Trade Misinvoicing: Challenges & Way Forward

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Illicit financial flows deprive nations of significant resources and pose a major threat to global economic stability. Tax evasion, currency controls, illegal trade in natural resources, smuggling, cross-border crime account for a major chunk of illicit funds flow. However, with an exponential increase in volume of commercial trade, trade mis-invoicing has emerged as a preferred mode of laundering illicit funds. Customs and global financial institutions have found it difficult to prevent and reduce the incidence of trade mis-invoicing. Against this backdrop, digitization of customs operations and single window system for trade processes can help in effective monitoring of transactions. Also, Artificial Intelligence, Big Data and Blockchain offer potential solutions for improving transparency in global trade processes, securing supply chains and improving trustworthiness of information. In addition, an international regulatory framework to prevent trade-based money laundering can be developed to minimize the flow of illicit funds laundered through trade mis-invoicing.

INTERNATIONAL trade has been a major driver of global economic growth and development. With trade, countries have specialized in commodities of their comparative advantage and facilitated efficient allocation of resources across the world. Trade facilitation also furthered the exponential growth in global trade witnessed over the years with volume of world merchandize trade growing by 9.7 per cent in 2021 and commercial services trade growing by 16 per cent[1].

Commercial trade has also been facilitated by the seamless transfer of funds across the world and availability of various trade finance instruments. However, the global financial system is increasingly being exploited by money launderers for transfer of illicit financial flows across regions. Tax evasion, currency controls, cross-border crime, illegal trade in natural resources, and smuggling account for a huge chunk of illicit funds. Over time, money launderers have developed sophisticated methods of misrepresenting the origin of illicit funds and integrating these into the formal banking channels with global trade being the most preferred channel. Deliberate over invoicing and under invoicing of trade bills, multi-invoicing, short and over shipments, phantom shipments and Black-Market Peso Exchange, are some of the most common methods used in trade for transfer of illicit funds.

However, given the ever-increasing volume of commercial trade, it is a daunting task for the Customs to track these shipments. Non-availability of real time information on prices of transacted goods, limited sectoral expertise, paucity of staff and commodity misclassification make it difficult to detect trade mis-invoicing. Likewise, financial institutions face numerous problems such as manual processing of trade documents, difficulty in assessment of true values of traded commodities and dual use of traded goods. Banks are also unable to ascertain the veracity of bills of lading or if multiple invoices were generated for the same shipment. Fear of losing business also forces banks to keep the payment processes simple and hassle free. The fast pace of commercial transactions also prevents the trade finance staff from conducting adequate due diligence.

Although the WTO Agreement on Customs Valuation provides for exchange of valuation information between customs administrations, importing countries need to fulfill a number of conditions before they can seek any information on transaction value from the Customs Authorities of the exporting countries. It is also an onerous task

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(Views expressed are personal.)

for the importing Customs department to use the alternate methods of valuation for assessment and that too in a specific sequence, as stipulated in the Agreement, to determine the actual transaction prices.

As per the Global FinanciaI Integrity (GFI) Report, the sum of value gaps identified in trade between 135 developing countries and 36 advanced economies over the period 2008-2017 is estimated to be US$8.8 trillion[2]. However, the problem of trade mis-invoicing is not just restricted to developing and least developed countries as significant amounts of illicit financial flows occur between the most advanced countries. The estimated value of trade mis-invoicing within OECD countries is estimated to be at least US$12 trillion over the period 2006-2016[3].

However, trade mis-invoicing has serious repercussions for the global economy with countries losing significant revenues and illicit funds being circulated for unlawful activities in the global financial system. The World Customs Organization (WCO) urges the Customs authorities to adopt an efficient risk management system and outlines three major steps in this direction. Customs should set up a valuation database to detect mis-invoicing and monitor international trade transactions at regular intervals to identify skewed export and import patterns. In addition, each trader and business operator should be assigned a risk rating based on compliance history to determine the appropriate Customs controls[4].

The WCO also advocates a comprehensive valuation control programme under which controls should be carried out at three stages, that is, pre-clearance, post-clearance and at the time of Customs clearance. Customs should also be given a mandate to access the financial database of traders to ensure correspondence between the invoiced value and the payments made[5].

Along with the Customs, financial institutions play an equally important role in minimizing the flow of illicit funds. Customer Due Diligence helps banks collect important information about their clients such as line of business, sources of income, trade partners and existing business relationship with other financial institutions. Transaction Due Diligence enables the trade finance staff to know whether payments are being directed to FATF black listed individuals or entities based in countries with poor AML/CFT regulations or if trade is occurring in high-risk goods or shipping vessels are being routed through tax havens. Advanced analytics can also help in effective monitoring of transactions for both financed as well as non-financed trade.

International organizations such as the Wolfsberg Group, Bankers Association for Finance & Trade (BAFT) and International Chamber of Commerce (ICC) also provide assistance to financial institutions in trade finance, anti-money laundering and combating terrorist financing. These organizations come out with a number of guidelines, reports and publications, to help banks in effective management of financial crime risks. Financial Action Task Force (FATF), the global anti-money laundering watchdog, also lays down forty recommendations to combat money laundering and terrorist financing.

Global databases such as the United States Federal Reserve Economic Data, International Monetary Fund Primary Commodity Data Portal, ITC Market Analysis Tools Portal, provide information on prices of traded goods and can be a ready reference for banks to verify transaction prices. GFTrade is another tool that can be used by Customs officials and financial institutions to compare transaction prices with average prices for previous trades of the same products as reported by the trading partner[6]. The database incorporates official trade data from 60+ countries and is updated on a monthly basis.

Most importantly, digitization of customs operations and trade processes is a prerequisite for implementation of technologies such as Artificial Intelligence, Big Data and Blockchain in international trade. In recent years, White Papers on promoting trade facilitation through blockchain have been prepared by the World Economic Forum, InterAmerican Development Bank and UN/CEFACT to highlight how blockchain can reduce information asymmetries and improve trustworthiness of global trade data. Korea Customs Services (KCS) has undertaken several projects on implementation of blockchain in trade operations and customs processes, apart from Singapore's Open Trade Blockchain (OTB)[7] and Taiwan's blockchain-enabled

Cross Border Digital Trade Platform[8]. CADENA is another blockchain enabled solution funded by IDB and implemented by Customs authorities of 8 countries in the Latin American region for validation of authorized economic operators under the Mutual Recognition Agreements[9].

In addition, attempts should also be made to ensure automatic exchange of information between Customs administrations. The SAFE Framework of Standards to Secure and Facilitate Global Trade[10] stresses on use of harmonized standards for sharing of advance electronic cargo information on inbound, outbound and transit shipments. The Framework lays down a number of standards to strengthen cooperation between Customs, businesses and government agencies; promotes use of smart security devices to monitor movement of goods; and includes provisions for implementation of mutual recognition.

India has also taken a number of initiatives towards digitization of customs processes, such as the Customs Single Window Interface for Facilitating Trade (SWIFT) portal, the ICEDASH dashboard, electronic messaging system between shipping lines and custodians for electronic delivery orders, machine-based automated clearance of imported goods, faceless assessment under Turant Customs scheme, the National Logistics Portal Marine (NLPM). However, multiple submissions of documents is still a routine practice for traders as the ICEGATE portal, the Participating Government Agencies (PGA) portal and the port operating systems (POS) are not fully integrated with each other[11]. Lack of standardization across Indian ports also results in traders following different procedures for different ports[12]. However, to achieve seamless integration in trade processes, the SWIFT portal should be strengthened first. Once the single window system works efficiently, transaction settlement facilities could also be introduced on the portal to help Customs ensure correspondence between the transaction value and financial transfers between traders. The Port Community System (PCS1x), now subsumed in the NLPM, had introduced a similar provision for a payment aggregator gateway to reduce dependency on bank specific payment ecosystem.

India had set up the National Import Database (NIDB) in 2001 to detect under-valuation of imported goods. However, issues such as data quality, training of assessing officers, availability of infrastructure at customs stations, updation of information in NIDB and monitoring[13] need to be addressed before the database can serve its actual purpose.

National governments may also establish and legalize public beneficial ownership registries to know the true ownership of trading companies, freight forwarders and shipping corporations. Appropriate legislation may be enacted to enable Customs and Tax Authorities to access these registries[14]. This will help in tracking down the ultimate perpetrators in any illicit funds flow transaction.

Countries like Germany[15] and Australia[16] have established mechanisms, like Anti Financial Crime Alliance and Fintel Alliance, respectively, to foster cooperation between financial regulatory authorities, institutions, law enforcement agencies, banks, organizations and security agencies to tackle money laundering and terrorist financing. India can also establish similar mechanisms for sharing information between Customs, Tax Department, Financial Intelligence Unit and Financial Sector players. Government may also explore the possibility of introducing stringent provisions for trade-based money laundering in the Prevention of Money Laundering Act (PMLA). Bilateral agreements for exchange of cargo information may also prove to be more useful than multilateral agreements for information exchange. India had signed an MoU with Maldives in 2021 to exchange pre-arrival information of cargo transported between the two countries. In addition to this, Government of India has recently notified a new set of Rules, known as the 'Customs (Assistance in Value Declaration of Identified Imported Goods) Rules, 2023', to check systematic under-valuation of imports. The new rules empower authorities to mandate additional disclosure and certification requirements for goods identified on the basis of past trend of under-invoicing[17].

Use of electronic bills of lading can prevent significant delays in clearance of goods and reduce incidence of phantom shipments and fake bills of lading. Upgradation of infrastructure and capacity building can equip the customs and the trade finance staff to effectively deal with trade mis-invoicing.

Most importantly, attempts should be made to develop an international regulatory framework which can provide the much-needed guidance to developing countries, who can then establish a similar framework at the national level for their financial institutions. A standardized framework will help in quick monitoring of suspicious transactions and reduce the incidence of duplicate letters of credit and multiple invoices. The issue of illicit financial flows via trade mis-invoicing was taken up at the G-20 Summit Hangzhou in 2016 when the World Customs Organization (WCO) was requested by the G-20 countries to prepare a report on the same. The G-20 Anti-Corruption Working Group under Indonesia's Presidency has also come out with a 'Compendium of Good Practices on Regulatory Framework and Supervisory Measures for Legal Professionals to Mitigate Corruption-Related Money Laundering Risks' to highlight the best practices adopted by G-20 countries to deal with money laundering cases involving legal professionals[18]. India's G-20 Presidency gives an opportunity to deliberate upon these issues and launch similar initiatives to reduce the incidence of trade mis-invoicing.

One of the targets under Sustainable Development Goal 16 stresses on reducing illicit financial flows and arms flows, strengthening the recovery and return of stolen assets and combating all forms of organized crime by 2030. However, this can be achieved only when there is cooperation between traders, organizations, financial institutions, and regulators, both at the global and national level.

NOTES

1 World Trade Statistical Review 2022.

2 Trade-Related Illicit Financial Flows in 135 Developing Countries: 2008-2017, March 2020.

3 Trade Misinvoicing in OECD Countries: What Can We Learn from Bilateral Trade Intensity Indices?

4 Illicit Financial Flows via Trade Mis-invoicing, *Study Report 2018*.

5 Illicit Financial Flows via Trade Mis-invoicing, *Study Report 2018*.

6 https://gfintegrity.org/gftrade/

7 https://globaletrade.services/products/blockchain

8 Taiwan Customs Launches World's First Blockchain-Enabled Cross Border Digital Trade Platform-Customs administration.

9 https://www.wto.org/english/res_e/reser_e/pres_corcuera.pdf

10 SAFE Framework of Standards 2021.

11 Reforming Port Processes in India for Logistics Efficiency, ADB Briefs, No. 187, September 2021.

12 Reforming Port Processes in India for Logistics Efficiency, ADB Briefs, No. 187, September 2021.

13 https://www.dov.gov.in/nidb-manual

14 Trade-Related Illicit Financial Flows in 135 Developing Countries: 2008-2017, March 2020.

15 https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Meldung/2019/meldung_190925_Anti_Financial_Crime_en.html

16 https://www.austrac.gov.au/about-us/fintel-alliance

17 https://www.cbic.gov.in/resources//htdocs-cbec/customs/cs-act/notifications/notfns-2023/cs-nt2023/csnt03-2023.pdf

18 G-20 Bali Leaders' Declaration 2022.

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