

Illicit Trade and Illicit Financial Flows

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Overview of the Presentation



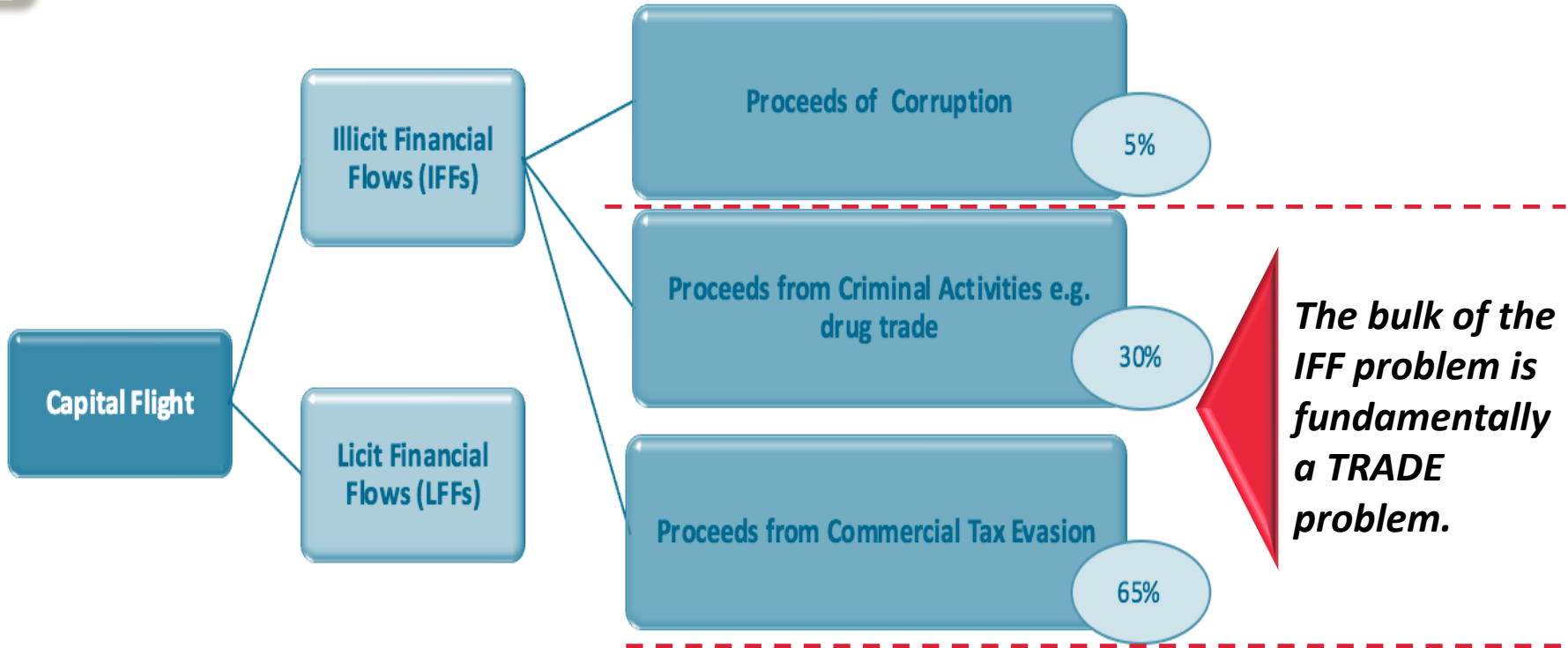
Presentation Overview

- 1 Introduction – the Relationship between Illicit Trade and IFFs**
- 2 Illicit Trade – A South African Perspective**
- 3 Cross-border Difficulties**
- 4 Curbing and Measurement**
- 5 Policy Actions to Curb Different Types of IFFs**

Introduction and Background



The Relationship between Illicit Trade and Illicit Financial Flows (IFFs)



- Dev Kar, lead economist at **Global Financial Integrity (GFI)**, defines IFF or illicit money as “money that is illegally earned, transferred, or utilised. Somewhere at its origin, movement, or use, the money broke laws and hence it is considered illicit.”
- **UNDP**, definition: “include, but are not limited to, cross-border transfers of the proceeds of tax evasion, corruption, trade in contraband goods, and criminal activities such as drug trafficking and counterfeiting.”

Introduction and Background



New Approach to Defining/Categorising IFFs for SDG Indicator 16.4.1

Components of IFFs for SDG Indicator 16.4.1.

Illicit Trade Components

Tax and Commercial Practices

Includes both **illegal practices** such as **tariff, duty and revenue offences, tax evasion, corporate offences and market manipulation**, but also practices that are **legal but may be considered illicit**.

Illegal Markets

Domestic & international trade in **illicit goods & services**; often involve a degree of criminal organization and are aimed at **creating profit**. They include any type of **trafficking in goods such as drugs, firearms, or services such as smuggling of migrants**

Theft-type and Terrorism

Forced, involuntary and illicit transfer of economic resources between 2 actors (e.g. theft, embezzlement, fraud). **Terrorism financing**, and all other financial flows of either licit /illicit origin used to fund illegal activities – are **illicit, voluntary transfers of funds between 2 actors**.

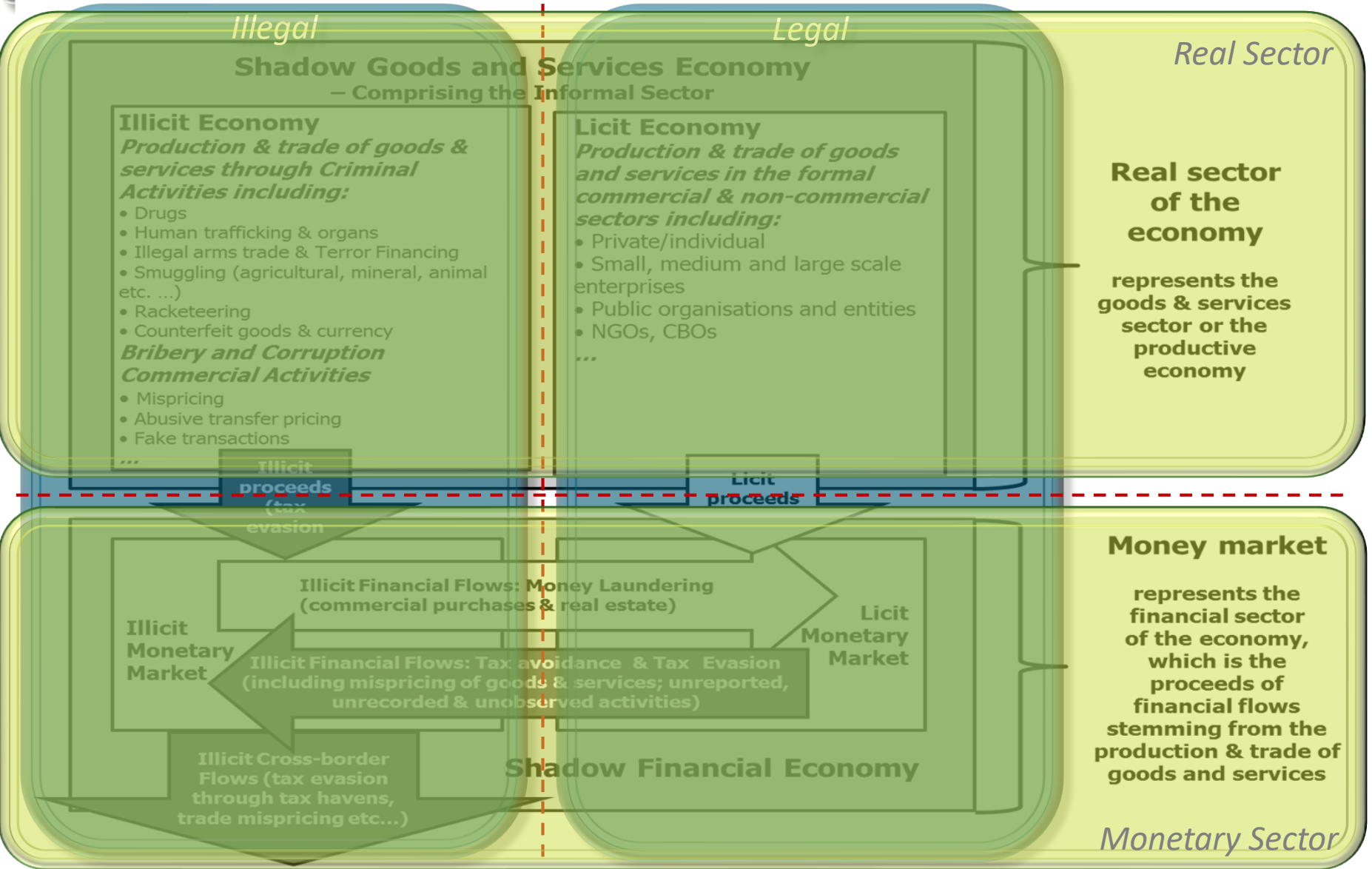
Corruption

Misuse of a public or private position for direct or indirect personal gain. UNCAC provides a list of acts considered as corruption including **bribery, embezzlement, trading in influence, etc.**

Introduction and Background







Illicit Trade is on the real side of the economy and the IFF on the monetary side



Introduction and Background



Some ideas where

	Illicit Financial Flows	Transfer Pricing	Trade Pricing	Trade Based Money Laundering
				
Concept	Economic (Financial/FDI)	Accounting and Tax	Economic (Trade)	Law Enforcement (Financial crimes)
Origins	<ul style="list-style-type: none"> Theory on Capital Flight 	<ul style="list-style-type: none"> Accounting Payments / Transactions between related entities 	<ul style="list-style-type: none"> Direction of Trade Statistics General Agreements on Trade 	<ul style="list-style-type: none"> Organised Crime Trans-national Crime Bootlegging
Status	<ul style="list-style-type: none"> Legal (ito Excon) Immoral/Illicit Illegal 	<ul style="list-style-type: none"> Legal Abusive form (mispricing) = Illegal 	<ul style="list-style-type: none"> Legal Trade mispricing – illicit/illegal 	<ul style="list-style-type: none"> Illegal



Illicit Drugs

Anti-piracy using the blockchain

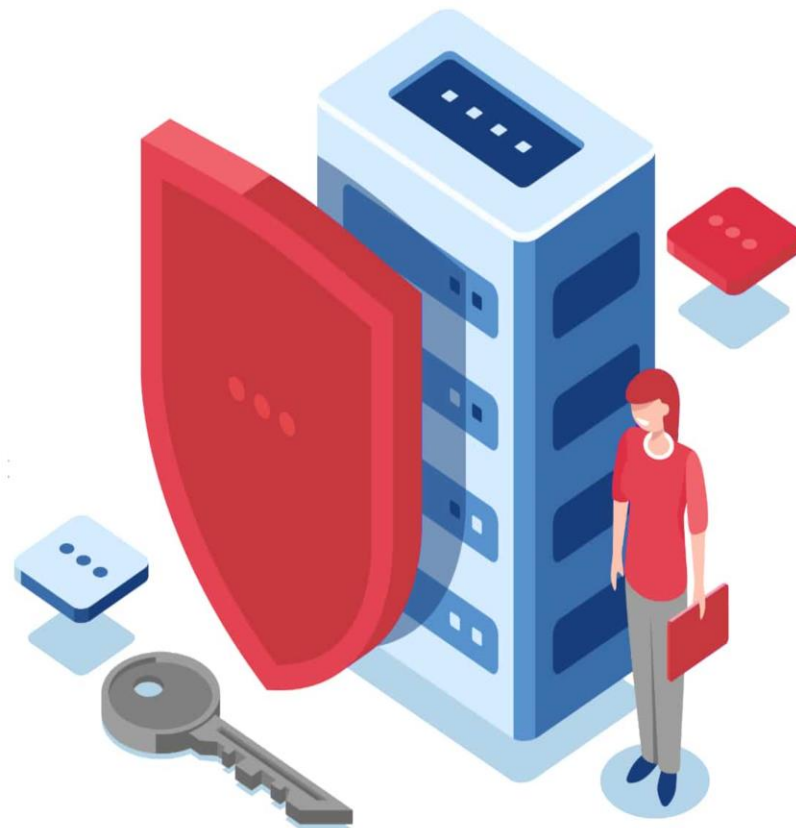
Custos combines patented blockchain technology with forensic watermarking to keep media files secure and unshared both online and offline, and to detect content leaks when they happen.

- Robust Watermarking
- Global Tracking
- Unique to Each Recipient
- Leak Alerts
- Embedded Bounties
- Pinpoint Leak Source



Oceans-megal-fishing-awarjs-ivory-and-rhino-horn-poaching

- SA calamari being hauled illegally as Falkland calamari



- Brussels bombings traced through Counterfeits



Illicit Trade – A South African Perspective



Illicit Trade in South Africa – Prevalent Sectors (2)

Forestry



- *Illegal logging is an issue for the Department of Agriculture with hotspots identified.*
- *Not quantified.*

Pharmaceuticals



- *TM Est. \$61,2m outflow (2013).*
- FIC and SARS adjusted estimate*

Pesticides



- *TM Est. \$300m (2013)*
- FIC and SARS adjusted estimated*

Petroleum



- *TM Est. \$7,7bn outflow (2013)*
 - *SARS focus area*
- FIC and SARS adjusted estimate*

Precious metals and gems



- *TM Est. \$5,2bn outflow (2013).*
- FIC and SARS adjusted estimate*

Illicit Trade – A South African Perspective



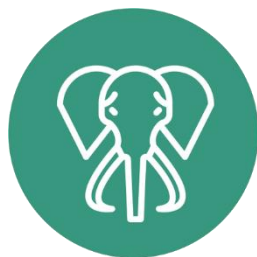
Illicit Trade in South Africa – Prevalent Sectors (3)

Trafficking in Persons



- *Not estimated.*
- *Seen as low risk...*
- *Clothing manufacturing – ILO SCORE study identified forced labourers being trafficked to work in Chinese sweat-shops*

Wildlife



- *Illicit rhino horn est. at \$785m (2013).*
- *Or \$795m including environmental lost opportunity cost*

Tobacco

- *TM Est. \$760m inflow (2013).*
FIC and SARS adjusted estimate
- *Seizures est. at \$190m (2019)*



Miscellaneous (commodities not specified elsewhere)

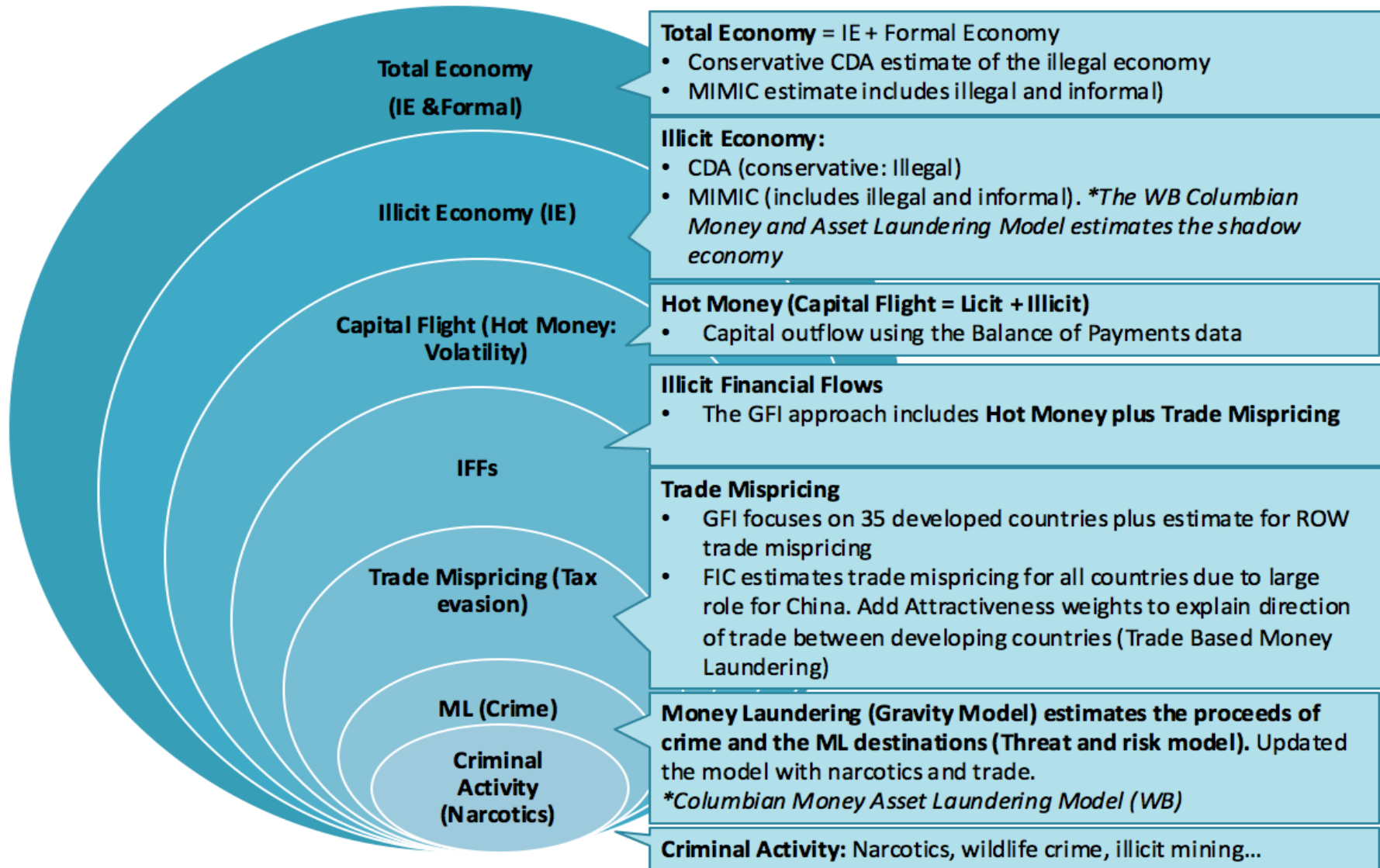
- *TM Est. \$33bn outflow (2013) or 75% of Trade Mis-invoicing*
FIC and SARS adjusted estimate
- *Non-monetised gold to China via Hong Kong*



Illicit Trade – A South African Perspective



Illicit Trade in South Africa – Measuring the Illicit Economy, Illicit Trade and IFFs



Cross-border Challenges, Measurement and Curbing Illicit Trade and IFFs



Only as good as the weakest link, your neighbouring country

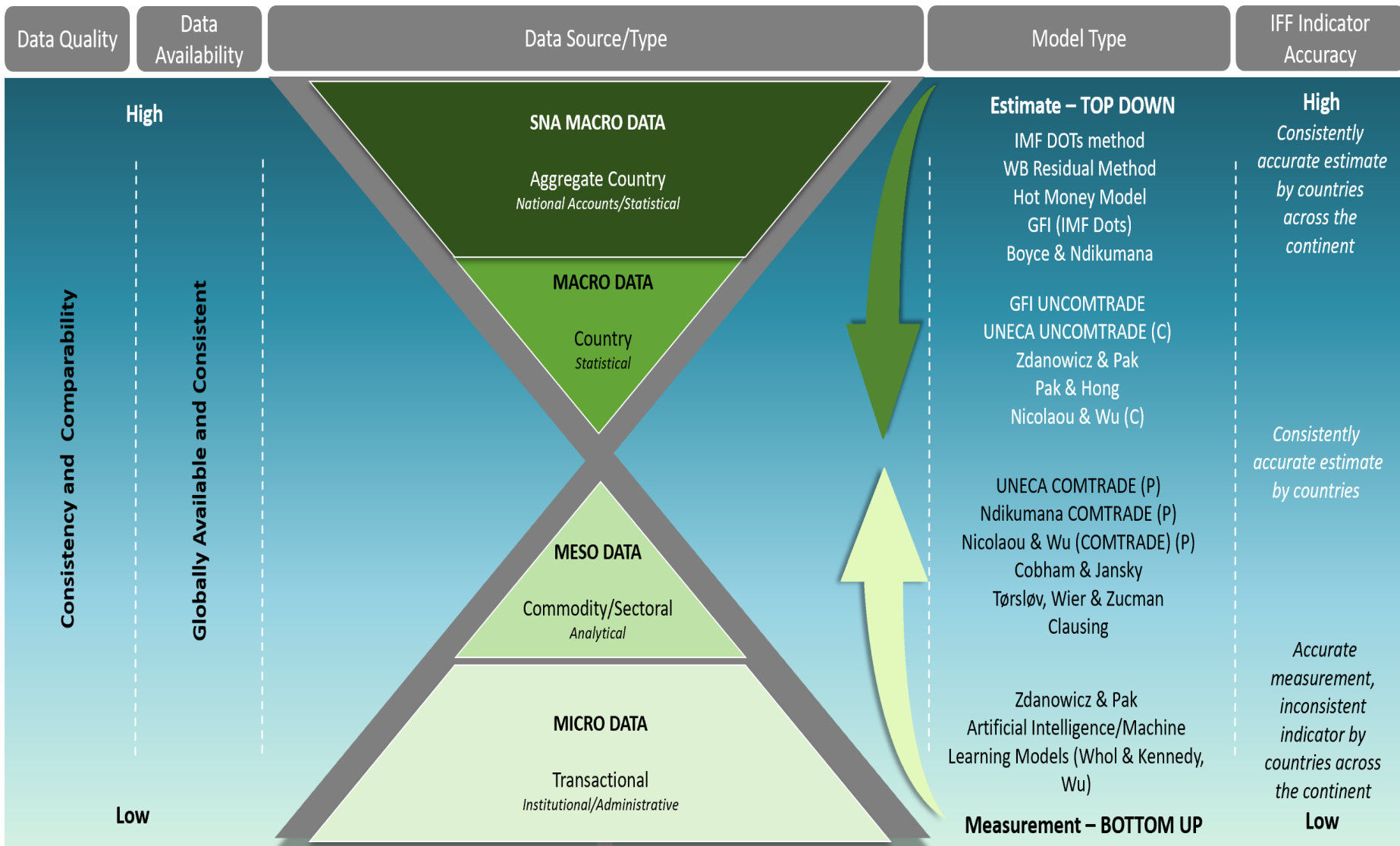
Manguzi protesters demand action over cross border crime at Kozi Bay (South Africa and Mozambique border)



Measurement and Curbing Illicit Trade and IFFs



Criteria to measure commercial tax malpractices – UNECA approach



Measurement and Curbing Illicit Trade and IFFs



Measuring a hidden phenomenon (UNECA): current capabilities in Africa

SDG
Indicator
16.4.1

Top-Down Estimate

Indicator A

MACRO
Estimate

Capital: Narrow Hot Money Model

Current: Trade Mis-invoicing (IMF) or Updated v2

Data Source:

- SNA MACRO
- IMF
- IMF DOTS

Indicator B

MESO
Estimate

Capital: Narrow Hot Money Model

Current: Trade Mis-invoicing (UNECA) *with variations*

Data Source:

- SNA MACRO (IMF)
- UNCOMTRADE

Indicator C

MICRO
Measure

Profit Shifting by MNCs (Cobham & Janský)

Undeclared Offshore Assets (Cobham & Janský)

Current: Trade Mis-invoicing (Zdanowicz & Pak)

AI-ML PILOT: Whol & Kennedy and Wu
Use supervised and unsupervised learning and clustering techniques

Data Source:

- OECD CRS
- Transactional
- CBN/NFIU - cross border
- NCS - Customs

Bottom-Up Measurement

Measurement and Curbing Illicit Trade and IFFs



Data anomalies and data challenges

- **Mapping:** Linking standardised (or harmonised) national I-O tables to international bilateral trade matrices is problematic, resulting in classification anomalies.
- **Coverage** of data is not complete in all countries, some developing countries do not report and mirror data is used. Quarterly data updates result in analysis inconsistencies
- **Reporting:** Exporters and importers may report the same trade differently due to various factors e.g. (import cost, insurance and freight), timing, FOB, inclusion and exclusion of some commodities, etc...
- **UNCOMTRADE reporting standards:** creates variances in reporting as some countries use General method, other use Special, some apply strict rules others not
- **UNCOMTRADE AND IMF DOTS Source and destinations countries:** Reported trade is affected by transit destinations and reporting anomalies of source and destination countries. This results in incorrect statements of the variances (Up/down)
- **Services:** Missing traded services hence the need to include the Hot Money analysis.
- **Clandestine Activities:** Measuring illicit financial flows/TBML is difficult at the macro level since proxies need to be used to estimate clandestine activities not reported

Policy Actions to Curb IFFs



Multi-disciplinary approach is the key

- **Addressing the data is the first critical step...** large variations in the results are problematic
- Enforcing **WCO's Unique Consignment Reference is CRITICAL**
- **Introducing a Benchmark pricing tool (e.g. GFTrade)** to be incorporated into customs risk engine to red flag suspicious
- Enforce **bilateral exchange of customs information** and introduce similar oversight and reporting structures as in the tax arena
- **Social Network Analysis and black-listing** of perpetrating enablers (from actual cases) – shipping companies, logistics companies, bankers, lawyers, accountants, auditors, etc.
- Cooperation and coordination between (domestic and international) authorities
 - ✓ Tax authorities
 - ✓ Customs authorities
 - ✓ Central banks
 - ✓ FIU's
 - ✓ LEAs and Judiciary



Policy Actions to Curb IFFs



Multi-disciplinary approach is the key

- Risk assessments critical and typology studies to flag risky perpetrators.
- Fundamental for **FIUs to analyse trade data** (at customs/granular level) for TBML
- Training and capacity building on IFFs, illicit trade, tax and commercial malpractices and TBML
- Standard ML transparency toolkit applies (KYC, ECDD, CbC reporting, Beneficial ownership,...)
- **Big data analysis and the use of artificial intelligence and machine learning is critical**
- **Identify enablers/perpetrators** (REGISTRY) and redline all their activities.

Policy Actions to Curb IFFs



Multi-disciplinary approach is the key

Comparison between Abusive Transfer Pricing and Trade Mispricing

Abusive Transfer Pricing

Trade Mispricing/Mis-invoicing/TBML

Policy Tools – General and Specific

- Automatic Exchange of Tax Information
- DTAs
- Beneficial Ownership
- Demand Resource Mobilisation;
- Base Erosion and Profit Shifting (including Country-by-Country Reporting); and

- Automatic exchange of customs information;
- GATT
- Beneficial Ownership
- Improved vetting and controls at customs authorities;
- Benchmark pricing tools in customs risk engine (i.e. the GFI TM online-real-time tool); and
- Enforcement of Unique Consignment Reference to track consignments

