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WCO Global Conference on

Illicit Financial Flows (IFFs)

& Trade Mis-Invoicing

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WCO Global Conference

The Headquarters of the World Customs Organization (WCO) hosted its Global Conference on Illicit Financial Flows and Trade Mis-Invoicing on May 23, 2018. The Conference brought together over 100 participants from various Customs administrations, international organizations and the private sector, that shared a common interest in this cross border trade issue. Illicit Financial Flows (IFFs) have become a major global issue and a significant research topic in the fight against corruption.

The reduction of IFFs have been prioritized by several international organizations including the United Nations, and have been targeted as part of its Sustainable Development Goals (SDGs). IFFs are generally linked to corruption, crime and tax evasion and often occur with the cross-border transfer of money and other financial assets. By their very nature, these cross-border transactions are both hard to track and difficult to measure. As such, enforcement agents like Customs, have committed to analyse and collaborate with other international organizations to combat this global problem.

Defining IFFs

A major challenge among stakeholders is achieving consensus on an appropriate definition for IFFs that incorporates the varying dimensions of all illicit cross-border transactions. According to the WCO, “unanimous agreement concerning definition, methodologies and even the extent of the problem has proven challenging, given the diversity of the stakeholders; from Tax and Customs administrations to Financial Intelligence Units to international organizations.”

WCO Study Report

In response, the WCO commissioned a Study Report on the topic of IFFs and trade mis-invoicing, pulling on expertise from Member administrations, the WCO Secretariat and other industry experts. The Study Report provided the narrative background to the Conference, where co-authors were invited to present their research. Chaired by the Secretary General of the WCO, Kunio Mikuriya, the opening session of the conference focused on assessing the dimensions of IFFs via trade mis-invoicing, and explored the various methodologies used by academia to analyse the subject area.

Illicit Financial Flows

Research Methods for IFF Assessment

Subject to the availability of data by researchers, the Partner Country Method and the Price Filter Method are preferred for the assessment of IFFs and trade mis-invoicing. The academic research conducted on IFFs and trade mis-invoicing was aligned to the WCO's Study Report and concluded that cross-referencing the two methods can be a useful mechanism to detect suspicious trade transactions.

The Partner Country Method

The partner country method is a trade analysis approach for estimating mispricing in international trade, based on data comparison of import/export statistics between trading partners. It is assumed that import and export values declared should reflect legitimate pricing that would have occurred between unrelated parties. This of course is subject to reliable information and the assumption of non-manipulation of trade statistics.

The Price Filter Method

The price filter method approach uses highly disaggregated trade data in the analysis of transaction prices for individual product categories in order to establish the legitimate price range for each. It is assumed that the legitimate price range established should reflect transaction values from unrelated parties whose commercial relationship is determined by applicable world market prices. This approach uses the interquartile price range of the trade data to determine the legitimate price of the commodity and is often referred to as the arms length price range. Another version of the price filter analysis method uses the availability of free market prices on a particular

What are Illicit Financial Flows ?

While the term illicit financial flows is increasingly used throughout global discussions, there is no consensus on its precise definition or the extent of its coverage. Illicit financial flows according to *Baker (2005) and the Global Financial Integrity (GFI),* refer to 'cross-border movements of money that is illegally earned, transferred, or utilized'. Additionally, legally earned money may become illicit, if for example, it is transferred abroad in violation of export control regulations or corporate tax laws.

Illicit capital may be transferred abroad in numerous ways. The Financial Action Task Force (FAFT) distinguishes 3 main methods in which money can be transferred cross border with limited scrutiny by government authorities, which are as follows:

- *i) through the use of the financial system,*
- *ii) through the physical movement of bank notes, and*
- *iii) through false documentation or declaration of traded goods and services (commonly called trade mispricing)*

Trade mis-invoicing

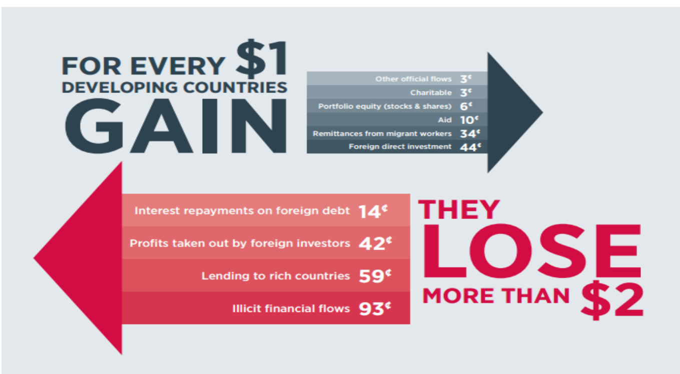
Trade mis-invoicing or trade mispricing is the largest component of IFFs, and is typically used with the intent of money laundering, directly evading taxes and customs duties, claiming tax incentives and dodging capital controls. It incorporates situations where contractually unrelated parties collude and intentionally misstate the quantity, value, or composition of goods on customs declarations or invoices, for the purpose of moving money illicitly across borders. This has negative implications on the verification of customs valuation, tariff classification and rules of origin. The movement of capital cross border has long been a topic of interest for customs administrations and other international organizations concerned with illicit financial flows.

Illicit Financial Flows

The World Bank Group (WBG)

The World Bank Group defines cross-border movement of capital associated with illegal activity, specifically, as that which is illegally earned, transferred or used. The WBG contemplates these activities under 3 main areas when:

- *The acts themselves are illegal (e.g., corruption, tax evasion); or*
- *The funds are the results of illegal acts (e.g., smuggling and trafficking in minerals, wildlife, drugs, and people); or*
- *The funds are used for illegal purposes (e.g., financing of organized crime).*



The World Bank Group (WBG) suggests that, irrespective of a precise definition of IFFs, flows and activities that have a clear connection with illegality are an impediment to development. Developing countries are particularly at risk for capital flight, largely resulting from the illegal exploitation of natural resources, inter alia, contributing to the diversion of monies from public priorities. The WBG prioritizes the understanding of how and why money flows out of developing countries, and devises strategies to stem these flows. These strategies are largely dependent on country context and the underlying factors that result in financial outflows. The WCO endorses such strategies and proposes that criminal activities by all means should be prevented and reinforced by strong sanctions targeting illegal tax evasion. Tax policies should be transparent, which should ameliorate revenue collection for governments and minimize

International initiatives

International initiatives have also been undertaken to limit tax evasion and address capital flight from the proceeds of crime. Although these initiatives are ongoing, efforts to stem IFFs have not been sufficient. International organizations such as the Organization for Economic Co-operation and Development (OECD) /Global Forum on Taxation, the Financial Action Task Force (FATF) and the United Nations (UN) Conventions against Drugs, Trans-national Organized Crime and Corruption (UNODC) have been instrumental and have led the cause for over two decades to curb global issues relating to IFFs. The WBG proposes that a new and invigorating approach is required to address the challenges of IFFs. Greater coordination and cooperation among the private sector, governments, international organizations and civil society is needed to devise more comprehensive strategies to reap greater rewards in curbing IFFs.

International Strategy

The WCO Global Conference on Illicit Financial Flows & Trade Mis-Invoicing is one such strategy which seeks to comprehensively explore solutions to minimize the negative effects of this global issue. The Conference was organized around three main themes which comprised of presentations from the WCO Secretariat, Academia, Customs administrations and other international organizations. The initiating discussion panel was chaired by the WCO Secretary General Kunio Mikuriya and began by exploring the “Magnitude of IFFs via Trade Mis-Invoicing”. Ensuing discussions continued with the sharing of “Best Practices in Combating IFFs and Trade Mis-Invoicing” which was chaired by Ping Liu, Director, WCO Trade and Tariff Directorate. The concluding discussions explored “New Technologies: Blockchain”, which was chaired by Ana Hinojosa,

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Recommendations

Coming out of the Global Conference, it was concluded that Customs needed to be better equipped in terms of material and human resources, to deal with the scourge of IFFs and trade mis-invoicing. Particular mention was made of the African continent and the devastating effects that IFFs had on several countries therein. Baso Sangqu, South African ambassador to Belgium urged Customs and other policy makers to do all within their power to counter the flow of illicit finances in all guises. Under invoicing of transaction values has typically been a topic of focus, especially in the verification of values declared to customs. However, over invoicing has become increasingly problematic for certain administrations and during the panel discussions on best practices, testimonials were offered by both Korea Customs and the Nigeria Customs Service, who advocated for a shift in focus from undervaluation to overvaluation. The FATF outlined practical policies that could be implemented by customs to facilitate information sharing, such as the standardization of data formats and the centralization of data for operational uses. The OECD advocated for interagency cooperation and the need to adopt a whole of government approach for strategy development to combat the problems associated with IFFs. New technologies such as blockchain were identified to explore the possibilities and potential limitations of such applications. Blockchain technology promotes transparency and allows the creation of immutable records and the decentralization and distribution of transaction ledgers. This technology supports accurate information sharing and is beneficial for revenue collecting agents such as customs and other tax administrations. The WCO highlighted that its Study report is a “living document” that will be shared among Members and represents “the culmination of many months of empirical analysis and collaboration between Administrations, the Secretariat and other industry experts.” The importance of keeping abreast of technological changes and advancements was also highlighted as the way forward, where the WCO and Customs were urged to keep abreast of the changes in the rapidly evolving technological realm.

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The International and Industry Liaison Unit is committed to raising the level of awareness on topics relating to the Caribbean Community, as well as issues concerning the wider topic of international trade, to both our internal and external stakeholders. Our monthly newsletter seeks to highlight global trade topics and their importance to Customs Administrations worldwide and specifically how they affect the Jamaica Customs Agency. As we realize our vision of becoming a modern Customs administration delivering excellent service, we recognize the importance of knowledge transfer in delivering our objectives and use this forum as our way of contributing to the vision of the JCA. The International Liaison Unit is located at the Myers Wharf head office and our officers are available to respond to your queries and clarify any points of concern.

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