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PERSPECTIVE PAPER

Benefits and Costs of the IFF Targets for the Post-2015 Development Agenda

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Introduction

As in all his work, Alex Cobham has done a very thorough and professional job analyzing the UN High Level Panel's (HLP) targets related to reducing illicit financial flows (IFFs). His writing is clear, the arguments are well made, he makes reference to works by others, and the paper is right in line (i.e. relevant) with the post-2015 debate.

Global Financial Integrity agrees with Cobham in several instances. For example, GFI concurs that the HLP's original three targets to reduce illicit flows and tax evasion, and increase asset recovery were undermined by framing them in dollar rather than percentage terms (although the HLP's focus on a simply-worded illicit flows target is to be applauded). Additionally, we agree that illicit flows are substantially larger than ODA and they adversely impact economic progress in the areas of economic growth, development outcomes, inequality and governance.

However, GFI differs with Cobham on two points. First, Cobham argues that the Open Working Group on Sustainable Development Goals (the HLP's successor organization) has improved upon the HLP's targets by including "greater detail" while that additional detail, in our view, muddies the focus and detracts from the primary objective of reducing IFFs. Second, his suggested replacement targets which focus on financial transparency measures, while very important, do not adequately advance the current state of play in the effort to reduce IFFs and therefore miss an opportunity for significant progress in this area.

Furthermore, this perspective paper will propose to the UN General Assembly a narrow SDG target on illicit flows which retains the very focused nature of the HLP's original version while incorporating a proportional measure (i.e. a percentage reduction) to indicate progress. GFI's suggested target for the post-2015 development agenda is as follows:

> "reduce illicit financial flows resulting from trade mis-invoicing by 50%"

The focus on illicit flows resulting from trade mis-invoicing is suggested because GFI's data shows that 80 percent of all quantifiable illicit financial flows are moved out of developing country economies through trade transactions. We note that GFI's proportional measurement indicator echoes Cobham's suggested measurement method.

Based on our analysis of potential dollar benefits and estimated costs to address trade mispricing GFI believes that a narrowly defined SDG target on IFFs as proposed here will have a benefit to cost ratio of at least 15 to 1.

Assessment of the Cobham Paper

In its final "Outcome Document" the Open Working Group included a target on reducing illicit flows but coupled it with other issues including reductions of arms sales and organized crime thereby making the target unwieldy, unmeasurable and, as a result, unachievable. This target – 16.4 – calls for countries to "significantly reduce illicit financial and arms flows, strengthen

recovery and return of stolen assets, and combat all forms of organized crime."[1] While these are important issues they dilute the focus on the harm illicit flows have on developing country economies. A concrete, measurable and achievable SDG target on IFFs will more likely be approved by the General Assembly.

Where Cobham sees a better "emphasis on global cooperation" and "greater detail," GFI fears this melding of targets with no specific percentage reduction in IFFs will cause confusion on targets and lead to weak policy recommendations. Ultimately, the ambiguity in the target will lead to failure.

Regarding the new recommendations made in the Cobham paper (ex. reduce to zero instances where beneficial ownership, automatic tax exchange and country-by-country reporting are not in place), they benefit greatly due to their specificity and measurability. Further, we agree that these steps toward financial transparency are extremely important and need to be implemented. Indeed, GFI has been working, in coordination with numerous other civil society organizations, to promote them globally for the past five years.

However, since efforts are already underway in numerous global fora to advance these transparency mechanisms, and great progress has been made towards their implementation, their addition to the Post 2015 SDG targets could be seen by many as redundant. Additionally, because these targets would not significantly advance work to reduce illicit flows beyond what is currently being pursued by the international community GFI believes endorsement of these proposals by the General Assembly would be an opportunity lost.

Further, financial transparency is only one side of the coin. Without efforts by the source countries to detect and interdict misinvoiced trade progress toward curtailing IFFs solely through transparency measures will be very limited. To not address the problem from the supply side would be to ignore a critically important component of the solution. Moreover, currently there are myriad efforts underway to tackle the issue from an international perspective such as the OECD's Base Erosion and Profit Shifting[2] process. An SDG target on IFFs would create the impetus for developing country engagement and would lead to governments taking responsibility to address the problem at its source. Furthermore, an IFF target will provide governments a quantitative indicator against which to measure progress.

Methodology Used to Determine the Magnitude of Illicit Financial Flows

Research on illicit financial flows at GFI show that trade misinvoicing accounts for nearly 80 percent of the nearly $1 trillion in illicit financial flowed from developing countries in 2011 (the

[1] http://sustainabledevelopment.un.org/focussdgs.html Accessed July 30, 2014.
[2] OECD, http://www.oecd.org/tax/beps.htm.

most recent year for which data are available).[3] Hence, efforts to curtail illicit outflows should naturally focus on curtailing trade misinvoicing.

The methodology we use to estimate misinvoicing compares each developing country's exports and imports to what each industrial country reports as having imported from and exported to that country using Direction of Trade Statistics (DOTS) from the IMF. Exporting countries record data on an f.o.b. basis, meaning free on board. This represents the cost of the goods delivered into the transporting vessel. Importing countries record data using the value of the goods plus the cost of insurance and freight charges necessary in delivering to the importing country. In the absence of transaction-specific data on freight and insurance, researchers at the IMF and elsewhere assume a fixed 10 percent of the total value (including insurance and freight) as the cost of freight and insurance. This is based on average observed costs of these components necessary in getting goods to importing countries. Advanced countries are used to estimate trade misinvoicing by developing countries because they are unlikely to misinvoice trade in order to shift capital abroad given freely usable currencies, open capital markets and lack of capital controls. Estimates of trade misinvoicing are then bumped up for developing countries' trade with the rest of the world. This advanced-country-bump-up method has been used by Ndikumana and Boyce (2011) and other researchers.

Advanced countries' exports to and imports from specific developing countries are derived based on partner-country trade data reported to the IMF by member countries for publication in the Direction of Trade Statistics (DOTS). The volume of illicit flows that are generated through trade misinvoicing is estimated as follows:

$$GER = [Xi] - Mj/\beta + [Mi/\beta] - Xj$$

where GER stands for the gross excluding reversals method of estimating illicit outflows due to trade misinvoicing (i.e. export under-invoicing plus import over-invoicing), Xi are the exports f.o.b. from developing country "i", Mj represents the corresponding imports reported by the advanced country "j" deflated by the insurance and freight factor β. The second component estimates import misinvoicing by comparing developing country "i's" imports Mi deflated by the insurance and freight factor β against Xj , the corresponding exports reported by advanced country "j". As noted, illicit outflows are indicated for export under-invoicing and import over-invoicing.

It should be noted that uncertainty about including IFFs as an SDG target due to a lack of precision in their measurement ignores the generally accepted belief that the magnitude of IFFs is understated given the amount of IFFs which cannot be estimated, such as misinvoiced service contracts and transfers of intellectual property, due to insufficient data sources.

Public Loss Due to Illicit Financial Flows

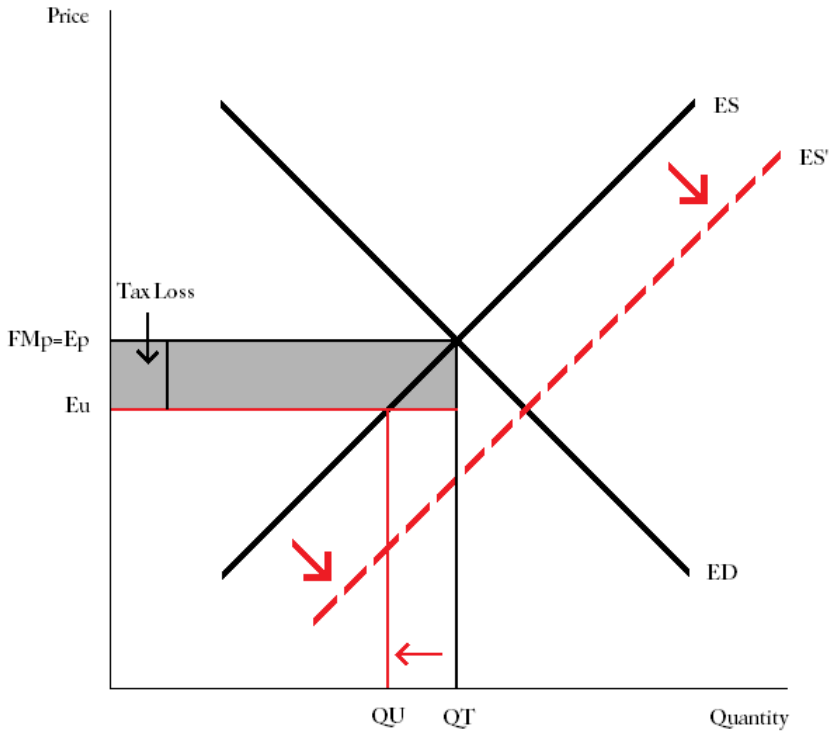
It is important to understand the harm caused to economies by illicit flows. It should be understood that an illicit private gain is always offset by a public loss. As the private gain typically

[3] Reference, *Illicit Financial Flows from Developing Countries: 2002-2011*, Table 6, page 15, Dev Kar and Brian LeBlanc, Global Financial Integrity, December 2013.

accrues to the upper income group and the public loss takes away from the government's ability to alleviate poverty, an adverse impact of illicit financial flows is to further worsen income inequality. In fact, research at GFI shows that in some instances greater income inequality (for example, through a larger number of high net worth individuals) enables the financing of illicit outflows on a larger scale. So illicit flows can both drive and be driven by income inequality. The following analysis illustrates the public loss that arises due to profit shifting through export under-invoicing.

Chart 1 shows how public loss, and its obverse private gain, arises due to export under-invoicing; the loss extends well beyond just a loss of government revenues. A simple mathematical exposition aided by the chart helps us to reach this conclusion. As an example, consider the exports of high-quality first-flush Darjeeling tea from India to the United States (represented by the export supply line ES) for which there is a demand (ED). Let us suppose that the tea is deliberately under-invoiced by the Indian exporter. While the lower price Eu pertains to a lesser quality tea, we assume that Customs officials are unable to distinguish the quality of teas merely through visual inspection.

Chart 1. Profit shifting a public loss through export under-invoicing



As required on all customs invoices, the exporter needs to provide three key pieces of information related to each transaction—the volume, value, and price involved in the transaction. Because Customs officials typically check the consistency between volume, value and price, we assume that, in under-invoicing the transaction, the exporter ensures consistency among the three by reporting a lower value rather than a higher quantity. The US importer pays the true price Ep which is equal to the free-market price (FMp) for that tea prevailing in world markets. The

quantity of tea exported at that true price is QT. In order to reduce the price of the tea to Eu, he does not increase the quantity under the contract but reduces the value declared to Customs. The lower value corresponds to the area EU*QT (price EU multiplied by quantity QT). It can be shown that the exporter could also shift capital abroad by blending in more poor quality tea in the total quantity shipped. In that case the supply curve shifts to the right represented by the broken line but we will confine the following analysis to the case of undervaluation rather than oversupply.

Whereas the correct total payment due to the tea exporter is Ep*QT, the exporter declares to Indian Customs that the payment he will receive is Eu*QT. Hence, the volume of illicit financial outflows due to export under-invoicing (IFFEU) is:

$$\begin{aligned} IFFEU &= Ep*QT - Eu*QT \\ &= QT*(Ep - Eu) \end{aligned}$$

Thus, the shaded area in the chart equal to total export volume QT multiplied by the difference in price Ep – Eu represents the illicit outflows directly related to export under-invoicing. The Indian exporter asks the US importer to deposit the balance of the payment IFFEU in an offshore account in Switzerland.

Let β be the profit on every dollar of tea exported (the profit margin on tea exports). Then the actual and declared profits are:

$$\begin{aligned} \text{Actual profits} &= \beta*(Ep*QT) \\ \text{Declared profits} &= \beta*(Eu*QT) \end{aligned}$$

The extent of profit shifting (PS) then is:

$$\begin{aligned} PS &= \beta*(Ep*QT) - \beta*(Eu*QT) \\ &= \beta QT*(Ep - Eu) \end{aligned}$$

So this is a fraction of the shaded area shown—the larger the profit margin β, the larger is the profit shifted holding all else unchanged. But the direct loss to the government exchequer is a fraction of the profit shifted. The fraction depends on the tax rate τ on corporate profits. Tax loss (TL) equals:

$$TL = \tau * [\beta QT*(Ep - Eu)]$$

It is clear that the total public loss to India is much larger than the sliver labeled "Tax Loss" in Chart 1. That is:

$$QT*(Ep - Eu) > \tau*[\beta QT*(Ep - Eu)],\ 1<\tau<0;\ 1<\beta<0$$

The public loss consists of two components suffered by two different branches of the Government of India—the Reserve Bank of India and the Ministry of Finance. We have shown that the Reserve Bank's loss of foreign exchange is much greater than the tax loss of the Ministry of Finance. In the absence of profit shifting, the private sector would retain the after-tax profits. So the shaded area

(total loss) consists of (i) a tax loss (ii) a loss of after tax profits and (iii) other illicit capital not related to profit shifting.

In other words, the extent of tax-related public loss varies directly with (i) the rate of profit β—the larger the profit rate the bigger the loss, (ii) quantity transacted QT—the larger the volume of trade subject to under-invoicing the more the loss, (iii) the tax rate on corporate profits—the higher the rate the more the loss, and (iv) the extent of under-invoicing—the larger the differential between actual and reported export price the larger is the tax-related public loss.

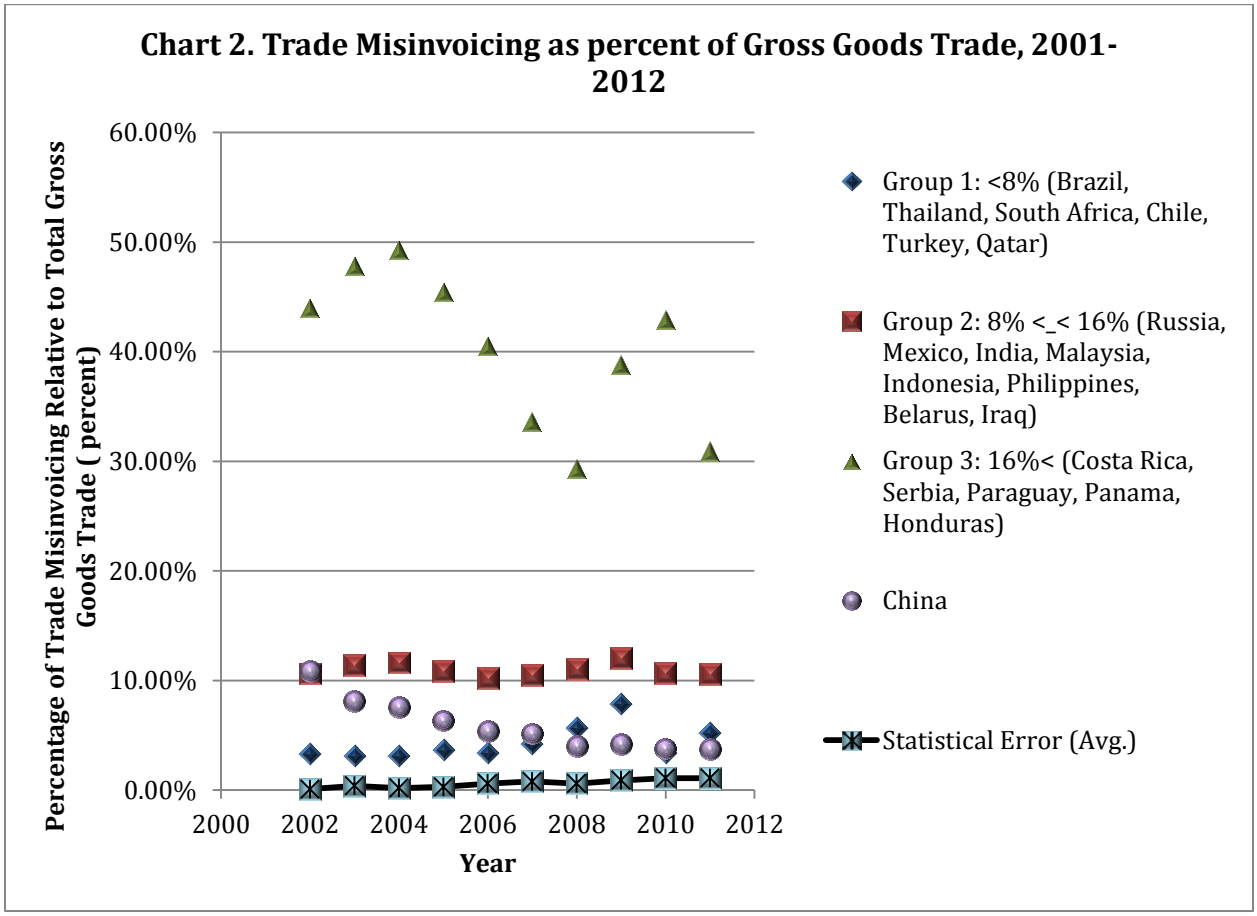
Similarly, import over-invoicing also entails a public loss even though the government in fact collects more import duties through over-invoicing. While a company initially pays the higher customs duties and applicable VAT on imports, it more than offsets the higher duties by claiming lower profits on its corporate taxes due to the higher import costs. This result flows directly from our assumption that private economic agents do not take any business decision that is detrimental to their profitability. Hence, the fact that companies over-invoice imports must be related to cost savings somewhere else or the motivation to shift capital abroad in order to circumvent exchange controls. Moreover, import over-invoicing may be related to export over-invoicing through which companies obtain a refund of VAT on imports that have been used as input in the export production process. The refund of VAT on exports with an import content is a feature of the VAT system in many countries in order to support domestic industry and stimulate exports.

For example, import under-invoicing is often responsible for generating illicit inflows, the other method being export over-invoicing. The under-invoicing of imports represents a deliberate attempt to evade customs duties on goods that attract a significant tariff rate. While the under-invoicing of imports represents technical smuggling of goods in that more goods or value were brought in than declared (an inflow of value), the practice leads to a direct loss of government revenues. Similarly, the practice of over-invoicing exports may represent attempts to fraudulently claim a government benefit such as export subsidies or a larger refund of value added tax on the import content of the exported goods. To treat illicit inflows as a benefit (rather than a cost) and net those against illicit outflows would seriously undermine the adverse impact of illicit flows on a developing country and would be akin to describing the concept of "net crime" which cannot be done. GFI's focus on illicit outflows represents one of two significant departures from academic literature on capital flight. The other departure arises from GFI's methodology of estimating trade misinvoicing by comparing developing countries' trade with vis-à-vis each advanced country rather than advanced countries as a group. The rationale for our methodology is that misinvoicing typically takes place by country and not as a group which is a purely statistical construct.

Another way to demonstrate public loss is through an examination of trade misinvoicing as a percentage of a country's gross goods trade (exports plus imports). The reason we present trade misinvoicing outflows as percent of the gross goods trade (and not, say, GDP) is that we want to compare the numerator (trade discrepancies) to a same denominator (gross goods trade) used by the IMF Balance of Payments Committee, the foremost authority on the quality of trade and balance of payments data. Chart 2 shows that the extent of trade misinvoicing outstrips statistical errors (averaging around 1 percent of gross goods trade) by such an order of magnitude that they cannot conceivably be attributed to statistical errors. We show a distribution of the 20 largest exporters of illicit capital through trade misinvoicing (accounting for 80 percent of such outflows

from developing countries) which are classified into three groups, plus China, according to extent of misinvoicing as a share of their total trade.

Group 3 (Costa Rica, Serbia, Paraguay, Panama, and Honduras) have outflows related to trade misinvoicing that are greater than 16 percent of goods trade. They are represented by the green triangles at the top of the chart. The second group, with misinvoicing between 8 and 16 percent of total trade, consists of Russia, Mexico, India, Malaysia, Indonesia, the Philippines, Belarus, and Iraq. Group 2 is represented by the red squares. Countries in Group 1, consisting of Brazil, Thailand, South Africa, Chile, Turkey, and Qatar, show outflows through misinvoicing that are less than 8 percent of their goods trade (green diamonds). China (silver squares) is shown separately because it tends to distort the pattern of misinvoicing of the group given its outsized weight. The distance each plot point is from the line representing the statistical errors (bottom of chart) represents the extent to which trade misinvoicing



undermines the potential value of trade activity. The statistical errors line reflects bilateral discrepancies which can be attributed to the errors in compiling trade data.

Even at the lowest level of discrepancies at around 3-5 percent of total goods trade, China's outflows through trade misinvoicing is estimated to be around US$96.7 billion per annum on average over the period 2002-2011, reaching US$137.6 billion in 2011. At the other extreme, misinvoicing of at least 30 percent of total goods trade in the case of Group 3 countries also represents a massive loss of capital.

Cost Benefit Analysis

In order to assist developing countries in hitting a trade-related illicit flows target by 50 percent, donor countries and the IFIs will need to provide funding to implement risk-based software tools and training which will enable customs departments to efficiently and effectively interdict specific shipments. We estimate the cost of implementing risk-based trade analysis software and training at about $2 million per country or, a little more than $300 million for all developing nations. This figure is based on a 2013 World Bank per-country cost estimate of $7 - $11 million to execute a fuller customs reform program needed to implement the Bali Agreement on Trade Facilitation (ATF)[4]. Given the great number of systems and procedures needed to implement the entire Bali ATF we used a per-country cost for that effort of $10 million and assumed the cost of the program to reduce illicit flows as 20 percent of the total figure (i.e. $2 million).

The estimated benefit, on the other hand, would be many times higher than the cost indicating that efforts to reach a 50 percent reduction target would be a low-risk/high reward proposition. We have already noted that trade-related IFFs are 80 per cent of all IFFs or, about $800 billion annually. A 50 percent reduction would mean $400 billion in global trade would be reported to governments. For the purposes of this exercise we assume a 10 percent pre-tax profit on those trade exchanges and a 20 percent tax rate (the tax rate estimate is based on an average of corporate tax rates, as determined by the PriceWaterhouseCoopers, the World Bank, Heritage Foundation, and International Finance Corporation) [5] for the 20 countries with the largest illicit outflows. Using these assumptions the potential government tax revenue garnered from a 50 percent reduction in trade-related illicit flows would be $8 billion.

An example of the potential impact of this scenario can be seen in Table 2 which shows the top 20 trade misinvoicing countries and the tax revenue that would be generated. The results of this exercise show that in any single year the potential tax revenue to be garnered from a 50 percent reduction in illicit flows is many times higher than the estimated $2 million per-country cost. Indeed, the benefit is often at least 15 times higher than the cost and in some instances many times that 15:1 ratio.

Globally, a $300 million investment in risk-based software and training could, based on these assumptions, provide some $8 billion in tax revenue which is more than 26 times the estimated cost. Further, while the costs are a one-time expense, the incremental revenue generated from IFF reductions will continue to accumulate over time. Moreover, in addition to generating new tax revenues the remaining gross capital from global trade – hundreds of billions of dollars – will have a multiplier effect in developing country economies as investment, consumption, and savings. We believe this confirms the earlier theoretical analysis that the tax lost due to trade misinvoicing is a mere sliver of the overall loss of capital to the economy.

[4] http://blogs.worldbank.org/trade/wto-trade-facilitation-agreement-development-opportunity. Retreived on July 31, 2014.

[5] http://www.doingbusiness.org/data/exploretopics/paying-taxes, http://www.heritage.org/index/explore?view=by-variables, http://taxsummaries.pwc.com/uk/taxsummaries/wwtsattachments.nsf/vwLUQuickChartAttachments/CJWY-8PCQAN/$File/WWTS percent20Quick percent20Chart percent20- percent20CIT percent20Rates percent201-July-2014.pdf, http://www.nationsencyclopedia.com/ all retrieved on July 31, 2014.

There are, of course, empirical and data limitations to this scenario and our calculation of potential tax revenue gains for governments is, by its nature, imprecise. We assume that profits related to global goods trade would be reported to tax authorities and that tax would be collected. Also, our calculation assumes a constant tax rate for all countries and commodities which is not the case given the tax rate variations noted in the four source documents. Additionally, some countries have different tax schemes based on commodity type which cannot be reflected in this broad examination of potential tax benefit provided here. The pre-tax profit amount is also arbitrary but, we believe, modest. In the end, this exercise was meant to provide an order-of-magnitude understanding of the potential tax gain resulting from a 50 percent reduction in illicit flows.

Even if the cost of implementation were to be 50 percent higher (ex. $3 million per country) the benefit would still be more than 15 times greater if the assumption of a 10 percent pre-tax profit and a 20 percent tax rate were maintained. Further, if we were to include a discount rate of between 3-5 percent on the project (due to increased wage and other labor costs), the total cost (based on the $2 million cost assumption) would be between $2.09-2.1 million. The impact of this discount rate on the cost-benefit analysis is, therefore, negligible.

(continued below)

Table 2. Estimate of Potential Tax Capture Based on a 50% Reduction of Trade-Related Illiicit Flows for Twenty Largest Misinvoicers 1/

(in millions of U.S. dollars)

(in millions of U.S. dollars)	Outflows Due to Trade Misinvoicing										
COUNTRY	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	CUMULATIVE
Belarus											
Actual Trade Misinvoicing During Period	$2,258	$3,141	$3,917	$4,144	$5,321	$9,080	$14,782	$9,207	$8,365	$14,088	$74,302
50% Reduction of Misinvoicing	$1,129	$1,570	$1,959	$2,072	$2,661	$4,540	$7,391	$4,603	$4,182	$7,044	$37,151
Pre-Tax Profit from Trade Activity (10%)	$113	$157	$196	$207	$266	$454	$739	$460	$418	$704	$3,715
Gov't Tax Revenue (Tax Rate = 20%)	$23	$31	$39	$41	$53	$91	$148	$92	$84	$141	$743
Brazil											
Actual Trade Misinvoicing During Period	$8,745	$11,136	$13,752	$16,602	$10,681	$14,212	$22,174	$22,052	$28,750	$32,824	$180,927
50% Reduction of Misinvoicing	$4,372	$5,568	$6,876	$8,301	$5,340	$7,106	$11,087	$11,026	$14,375	$16,412	$90,464
Pre-Tax Profit from Trade Activity (10%)	$437	$557	$688	$830	$534	$711	$1,109	$1,103	$1,438	$1,641	$9,046
Gov't Tax Revenue (Tax Rate = 20%)	$87	$111	$138	$166	$107	$142	$222	$221	$288	$328	$1,809
Chile											
Actual Trade Misinvoicing During Period	$1,894	$1,818	$2,550	$3,386	$3,520	$3,992	$8,046	$3,488	$5,101	$5,304	$39,099
50% Reduction of Misinvoicing	$947	$909	$1,275	$1,693	$1,760	$1,996	$4,023	$1,744	$2,551	$2,652	$19,550
Pre-Tax Profit from Trade Activity (10%)	$95	$91	$128	$169	$176	$200	$402	$174	$255	$265	$1,955
Gov't Tax Revenue (Tax Rate = 20%)	$19	$18	$26	$34	$35	$40	$80	$35	$51	$53	$391
China											
Actual Trade Misinvoicing During Period	$67,498	$69,284	$87,757	$90,315	$94,555	$112,056	$102,972	$92,538	$112,924	$137,582	$967,481
50% Reduction of Misinvoicing	$33,749	$34,642	$43,878	$45,157	$47,277	$56,028	$51,486	$46,269	$56,462	$68,791	$483,740
Pre-Tax Profit from Trade Activity (10%)	$3,375	$3,464	$4,388	$4,516	$4,728	$5,603	$5,149	$4,627	$5,646	$6,879	$48,374
Gov't Tax Revenue (Tax Rate = 20%)	$675	$693	$878	$903	$946	$1,121	$1,030	$925	$1,129	$1,376	$9,675
Costa Rica											
Actual Trade Misinvoicing During Period	$2,307	$3,440	$4,653	$5,291	$5,377	$5,536	$6,768	$8,727	$17,196	$20,890	$80,184
50% Reduction of Misinvoicing	$1,153	$1,720	$2,327	$2,646	$2,689	$2,768	$3,384	$4,363	$8,598	$10,445	$40,092
Pre-Tax Profit from Trade Activity (10%)	$115	$172	$233	$265	$269	$277	$338	$436	$860	$1,045	$4,009
Gov't Tax Revenue (Tax Rate = 20%)	$23	$34	$47	$53	$54	$55	$68	$87	$172	$209	$802
Honduras											
Actual Trade Misinvoicing During Period	$2,679	$2,722	$2,920	$2,984	$3,031	$3,041	$3,294	$2,869	$3,457	$3,560	$30,558
50% Reduction of Misinvoicing	$1,339	$1,361	$1,460	$1,492	$1,515	$1,521	$1,647	$1,435	$1,729	$1,780	$15,279
Pre-Tax Profit from Trade Activity (10%)	$134	$136	$146	$149	$152	$152	$165	$143	$173	$178	$1,528
Gov't Tax Revenue (Tax Rate = 20%)	$27	$27	$29	$30	$30	$30	$33	$29	$35	$36	$306
India											
Actual Trade Misinvoicing During Period	$7,703	$10,068	$18,697	$19,575	$27,569	$33,108	$44,645	$28,336	$66,770	$83,221	$339,691
50% Reduction of Misinvoicing	$3,852	$5,034	$9,348	$9,787	$13,784	$16,554	$22,323	$14,168	$33,385	$41,610	$169,846
Pre-Tax Profit from Trade Activity (10%)	$385	$503	$935	$979	$1,378	$1,655	$2,232	$1,417	$3,338	$4,161	$16,985
Gov't Tax Revenue (Tax Rate = 20%)	$77	$101	$187	$196	$276	$331	$446	$283	$668	$832	$3,397
Indonesia											
Actual Trade Misinvoicing During Period	$13,033	$13,039	$15,342	$13,123	$16,036	$17,063	$27,080	$17,581	$13,341	$16,208	$161,847
50% Reduction of Misinvoicing	$6,516	$6,519	$7,671	$6,561	$8,018	$8,532	$13,540	$8,791	$6,671	$8,104	$80,924
Pre-Tax Profit from Trade Activity (10%)	$652	$652	$767	$656	$802	$853	$1,354	$879	$667	$810	$8,092
Gov't Tax Revenue (Tax Rate = 20%)	$130	$130	$153	$131	$160	$171	$271	$176	$133	$162	$1,618
Iraq											
Actual Trade Misinvoicing During Period	.	.	.	.	.	.	$10,423	$12,023	$14,331	$11,760	$48,538
50% Reduction of Misinvoicing	.	.	.	.	.	.	$5,212	$6,012	$7,166	$5,880	$24,269
Pre-Tax Profit from Trade Activity (10%)							$521	$601	$717	$588	$2,427
Gov't Tax Revenue (Tax Rate = 20%)							$104	$120	$143	$118	$485
Malaysia											
Actual Trade Misinvoicing During Period	$19,346	$20,758	$26,733	$28,740	$29,260	$31,608	$32,531	$29,266	$43,166	$44,218	$305,626
50% Reduction of Misinvoicing	$9,673	$10,379	$13,366	$14,370	$14,630	$15,804	$16,266	$14,633	$21,583	$22,109	$152,813
Pre-Tax Profit from Trade Activity (10%)	$967	$1,038	$1,337	$1,437	$1,463	$1,580	$1,627	$1,463	$2,158	$2,211	$15,281
Gov't Tax Revenue (Tax Rate = 20%)	$193	$208	$267	$287	$293	$316	$325	$293	$432	$442	$3,056

Mexico											
Actual Trade Misinvoicing During Period	$33,718	$33,674	$35,921	$43,669	$47,663	$58,592	$60,025	$33,733	$32,180	$27,362	$406,537
50% Reduction of Misinvoicing	$16,859	$16,837	$17,961	$21,835	$23,832	$29,296	$30,012	$16,866	$16,090	$13,681	$203,269
Pre-Tax Profit from Trade Activity (10%)	$1,686	$1,684	$1,796	$2,183	$2,383	$2,930	$3,001	$1,687	$1,609	$1,368	$20,327
Gov't Tax Revenue (Tax Rate = 20%)	$337	$337	$359	$437	$477	$586	$600	$337	$322	$274	$4,065
Panama											
Actual Trade Misinvoicing During Period	$2,235	$2,414	$2,709	$3,571	$4,632	$5,092	$5,800	$5,189	$5,191	$0	$36,832
50% Reduction of Misinvoicing	$1,118	$1,207	$1,354	$1,785	$2,316	$2,546	$2,900	$2,594	$2,595	$0	$18,416
Pre-Tax Profit from Trade Activity (10%)	$112	$121	$135	$179	$232	$255	$290	$259	$260	$0	$1,842
Gov't Tax Revenue (Tax Rate = 20%)	$22	$24	$27	$36	$46	$51	$58	$52	$52	$0	$368
Paraguay											
Actual Trade Misinvoicing During Period	$810	$1,789	$2,183	$2,545	$3,268	$3,346	$5,415	$4,769	$6,941	$7,993	$39,059
50% Reduction of Misinvoicing	$405	$895	$1,092	$1,273	$1,634	$1,673	$2,707	$2,385	$3,471	$3,997	$19,529
Pre-Tax Profit from Trade Activity (10%)	$40	$89	$109	$127	$163	$167	$271	$238	$347	$400	$1,953
Gov't Tax Revenue (Tax Rate = 20%)	$8	$18	$22	$25	$33	$33	$54	$48	$69	$80	$391
Philippines											
Actual Trade Misinvoicing During Period	$4,897	$7,358	$8,942	$11,614	$8,386	$7,981	$6,902	$5,636	$5,212	$10,882	$77,809
50% Reduction of Misinvoicing	$2,449	$3,679	$4,471	$5,807	$4,193	$3,991	$3,451	$2,818	$2,606	$5,441	$38,905
Pre-Tax Profit from Trade Activity (10%)	$245	$368	$447	$581	$419	$399	$345	$282	$261	$544	$3,890
Gov't Tax Revenue (Tax Rate = 20%)	$49	$74	$89	$116	$84	$80	$69	$56	$52	$109	$778
Qatar											
Actual Trade Misinvoicing During Period	$0	$0	$0	$0	$206	$261	$4,456	$18,967	$1,153	$5,577	$30,620
50% Reduction of Misinvoicing	$0	$0	$0	$0	$103	$130	$2,228	$9,484	$576	$2,788	$15,310
Pre-Tax Profit from Trade Activity (10%)	$0	$0	$0	$0	$10	$13	$223	$948	$58	$279	$1,531
Gov't Tax Revenue (Tax Rate = 20%)	$0	$0	$0	$0	$2	$3	$45	$190	$12	$56	$306
Russia											
Actual Trade Misinvoicing During Period	$20,439	$32,125	$41,266	$49,606	$66,825	$72,337	$100,921	$123,065	$125,897	$179,039	$811,519
50% Reduction of Misinvoicing	$10,220	$16,063	$20,633	$24,803	$33,413	$36,169	$50,461	$61,533	$62,949	$89,520	$405,760
Pre-Tax Profit from Trade Activity (10%)	$1,022	$1,606	$2,063	$2,480	$3,341	$3,617	$5,046	$6,153	$6,295	$8,952	$40,576
Gov't Tax Revenue (Tax Rate = 20%)	$204	$321	$413	$496	$668	$723	$1,009	$1,231	$1,259	$1,790	$8,115
Serbia											
Actual Trade Misinvoicing During Period	$5,469	$7,409	$9,776	$6,433	$5,278	$4,070	$0	$5,527	$2,655	$2,462	$49,079
50% Reduction of Misinvoicing	$2,735	$3,705	$4,888	$3,217	$2,639	$2,035	$0	$2,763	$1,327	$1,231	$24,539
Pre-Tax Profit from Trade Activity (10%)	$273	$370	$489	$322	$264	$203	$0	$276	$133	$123	$2,454
Gov't Tax Revenue (Tax Rate = 20%)	$55	$74	$98	$64	$53	$41	$0	$55	$27	$25	$491
South Africa											
Actual Trade Misinvoicing During Period	$805	$0	$2,542	$3,387	$9,893	$18,730	$19,787	$16,710	$3,858	$23,732	$99,443
50% Reduction of Misinvoicing	$403	$0	$1,271	$1,693	$4,946	$9,365	$9,894	$8,355	$1,929	$11,866	$49,722
Pre-Tax Profit from Trade Activity (10%)	$40	$0	$127	$169	$495	$937	$989	$836	$193	$1,187	$4,972
Gov't Tax Revenue (Tax Rate = 20%)	$8	$0	$25	$34	$99	$187	$198	$167	$39	$237	$994
Thailand											
Actual Trade Misinvoicing During Period	$4,954	$6,080	$6,535	$11,987	$11,513	$10,427	$20,550	$14,769	$20,402	$29,114	$136,330
50% Reduction of Misinvoicing	$2,477	$3,040	$3,268	$5,993	$5,756	$5,213	$10,275	$7,384	$10,201	$14,557	$68,165
Pre-Tax Profit from Trade Activity (10%)	$248	$304	$327	$599	$576	$521	$1,028	$738	$1,020	$1,456	$6,817
Gov't Tax Revenue (Tax Rate = 20%)	$50	$61	$65	$120	$115	$104	$206	$148	$204	$291	$1,363
Turkey											
Actual Trade Misinvoicing During Period	$1,748	$1,998	$0	$1,851	$1,358	$3,502	$3,343	$8,180	$4,108	$10,203	$36,290
50% Reduction of Misinvoicing	$874	$999	$0	$925	$679	$1,751	$1,671	$4,090	$2,054	$5,101	$18,145
Pre-Tax Profit from Trade Activity (10%)	$87	$100	$0	$93	$68	$175	$167	$409	$205	$510	$1,815
Gov't Tax Revenue (Tax Rate = 20%)	$17	$20	$0	$19	$14	$35	$33	$82	$41	$102	$363
1/ Four sources were used to estimate the corporate tax rate for these 20 countries: the World Bank, PriceWaterhousCoopers, the Heritage Foundation and the International Finance Corporation. The tax rate for each country was averaged and then the average for all 20 countries was determined which resulted in a global tax rate of 20 percent.											

Supporting Factors for an SDG Target on Trade-Related Illicit Flows

GFIs narrowly-defined target has considerable strengths which support sustainable development goals including:

1. Limiting the target to trade-related illicit flows will focus on the largest (80 percent) part of the IFF problem;
2. Progress toward the target can be measured using official government statistics provided to the IMF;
3. The target is achievable because it can be addressed though risk-based trade analysis and capacity building in developing country customs departments;
4. Progress toward the target will enhance domestic resource mobilization which will help countries reach SDG targets in health, human rights, and education;
5. In addition to tax revenue, a far larger amount of capital will remain in developing country economies;
6. The target is universal since it will complement transparency measures already underway at the OECD.

The importance of domestic resource mobilization (DRM) as a path to sustained development has taken hold in recent years. And in conjunction with the goals of increasing DRM, curtailing trade-related IFFs will be a 'development enabler' due to additional tax collection and increased capital flowing into developing country economies. Including an SDG target on IFFs will generate revenue needed to help achieve the other likely SDG targets such as ending malnutrition and achieving universal health coverage.

A recent article in the Journal of the Royal Society of Medicine (NB: Alex Cobham is one of the paper's authors) showed the potential impact of reduced IFFs by estimating "the cost of IFFs in terms of the additional time required to reach MDG 4 for 34 countries in sub-Saharan Africa." The findings suggest that reducing illicit flows would play a significant role in helping countries achieve MDG 4 more quickly and "if IFFs were completely curtailed . . . even those countries that would not achieve their targets would be able to achieve the target . . . in the absence of IFFs."

Conclusion

The corrosive impact IFFs have on development is well documented and well understood. The international community has taken action to address the demand side of the equation by beginning to implement financial transparency measures that will make it more difficult to deposit, hide and launder illicit funds in western financial institutions. The next critical step in the process is for developed and developing countries to address the supply side of the equation. The most impactful way to accomplish this is to implement a Post 2015 SDG target to cut trade-related illicit flows by 50 percent. Given that this proposed target is concrete, timely, measurable, achievable, universal and a revenue generator, GFI believes it should a primary focus of the development agenda until 2030.

This paper was written by Tom Cardamone, Managing Director at Global Financial Integrity and Dev Kar, Chief Economist at Global Financial Integrity. The project brings together more than 50 top economists, NGOs, international agencies and businesses to identify the goals with the greatest benefit-to-cost ratio for the next set of UN development goals.

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Copenhagen Consensus Center is a think tank that investigates and publishes the best policies and investment opportunities based on how much social good (measured in dollars, but also incorporating e.g. welfare, health and environmental protection) for every dollar spent. The Copenhagen Consensus was conceived to address a fundamental, but overlooked topic in international development: In a world with limited budgets and attention spans, we need to find effective ways to do the most good for the most people. The Copenhagen Consensus works with 100+ of the world's top economists including 7 Nobel Laureates to prioritize solutions to the world's biggest problems, on the basis of data and cost-benefit analysis.