Trade Integrity – A New Guiding Concept in Global Development

Conventional wisdom among development economists holds that increasing international trade is a highly effective tool to boost domestic resources for developing countries and is a key economic driver.[1] Further, the World Trade Organization has as a central tenet that trade facilitation[2] – the digitization of trade transactions – will accelerate processing of goods through ports and that more efficient handling will increase VAT and customs duties.

To be sure, this "more, faster" school of thought on global trade will bring increased benefits to developing economies. However, the singular focus to improve port-clearance efficiency fails to address the deficiencies inherent in the global trading system due to opacity of various forms. This opacity, in turn, is a structural flaw in the financial architecture which undermines a country's ability capture fully the revenues due them from their international trade transactions. On a global scale, cumulative lost revenues equate to a gross economic injustice, which undermines progress towards the Sustainable Development Goals (SDGs).

This Note introduces the concept of 'Trade Integrity,' provides an overview of the various types of opacity in global trade transactions, and proposes concrete solutions to eliminate the underlying asymmetries so governments can reap the proper rewards of international trade. Trade Integrity, defined as "international trade that is legally sourced, properly priced and delivered transparently," is meant to be a goal for all countries as well as a global norm to help support economic development, especially among countries that struggle to provide a robust social safety net.

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The need for new thinking in this area is apparent from the UN's *Financing for Sustainable Development Report 2023*[3] which has an entire chapter dedicated to trade as a driver of development. However, that chapter never mentions trade misinvoicing, trade fraud, trade-based money laundering or other trade-related issues that degrade the positive impact trade can have for developing economies. It completely ignores the estimated $1.6 trillion in trade misinvoicing that occurs in trade with developing nations each year[4] and the opportunity cost (i.e. reduced funds to reach SDG targets) due to illicit financial flows related to that illegal activity. This lack of focus on challenges to Trade Integrity mirrors the three trade-related targets in SDG 17 which only focus on increasing trade

[1] SDG Target 17.11 seeks to "significantly increase the exports of developing countries. ......"
[2] Trade facilitation was a primary outcome of the Bali round of trade talks in 2013
[3] United Nations Department of Economic and Social Affairs, April 2023, (https://tinyurl.com/bdd7tk76).
[4] Global Financial Integrity, *Trade-Related Illicit Financial Flows in 134 Development Countries: 2009-2018,* December 16, 2021, (https://tinyurl.com/36ada9tt).

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volumes and reducing trade barriers.[5] As such, the following section will examine opacity in three specific areas: valuation data, vessel ownership/operation and natural resource extraction in the fishing sector, and will discuss how they each undermine a country's ability to collect revenue.

The absence of invoice valuation data exchange between exporting and importing countries facilitates one of the largest known sources of illicit financial flows (IFFs) – trade misinvoicing. Global Financial Integrity (GFI) estimates trade misinvoicing (the purposeful pricing of goods outside an expected range of variation in order to evade customs duties, income taxes and VAT taxes) at $1.6 trillion per year.[6] The estimated revenue loss to developing country government coffers from misinvoicing is about 18 percent of the total but it must be noted that the entire misinvoiced amount is frequently lost to the national economy. With a $4 trillion annual funding gap to reach the SDGs,[7] every dollar gained is vitally important.

The reason this practice is so pervasive[8] is due to a lack of invoice data exchange between the exporting and importing country customs departments. Opacity in valuation information – there is no international requirement to exchange this data between countries – provides an opportunity for unscrupulous importers and exporters to misinvoice goods because in most cases customs officials do not have a good basis for value comparison. This occurs especially in developing countries where capacity for valuation investigations is low, volumes of trade are relatively high and digitization has increased the pace of goods clearance. Ironically, the concerted push for trade facilitation may exacerbate trade misinvoicing by reducing the time customs valuation officers have to examine invoices. Ultimately, importers and exporters enjoy a low-risk/high-return (and illegal) activity especially in large-volume or high-valuation transactions.

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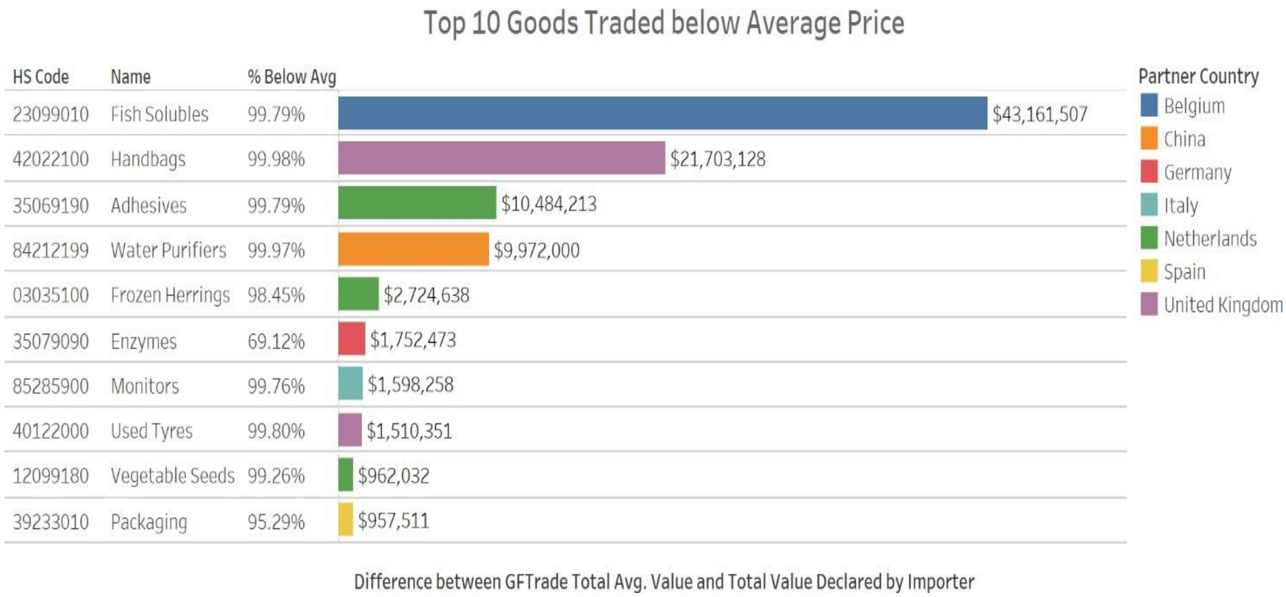
In addition to using UN Comtrade date to analyze misinvoicing at a global scale, GFI has had an opportunity to examine the magnitude of misinvoicing in several countries that utilized its GFTrade valuation assessment tool.[9] By using the results from valuation comparisons conducted by customs officials, GFI has identified massive amounts of misinvoicing in several instances. In the case of 'Country A,'[10] in one three-month period customs officials identified $100 million in misinvoiced goods flagged by the tool (Fig. 1 below).

[5] United Nations Development Program, (https://tinyurl.com/569s9w3r).
[6] Based on the UN Comtrade dataset and filtered to eliminate 'noise' in the data, GFI's methodology involves a "mirror analysis" or a comparison of the valuation of goods as stated in invoices in the exporting and importing countries. Honed and improved over the last decade and a half, in 2021 GFI's methodology was included in an UNCTAD analysis of leading methods of estimating trade-related IFFs.
[7] United Nations Trade and Development program estimate (https://tinyurl.com/2p9ncuht).
[8] A Commissioner-General of an African nation's customs department told GFI he estimated that 80 percent of all imports into his country were misinvoiced.
[9] GFTrade provides customs departments with the ability to detect significant variations in goods valuation based on values of the same goods traded between the same two partner countries within the past 12 months.
[10] In an agreement with governments using GFTrade, GFI agreed to anonymize country names.

Figure 1



In 'Country B,' 2,381 transactions were checked in the GFTrade database during the course of one year with 57 percent being flagged for potential misinvoicing. The valuation gap between those goods and similar goods traded within the previous year was over $260 million. In addition, in the case of 'Country C,' customs officials queried 505 transactions in a six-week period with 221 of these flagged for substantial variations. The gap between prices for the flagged goods and those of similar recent trades was close to $80 million. Again, these figures represent valuation gaps (not revenue losses to the government) but given the relatively low number of comparisons during these time periods and the very large dollar gaps it is clear that misinvoicing continues to be a highly problematic activity.

Opacity in vessel ownership also poses a significant challenge. In the spring of 2023, GFI collaborated with S&P Global (a widely recognized commercial shipping data firm) and the non-profit research organization International Institute of Banking Law and Practice, to publish a briefing paper that examined the availability of Group Owners (i.e. Company name) for all commercial vessels involved in global trade.[11] Of the more than 68,000 vessels identified over 12 percent, or more than 8,300 ships, had no known company name associated with the ship.[12]

The surprising lack of company name information (not to be confused with beneficial owner information, which is a far more stringent criteria that requires the name of the individual or individuals who own or control a company) is a serious phenomenon because our survey showed a strong correlation (69%) between a vessel with an unknown Group Owner and risky behavior such as operating near sanctioned countries or turning off their AIS detection systems ("going dark") for extended periods of time.

Further, of the vessel cohort with unknown Group Owners, one-third fly flags from just three countries: Panama, Liberia and the Marshall Islands. The implication of this relationship is that all three nations provide so-called 'flags of convenience' – registration for ships owned by companies not located in those jurisdictions – which are widely known to have low levels of regulation and accountability in the shipping industry. It has been widely reported that

[11] Fishing vessels were not included in the analysis.
[12] Global Financial Integrity et. al., "Vessel Ownership, Trade Finance and Regulatory Compliance," April 14, 2023, https://tinyurl.com/273p2suu).

ships flying flags of convenience (FoC) have been linked to countless incidents of worker rights violations, environmental degradation and illegal fishing among other troublesome activities.

Moreover, unpublished research by GFI shows a noteworthy correlation between FoC ships and seizures of illegal (ex. narcotics) or counterfeit goods in the U.S. and Europe. While the datasets are small (27 cases in the U.S. and 11 in Europe),[13] in the incidents in which a vessel was identified as delivering goods ultimately seized by law enforcement, a ship flying a flag of convenience were involved 50 percent of the time. Globally, approximately 30,000 ships fly flags of convenience and for developing countries, with low capacity in port and small coast guard fleets, the prevalence of FoC ships can have a substantial impact on the health and safety of consumers.

Additionally, research shows a very high correlation between IUU fishing and ships having no known beneficial owner.[14] And as the Coalition for Fair Fisheries Arrangements recently noted, "beneficial owners are the masterminds behind IUU fishing by the vessel and benefit most from it."[15] Despite the recognized linkage between beneficial owners of fishing vessels and IUU fishing, there are no global requirements for any commercial shipping vessel to provide beneficial ownership information.

Given these clusters of opacity, the entire trade ecosystem - the goods, the pricing and the delivery - should be under scrutiny by the international community.

While estimates vary, this scourge[16] is estimated to cost the global economy in the neighborhood of $25 billion annually[17] with lesser developed nations suffering the brunt of the problem.[18] Further, fishing vessels involved in illegal harvesting of seafood are also known to be involved in "transnational organized criminal activities such as drug, human, and small arms trafficking, illicit oil bunkering, trade in contraband goods, document fraud, [and] money laundering"[19] as well as smuggling and sanctions evasion. Given these clusters of opacity, the entire trade ecosystem - the goods, the pricing and the delivery - should be under scrutiny by the international community.

With the planning for the Fourth International Conference on Financing for Development (FfD4) now underway, GFI proposes two measures to address opacity in global trade. The ultimate goal is to promote Trade Integrity which will increase revenues to reach the SDGs, reduce transnational organized crime and protect marine life from illegal fishing. Specifically, GFI urges the FfD4 to call for the implementation of "Blockchain in Every Port" and a public "Global Beneficial Ownership/Operating Registry for Commercial Vessels."

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[13] Both U.S. and European customs agencies do not commonly publicize a vessel name when announcing seizures of illegal or counterfeit goods. In cases where GFI was able to identify linkages, data found in media reports or in customs department press releases was used.

[14] WWF, *Beneficial ownership in the fishing sector and links to corruption,* December, 2021, (https://tinyurl.com/ynfuvy9z).

[15] CFFA, *States have an obligation to act against beneficial owners of vessels involved in IUU fishing,* March 19, 2024, (https://tinyurl.com/ycyd74bs).

[16] *The Economist,* "The world is waking up to the scourge of illegal fishing," November, 8, 2021, (https://tinyurl.com/5yu3jpf4).

[17] National Oceanic and Atmospheric Administration, *Countering IUU Fishing: Partnership for Sustainably Managed Fisheries,* March 14, 2023, (https://tinyurl.com/5n6s5nmu).

[18] *The Guardian,* "Illegal fishing spurs billions in losses for developing countries, study says," October 26, 2022, (https://tinyurl.com/jyanpw63).

[19] From the Organization of African, Caribbean and Pacific States, June 17, 2022 (https://tinyurl.com/4nzv3y5b).

As noted earlier, trade misinvoicing is so prevalent because there is a data gap between exporting and importing customs departments. The importing customs department does not know the value of the goods in its port was when it left the exporting nation. Without that information the importing customs department cannot determine, without some effort, if the goods are priced correctly. Currently many developing country customs departments search Amazon and Alibaba websites to try to determine whether goods are properly valued. Not only is this a slow and rudimentary way to obtain pricing information, the values they see are retail prices which more often than not will not match wholesale prices used in global trade transactions. A far better system is needed.

To address this, the FfD4 should call for a global system of trade data exchange referred to as “Blockchain in Every Port.” In this system, blockchain technology is implemented at all ports so that valuation data can be sent from exporting country to importing country as soon as the goods exit the port. This automatic, immutable and secure (i.e. private) exchange of valuation information will revolutionize the way customs departments evaluate the accuracy of pricing information on an invoice. If there is a significant difference in values between the exporting and importing invoice the customs department can begin an investigation and, if no plausible explanation for the difference is forthcoming, the proper customs duties and VAT can be collected. Properly implemented and utilized, this system could raise tens of billions of dollars in revenue for developing countries each year. Given that implementation of this system would be in ports and addresses opacity in the global trade ecosystem, the World Customs Organization and the World Trade organizations are the likely international bodies to spearhead this effort.

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To counter the ill-effects of a dearth of information about the owners and operators of vessels, FfD4 should call for a public, global beneficial ownership (BO) registry to be established. Given that some 130 governments have committed to creating a similar registry on a national level, the concept of requiring beneficial ownership information is now firmly established. Since commercial vessels operate on an international basis it is logical to require owners to report their identities to a global registry. To be clear, this is not a proposal to eliminate a country’s right to issue flags to any vessel. A public, Global BO Registry for Commercial Vessels is simply a transparency tool to assist law enforcement in their efforts to disrupt, interdict and prosecute bad actors who misuse vessels for nefarious purposes. The International Maritime Organization, as the current issuer of vessel registration numbers, is the logical agency to be tasked with implementation of the platform as well as validation and verification of the data.

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The two mechanisms proposed here to create transparency in an otherwise opaque global trading system are neither technically nor financially difficult to implement. In both cases the technology to execute these ideas is proven and is relatively inexpensive. Indeed, promoting Trade Integrity and implementing the solutions to opacity in international trade is merely a matter of political will. By endorsing these proposals, the FfD4 conference will assist developing nations in capturing all revenues due to them from their international trade transactions. By establishing Trade Integrity as a global norm, the new mantra for international trade will become “more, faster, transparently.”

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