individual seeking to claim title over such assets), this can reduce the time to confiscate assets from a period of years to a period of several months, and thus bolster public confidence in the judicial system, as well as facilitate the funding of high-priority development needs, as well as funding for law enforcement and judiciary entities charged with the fight against organised crime and corruption.

11. Empower the Taxing Authority to More Effectively Seize and Confiscate Assets

Given that Azerbaijan is estimated to lose over US 33 million in taxes every year,[137] consideration should be given to strengthening the authority and capacity of the Taxing Authority, to allow it to more effectively seize and confiscate assets (while still providing due process) linked to tax evasion and other unreported income and assets.

12. Strengthen Mechanisms for Investigating Authority Access to Financial Information

Consideration should be given to empowering ML/TF investigating authorities to access financial information including financial transactions, bank accounts or tax payments, commercial or professional secret information in the pre-investigative phase without initiation of an official investigation. This should be accompanied with

qualitative mechanisms for sanctioning investigating authorities for any abuse or mis-use of such information.

13. Strengthen Reporting Requirements of Multinational Companies

Consideration should be given to strengthening mechanisms to ensure that multinational companies publicly disclose their revenues, profits, losses, sales, taxes paid, and subsidiaries.

14. Tighten Controls on Financial Institutions to:

a. Report suspicious transactions;

b. Identify true ("beneficial") owners of bank accounts, companies and trusts;

c. Vigorously sanction financial institutions and other reporting entities which do not comply, including heavy fines and/or closure (temporary or permanent) of such financial institutions or reporting entities; and

d. Ensure that all reporting entities report suspicious financial transactions to the FMS.

15. Strengthen Anti-Corruption Monitoring and Awareness Plans

Consideration should be given to strengthening anti-corruption awareness plans and measures for corruption-prone sectors, such as the health and the security sectors, and adapt activities for various target groups, with appropriate funding for implementing these measures.

16. Bolster Capacity-Building that Incentivises Ethical Conduct, Including for Members of the Judiciary

Consideration should be given to developing systematic and ongoing training programmes on ethical conduct for judges. Training should include topics such as conflict of interests, incompatible activities, financial disclosure requirements, gift policies, and reporting of corruption. Mechanisms should be considered for not only preventing and reporting corruption, but for incentivising ethical conduct.

17. Bolster Dialogue (and Effective Responses to Dialogue) with Civil Society

Strong consideration should be given to strengthening mechanisms for regular dialogue and feedback from civil society and citizens, particularly with respect to where recovered assets should be distributed, as this will help to engender public confidence with respect to transparency in the management and distribution of recovered assets.

18. Bolster Cross-Border Cooperation Regarding the Tracing freezing, Seizure, Confiscation and Recovery of Illicitly-Obtained Assets

Consideration should be given to strengthening regional and international cooperation, particularly through regular face-to-face dialogue with police and prosecutorial focal points in other key countries regarding the tracing, freezing, seizure, confiscation and recovery of assets linked to organised criminal activity (and corruption), and the speedy resolution of pending cases. Such can include, on a case-by-case basis, agreements to share confiscated assets, as a means to incentivise cross-border cooperation.

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The United Nations Interregional Crime and Justice Research Institute (UNICRI) was established in 1968 pursuant to Economic and Social Council Resolution 1086 B (XXXIX) of 1965, which urged an expansion of the United Nations activities in crime prevention and criminal justice. The Institute is an autonomous institution and is governed by its Board of Trustees.

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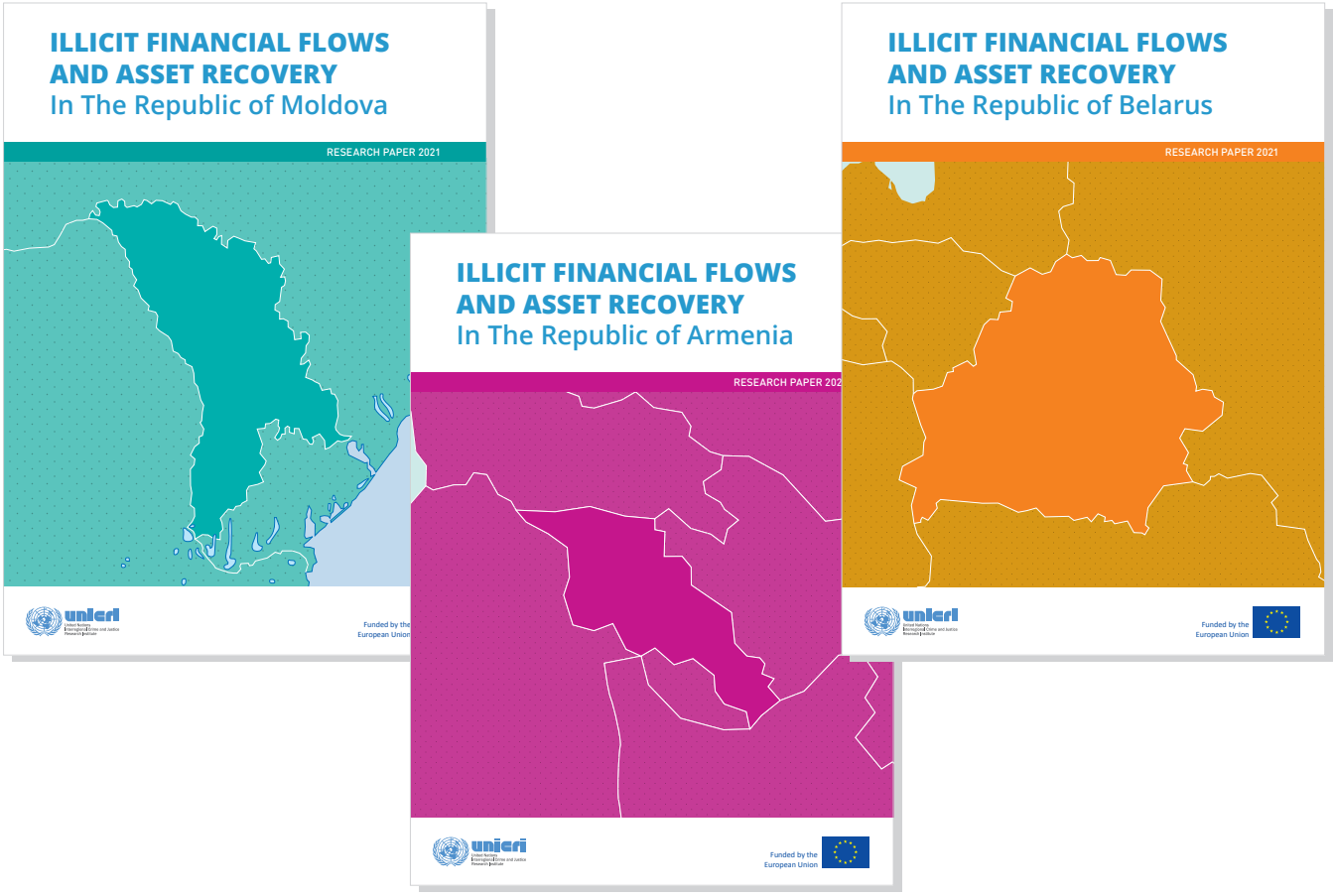

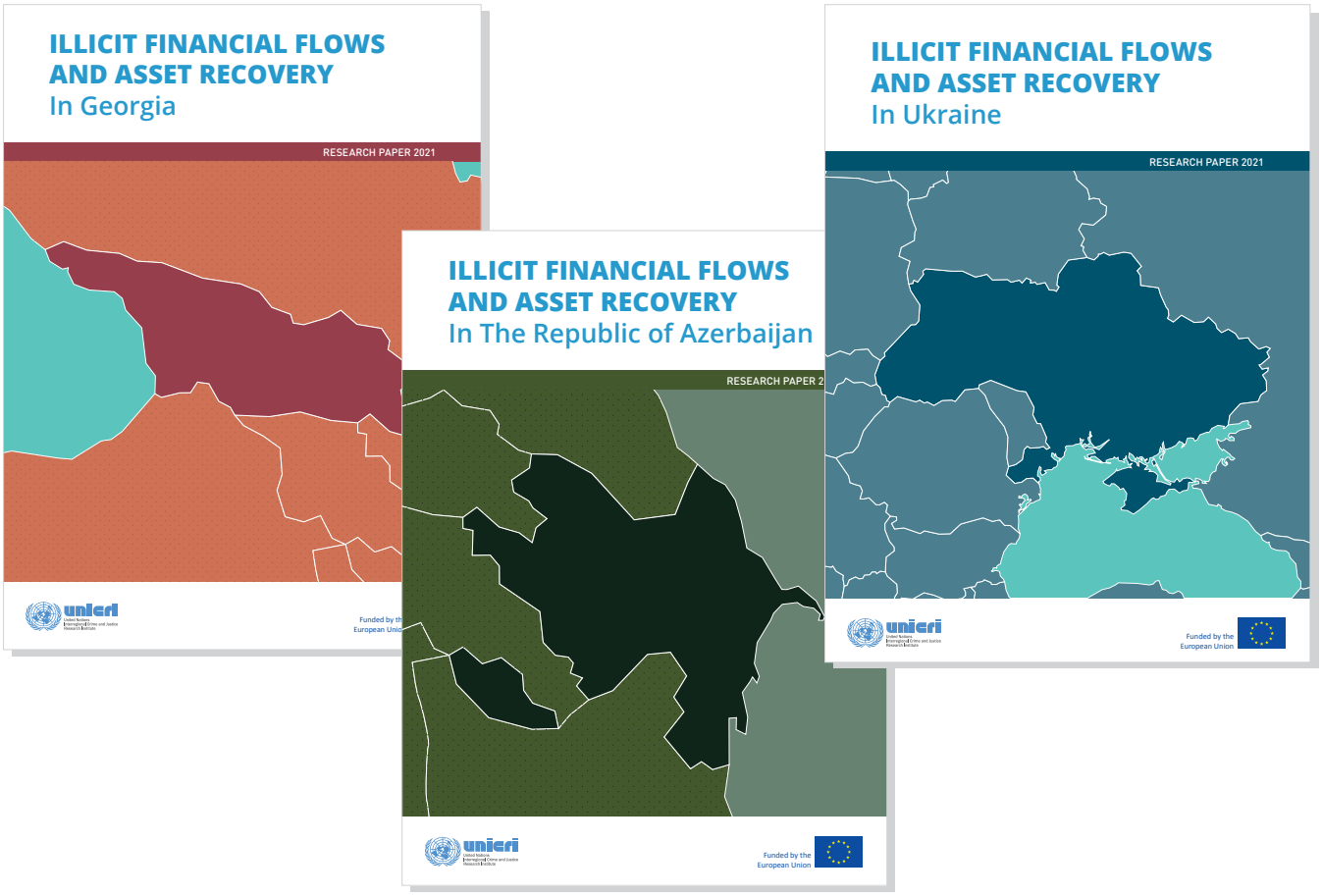

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