

GLOBAL FINANCIAL INTEGRITY

# Illicit Financial Flows & Colombia



Global Financial Integrity

October 2019





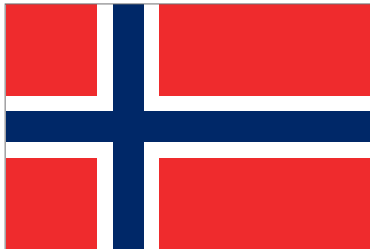
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## Global Financial Integrity

October 2019

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# Executive Summary

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Using United Nations trade data, Global Financial Integrity (GFI) analyzed the degree of trade misinvoicing in Colombia in 2016, finding **a gap of \$10.8 billion between the values reported by Colombia and those reported by all its trading partners.** Furthermore, using value-added tax, customs duties, corporate income tax and royalty rates in Colombia, we estimate **the Colombian government lost approximately US\$2.8 billion in revenue due to trade misinvoicing in 2016.** This amount is equivalent to roughly 5.2 percent of total Colombian tax revenues collected that year.

Further analysis shows that illicit outflows due to misinvoicing were US\$6.1 billion in 2016 and illicit inflows were US\$4.8 billion. The products most often associated with misinvoicing include mineral fuels, precious stones & metals and machinery, while the trading partner countries most often associated with misinvoiced trade transactions were the United States, China and Mexico.

The Economist Intelligence Unit's (EIU) analysis of illicit financial flows in Colombia highlighted the primary sources of IFFs including trade misinvoicing, grand corruption, tax evasion, smuggling and transnational crime. EIU notes that each of these activities occurs in Colombia and that the informal economy in the country provides a favorable environment for illicit activities of many types. Additional factors—ranging from the cultural and geographic to institutional and economic—explain the scale of criminal activities in the country. The inefficiency of the legal system (which prosecutes only five percent of crimes), the lack of effective state presence in vast areas of the national territory and the long-standing existence of illegally armed groups (leftist guerrillas, right-wing paramilitaries and other criminal organizations) and their involvement in numerous illicit activities, are among the principal factors behind the crimes that generate IFFs impacting Colombia.

In its opportunity cost analysis, GFI partner Cedetrabajo demonstrated how social programs highlighted in the National Development Plan (NDP) could benefit from additional resources. Using the NDP's allocations of government funds as a guide for the hypothetical allocation of the US\$2.8 billion in lost revenue to trade misinvoicing, additional resources could be distributed as follows: US\$377.9 million for SDG 16 Peace, justice and strong institutions; US\$358.1 million for SDG 3 Health & well-being; US\$279.2 million for SDG 9 Industry, innovation and infrastructure; US\$270.7 million for SDG 11 Sustainable cities and communities; and more for the remaining goals. The findings indicate that if Colombia curbed revenue loss due to trade misinvoicing, it could realize more than eight times its NDP four-year projected spending for development.

Given these findings GFI makes several recommendations with special emphasis on the following:

- The Colombian government should assess the risks to trade misinvoicing, security and the overall abuse of trade channels before streamlining any compliance procedures along customs areas that may be classified as high risk or vulnerable;

- Colombia should consider adopting GFI’s online tool—GFTrade—which builds the capacity of customs authorities to better detect trade misinvoicing in real time;
- Colombia should consider introducing the requirement of beneficial ownership as part of its customs law and Colombia should take steps to create a public registry on beneficial ownership information that is accessible to all relevant agencies, especially Natural Directorate of Taxes and Customs (DIAN); and
- Future Colombian National Risk Assessments must involve DIAN and the systems and measures required to mitigate the abuse of land, air and sea trade channels for the purpose of trade misinvoicing.

# Chapter 1: Illicit Financial Flows & Colombia

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Written by



## 1. The Impact of Illicit Financial Flows

### Overview of Illicit Financial Flows

Illicit financial flows (IFFs) refer to the “cross-border movement of capital associated with illegal activity or more explicitly, money that is illegally earned, transferred or used that crosses borders.”<sup>1</sup> IFFs are generated by a variety of activities such as drug trafficking, trade misinvoicing, grand corruption, counterfeiting, illegal exploitation of natural resources, tax evasion, and terrorist financing, among others.

IFFs flourish in countries facing high levels of violence or conflict and/or where shadow economic activities, that is, activities that occur outside of the government’s approval, monitoring and taxation, account for an important share of total GDP.<sup>2</sup> Globalization of trade, migration, urbanization and technological innovation—especially in cyberspace—all facilitate the flow of IFFs.<sup>3</sup>

Such illicit activity generates significant costs that divert money from public priorities and crowd out the private sector, have negative impacts on the environment and human health, and generate enormous economic and socio-political distortions, principally for developing countries.<sup>4</sup>

Illicit money outflows strip an economy of funds that could have been directly or indirectly spent—for example, on social priorities and other public goods. When entering countries, illicit money does so without government oversight, thereby evading taxes and undermining institutions. Further, the illicit inflows may be used to finance, and therefore perpetuate, illegal activities, such as purchasing the chemical precursors needed to convert coca to cocaine or provide financial support to terrorist and/or guerrilla groups. Even where IFFs are directed towards legitimate business activities, such as real estate, this negatively impacts the wider economy by generating distortions.

Because of their illicit nature, estimating the size of IFFs is complex and the methodologies used are subject to controversy. Global Financial Integrity (GFI), a US-based independent think tank

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<sup>1</sup> World Bank. 2017. Illicit Financial Flows (IFFs). Brief. July 7, 2017. Accessed at: <http://www.worldbank.org/en/topic/financialsector/brief/illlicit-financial-flows-iffs>

<sup>2</sup> More on shadow economy definition and measurement can be found in Schneider F. “Shadow Economies and Corruption All Over the World: What Do We Really Know?” 2006. [https://www.researchgate.net/publication/5141532\\_Shadow\\_Economies\\_and\\_Corruption\\_All\\_Over\\_the\\_World\\_What\\_Do\\_We\\_Really\\_Know](https://www.researchgate.net/publication/5141532_Shadow_Economies_and_Corruption_All_Over_the_World_What_Do_We_Really_Know)

<sup>3</sup> OECD. 2015. Illicit Trade: Converging Criminal Networks. Accessed at: <http://www.thecre.com/ccsf/wp-content/uploads/2015/12/illlicit-trade-converging-criminal-networks.pdf>

<sup>4</sup> World Bank. 2017.

that specializes in research on IFFs, calculates that in 2015 trade-related illicit funds entering and exiting developing economies totaled close to US\$1 trillion.<sup>5</sup> GFI estimates that, on average, IFFs accounted for 22 percent of developing countries' total trade with advanced economies the same year.<sup>6</sup> Generally, illicit financial outflows from developing economies end up in advanced economies, such as the US and the UK, as well as tax havens like Switzerland, Singapore and certain Caribbean islands.

## Sources of IFFs and Their Impact on Developing Nations

To contextualize the findings of this report, it is important to distinguish which activities can be used to generate illicit funds. The following activities are common sources of IFFs:

- **Trade misinvoicing**—the deliberate manipulation of the value of a trade transaction by falsifying, among others, the price, quantity, quality, and/or country of origin of goods or services by at least one party to the transaction;<sup>7</sup>
- **Corruption**—the abuse of entrusted power for private gain;<sup>8</sup>
- **Tax evasion**—the underpayment or non-payment of taxes;
- **Smuggling**—the illegal movement of goods from one legislation to the other;
- **Transnational crime**—offenses that involve one or more jurisdictions, such as drug trafficking, trade of counterfeit merchandise, human trafficking, and the illegal trade in natural resources.

Many of these IFF-generating activities are sizeable for developing countries and have significantly negative impacts on them.

Trade misinvoicing, for example, is, according to GFI, the largest component of IFFs measured through trade moving to and from developing countries. Trade-related illegal outflows were particularly sizeable for South Africa (US\$10 billion), Nigeria (US\$8.3 billion), Mexico (US\$43 billion), Brazil (US\$12 billion), Colombia (US\$7 billion) and Malaysia (US\$33 billion).<sup>9</sup> The money leaving these economies depletes resources that could otherwise be spent on national priorities.

But there are also sizeable illicit trade-related inflows to developing economies that could create distortions, even if they are invested in licit activities. GFI estimates the developing nations receiving the largest amounts of trade-related illicit inflows include Poland (US\$32 billion), Vietnam (US\$23

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<sup>5</sup> Global Financial Integrity (GFI). 2019. Illicit Financial Flows To and From 148 Developing Countries: 2006-2015. January 2019. Accessed at: <https://www.gfintegrity.org/report/2019-iff-update/>

<sup>6</sup> Ibid, GFI 2019.

<sup>7</sup> GFI. 2019. Trade Misinvoicing. Accessed at: <https://www.gfintegrity.org/issue/trade-misinvoicing/>

<sup>8</sup> Transparency International (TI). 2019. How do you define corruption? Accessed at: <https://www.transparency.org/what-is-corruption#define>

<sup>9</sup> Global Financial Integrity (GFI). 2019. Illicit Financial Flows To and From 148 Developing Countries: 2006-2015. January 2019. Accessed at: <https://www.gfintegrity.org/report/2019-iff-update/>

billion), Thailand (US\$21 billion), Indonesia (US\$15 billion), Panama (US\$18.3 billion) and Argentina (US\$4.8 billion).<sup>10</sup>

**Corruption**, a key generator of IFFs, is widespread in developing nations. Measuring the impact of corruption is extremely difficult; there are no updated studies that provide a monetary estimation at a global scale. Corruption measures are mostly based on perception surveys, although some studies approach the subject by measuring governance and institutional standards. Another limitation is that corruption research is generally focused on the public-sector, thus leaving aside the extent of this crime within the business community, for example, and neglecting the fact that corruption is usually originated by the private party that offers the bribe to the corrupt government official.

Corruption impacts developing nations in different ways, ranging from hampering democracies and economies, to harming the environment and, consequently, human lives.<sup>11</sup> It often diverts funds to private consumption, instead of allowing their use for public spending in areas such as health and education where the money has higher multiplying effects.<sup>12</sup> A 2004 estimate by the World Bank put the size of bribery at around US\$1 trillion a year worldwide, and around US\$20-40 billion a year in developing countries.<sup>13</sup>

**Transnational crime is another key source of IFFs.** Developing countries are both the source and destination of crimes including drug trafficking, trade of counterfeit goods, human trafficking, trafficking in firearms, cybercrime and trafficking in natural resources, wildlife and cultural property.<sup>14</sup> In 2009 the United Nations Office for Drugs and Crime (UNODC) assessed the value of transnational crime at US\$870 billion in 2009,<sup>15</sup> while in 2017 GFI estimated it at averaging US\$1.6 trillion to US\$2.2 trillion a year.<sup>16</sup> According to the GFI research, counterfeiting and pirated goods is the largest transnational criminal activity, generating US\$923 billion to US\$1.13 trillion a year. China is the largest source of this crime, with counterfeit pharmaceuticals the main traded product.<sup>17</sup> Drug trafficking is the second-largest transnational crime, amounting to US\$426 billion to US\$652 billion a year, driven by trade in cannabis, cocaine, opiates and amphetamine-type stimulants (ATS). Colombia, the subject of this report, remains the largest cocaine producer in the world. Combined, counterfeiting and drug trafficking account for over 80 percent of total transnational crime in this country.<sup>18</sup>

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<sup>10</sup> Global Financial Integrity (GFI). 2019. Illicit Financial Flows To and From 148 Developing Countries: 2006-2015. January 2019. Accessed at: <https://www.gfintegrity.org/report/2019-iff-update/>

<sup>11</sup> Ibid, TI 2019.

<sup>12</sup> OECD 2014. "Illicit Financial Flows from Developing Countries: Measuring OECD Responses". Accessed at: [https://www.oecd.org/corruption/Illicit\\_Financial\\_Flows\\_from\\_Developing\\_Countries.pdf](https://www.oecd.org/corruption/Illicit_Financial_Flows_from_Developing_Countries.pdf)

<sup>13</sup> Ibid, OECD. 2014.

<sup>14</sup> United Nations Office for Drugs and Crime (UNODC). 2011. Transnational Organized Crime. The Globalized Illegal Economy. Accessed at: [https://www.unodc.org/documents/toc/factsheets/TOC12\\_fs\\_general\\_EN\\_HIRES.pdf](https://www.unodc.org/documents/toc/factsheets/TOC12_fs_general_EN_HIRES.pdf)

<sup>15</sup> Ibid UNODC 2011.

<sup>16</sup> Global Financial Integrity (GFI). 2017. Transnational Crime and Developing World. March 2017. Accessed at: <https://www.gfintegrity.org/report/transnational-crime-and-the-developing-world/>

<sup>17</sup> Ibid GFI 2017.

<sup>18</sup> Rocha, R. 2011. "Las Nuevas Dimensiones del Narcotráfico en Colombia". Oficina de las Naciones Unidas contra la Droga y el Delito—UNODC. Ministerio de Justicia y del Derecho. 2011. Accessed at: <https://www.ispionline.it/it/documents/T.R.Mafie.Rocha.19.11.pdf>

Aside from harming individuals—through drug addiction and sexual exploitation, for example—funds from transnational crimes cause tremendous economic, political, social and institutional distortions, all of which harm the path to sustainable development.<sup>19</sup> There is rising consensus about the relationship between transnational crime and terrorist networks. Terrorists usually finance their operations through well-organized transnational crimes, such as drug trafficking, counterfeiting of goods, or animal trafficking, to name a few. Evidence suggests that terrorists often share networks and schemes to move money with transnational crime networks. In parallel, there is evidence of close links between organized criminal bands, guerrilla groups and terrorist groups, all of which are involved in trafficking illicit drugs. Activities in Colombia and West Africa are examples of this.<sup>20</sup>

## 2. Economic and Social Impact of IFFs in Colombia

This section discusses the impact of IFFs in Colombia, particularly those flows generated by drug trafficking, corruption and illegal mining.

We begin by briefly reviewing why Colombia, a country characterized by sound economic stability and institutional resilience amid high levels of violence, registers sizeable illegal activities that in turn generate IFFs. One key reason is the large size of Colombia’s “shadow economy”—a technical term that often includes both informal yet legal activities that are not registered with the government or linked to the formal tax payments system as well as illegal activities that are part of the black market.

Illicit activities usually flourish in economies where informality is high.<sup>21</sup> A pioneering study led by Professor Friedrich Schneider of the University of Linz, Austria, found that the size of the informal economy in Colombia—which, excludes criminal activities like drug trafficking, smuggling, prostitution, and corruption—rose from 20 percent of official GDP in the late 1970s to 42 percent in 2000.<sup>22</sup> In an interview with the Economist Intelligence Unit (EIU), Mr. Schneider stated that, according to his most recent estimates (yet to be published), Colombia’s informal economy accounted for 36.2 percent of GDP in 2018. “This is consistent with the fall of unemployment, rising salaries, improved business liberties and lower taxes,” he stated, while making reference to the most common factors contributing to shadow activities: high taxes (including those levied on payroll), complex registration procedures with the government and high unemployment rates. Separately from his studies on the informal economy, Mr. Schneider estimates that the scale of illicit activities, “at no more than 5 percent of GDP at present,” is well below the scope of the informal economy.

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<sup>19</sup> United Nations Office for Drugs and Crime (UNDOC). 2019. Transnational organized crimes threat assessment. Accessed at: <https://www.unodc.org/unodc/data-and-analysis/TOC-threat-assessments.html>

<sup>20</sup> Ibid, GFI 2017.

<sup>21</sup> Ibid, OECD 2015.

<sup>22</sup> Schneider F., B. Hametner. 2007. “The Shadow Economy in Colombia: Size and Effects on Economic Growth”. Working Paper. Johannes Kepler University of Linz. January 2007. Accessed at: <https://www.researchgate.net/publication/5141538>

While the extent of Colombia's informal economy provides a favorable environment for illicit activities, there are other factors—ranging from the cultural and geographic to institutional and economic—that explain the scale of criminal activities in the country. The inefficiency of the legal system (which processes only five percent of crimes), the lack of effective state presence in vast areas of the national territory and the long-standing presence of illegally armed groups (leftist guerrillas, right-wing paramilitaries and other criminal organizations) and their involvement in numerous illicit activities, are among the principal factors behind the crimes that generate IFFs impacting Colombia.<sup>23</sup> Some research also points to rising migration as an enabler for the expansion of Colombian criminal networks internationally.<sup>24</sup>

## Drug Trafficking

Drug trafficking is one of the primary sources of IFFs impacting Colombia. It is estimated that the illicit inflows to Colombia related to drug trafficking totaled US\$44 billion between 1981 and 2009 (on average, US\$1.6 billion a year), compared with US\$26 billion from smuggling (US\$0.9 billion a year) and US\$24 billion from trade misinvoicing (US\$0.85 billion a year) over the same period.<sup>25</sup>

A more recent estimate suggests that, altogether, illicit inflows from various criminal activities including narcotrafficking peaked at almost 12 percent of Colombia's GDP in 2001, but declined to two percent of GDP by 2013, coinciding with more effective counter-narcotic efforts under Plan Colombia (a U.S.-Colombia multi-year, multi-billion initiative to fight drugs).<sup>26</sup> As shown in the graph below, drug trafficking flourished in the 1980s and 1990s, pushing IFFs related to narcotics and money laundering to a record of over ten percent of GDP in 2000, but then began to fall, especially since 2007, until reaching about one percent of GDP by 2013. Meanwhile, inflows from other criminal activities, which have remained relatively stable historically, began to rise moderately from the mid-2000s, suggesting that in light of increased repression, criminal actors may have moved to other illegal industries.

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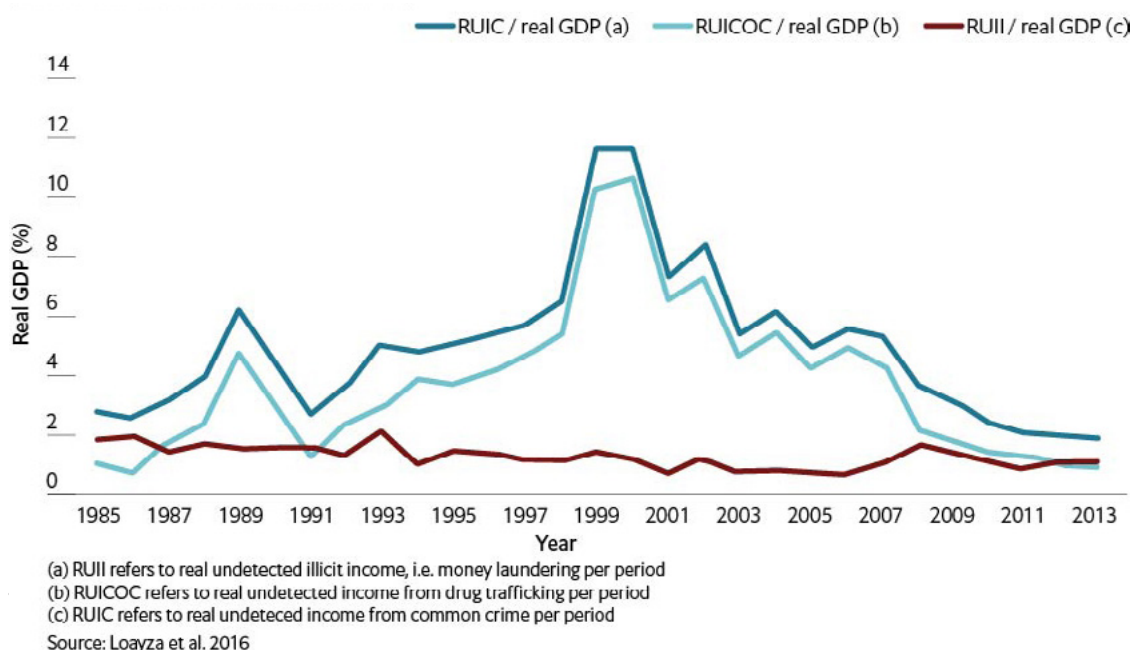
<sup>23</sup> Anzola M., F. Thoumi. 2012. "Illicit Capital Flows and Money Laundering in Colombia". Draining Development? Controlling Flows of Illicit Funds from Developing Countries. Edited by Peter Reuter. World Bank. <http://documents.worldbank.org/curated/en/305601468178737192/pdf/668150PUB0EPI0067848B09780821388693.pdf>

<sup>24</sup> Ibid, OECD, 2015.

<sup>25</sup> Rocha, R. 2011. "Las Nuevas Dimensiones del Narcotráfico en Colombia". Oficina de las Naciones Unidas contra la Droga y el Delito—UNDOC. Ministerio de Justicia y del Derecho. 2011. Accessed at: <https://www.ispionline.it/it/documents/T.R.Mafie.Rocha.19.11.pdf>

<sup>26</sup> Loayza, N, M. Misas, E. Villa. 2016. "Illicit Activity and Money Laundering from an Economic Growth Perspective. A Model and an Application to Colombia". World Bank Policy Research Working Paper 7578. February 2016. Accessed at: <https://openknowledge.worldbank.org/handle/10986/23917>

**Figure 1. Missing millions (undetected illicit income in Colombia)**



Further research is required to determine how narcotics-related IFFs have responded to the jump in coca crops and cocaine production in Colombia since 2013. The UNODC estimates that the area harvesting coca crops in Colombia increased in 2017 for the fourth consecutive year, to an all-time high of 171,000 hectares compared to a record low of 50,000 hectares in 2013.<sup>27</sup> In tandem, cocaine output reached a historical record of 1,379 tons in 2017, 31 percent higher than in 2016.

The resurgence of the cocaine industry in Colombia coincides with various changes in the structure of the business that may impact the way IFFs from this criminal activity are being generated. For example, in an interview with the EIU for this report, Juan Gonzalo Zapata, a researcher at Colombian think-tank Fedesarrollo, referred to the presence of new actors in the cocaine commercialization chain: “The Mexican cartels are now more present than ever in Colombia, though guerrillas and other illegally armed groups continue to exert control in some areas of the country.” With the Mexican cartels controlling the distribution of drugs in the US (the world’s biggest market for cocaine), many of the proceeds from US drug sales are being sent to Mexico instead of Colombia. At the same time, according to Mr. Zapata, shifts in the cocaine consumption habits in the US, coupled with the increased control of the business by Mexican cartels, has driven Colombian drug traffickers to increase their exports to other markets such as Europe, Asia-Pacific (to a lesser extent), and increasingly to other Latin American countries. Further, Zapata underscored

<sup>27</sup> UNODC. 2018. Coca crops in Colombia at all-time high, UNDOC reports. 19 September 2018. Accessed at: <https://www.unodc.org/unodc/en/frontpage/2018/September/coca-crops-in-colombia-at-all-time-high--unodc-report-finds.html>

the emergence of the industry of *microtráfico* in Colombia, a term describing the growing internal market for illegal drugs in the country, which has led to a “shift from an exporter into a consumer country of illicit drugs”. The Colombian government estimates that *microtráfico* is now equivalent to 0.75 percent of GDP.

### ***The Impacts of Drug Trafficking***

There is consensus that drug trafficking has multiple negative effects on Colombia’s economy, institutions and social fabric. Perhaps most important, narco-trafficking has provided crucial funding to illegally armed groups such as the now-defunct Revolutionary Armed Forces of Colombia (Spanish: *Fuerzas Armadas Revolucionarias de Colombia*, FARC) and the National Liberation Army (Spanish: *Ejército de Liberación Nacional*, ELN) that perpetrate violence, undermine institutions and control other crimes. “Something happened in Colombia during the 1980s and 1990s that drove guerrillas and, in recent years, other illegally armed groups like the *BACRIM* [short for *bandas criminales*, or criminal gangs] to participate in drug trafficking and use the drug money to conduct other illegal business such as contraband (specially cigarettes and liquor), extortion, prostitution and illegal trade of merchandise (such as mining, gasoline and even cooking oil),” stated Mr. Zapata.<sup>28</sup>

To a lesser extent than during the era of the big Colombian drug cartels of the 1980s and 1990s, which, according to Mr. Zapata, have been replaced by multiple smaller criminal networks, drug traffickers continue to bribe public officials, thus remaining an important source of corruption in Colombia. The criminal networks that now dominate the drug trade and other illicit activities, such as smuggling and illegal gold trade, often require the participation of public officials who accept bribes to allow their illicit business to operate (although in many cases these officials are subject to intimidation). Later in this section we will present a more detailed discussion of the impact of corruption and illegal gold mining on the country and IFFs.<sup>29</sup>

While the above are the main direct impacts of narco-trafficking in Colombia, there are also indirect negative impacts from the channels that criminals use to bring their monetary funds to Colombia. In an interview with the EIU, Marcela Anzola, an independent consultant on foreign investment and anti-corruption matters, stated that: “Most of the money from drugs usually returns (to Colombia) ... It still is relatively easy to hide or invest illegal fortunes in Colombia, despite increased controls. Colombian drug traffickers have historically repatriated their illicit money through five preferred mechanisms: smuggling; overstatement of remittances from workers abroad; trade misinvoicing; overstated foreign capital inflows; and cash couriers.<sup>30</sup> That said, there is some consensus among experts that smuggling is the preferred method used by drug traffickers to launder their money in Colombia (see the case study on smuggling below.)

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<sup>28</sup> *BACRIM* are organised criminal bands or gangs that emerged mainly from the former large drug cartels (principally the Medellín, Cali and Norte del Valle cartels) and the remnants of the right-wing paramilitary groups that did not demobilise in the mid-2000s. According to InSight Crime, the term *BACRIM* is used currently to describe “any criminal structure not linked to the Marxist rebels”. See Jeremy McDermott, “The *BACRIM* and Their Position in Colombia’s Underworld,” *InSight Crime*, 2 May 2014, <https://www.insightcrime.org/investigations/bacrim-and-their-position-in-colombia-underworld/>

<sup>29</sup> More on the subject of negative impacts from drug trafficking in Colombia can be found in Loayza 2016 and Rocha 2011.

<sup>30</sup> *Ibid*, Rocha 2011.

## CASE STUDY

### Trade-based money laundering: a favored money laundering method for narcotraffickers

The EIU interviewed a former high-ranking Colombian government official, who preferred to remain anonymous, on the recent trends of smuggling goods into the Colombian economy: “Drug trafficking is the largest source of crime in Colombia and the traffickers’ preferred way to launder their drug money is contraband.”

The official explained that, despite increased controls and more effective enforcement in recent years, trade-based money laundering (TBML) remains a preferred instrument for money laundering as it offers “lesser risk” of being caught by authorities compared with other mechanisms that use the banking system or require some form of registration, such as remittances.

“I estimate that contraband amounts nowadays to US\$5 billion a year,” the source stated, before explaining how narcotraffickers operate the “business.” Drug traffickers do not launder the money themselves, rather they use specialized criminal networks. For example, a drug trafficker wanting to launder US\$1 million could buy merchandise with those proceeds in a country with poor legislation, transparency and enforcement of foreign trade such as Panama, and then sell that merchandise in Colombia. They usually buy goods that are easy to sell, like clothing, shoes, alcohol and cigarettes. There are two options for getting the merchandise to Colombia:

- i) An informal channel, such as physically smuggling the merchandise into the country, which is usually done through trails in border zones or free-trade zones prone to corruption, such as Maicao in the Guajira province, next to the border with Venezuela and close to the Caribbean islands (another major source of smuggled goods, principally liquor and cigarettes coming from Aruba);
- ii) A formal channel, that is, legitimate trade; the merchandise may be declared or undeclared (i.e. physically smuggled). The Colombian ports of Buenaventura and Barranquilla are often used to move illicit merchandise. If the merchandise is declared, the launderer can declare its legitimate value or they may use trade misinvoicing, declaring the import of US\$1 million of merchandise for a much lower value, say US\$100,000.

“It is very difficult for authorities to curb smugglers due to the lack of cooperation and controls in source countries like Panama and Venezuela,” the source stated, explaining that some countries, such as Panama, do not exert customs controls and offer legislation that facilitates the creation of shell companies for smugglers.

Colombia has increased its efforts against trade fraud significantly. Our anonymous source also highlighted Colombia’s bold efforts to reform the *Dirección de Impuestos y Aduanas Nacionales* (DIAN, the national taxes and customs bureau), chiefly by removing politically appointed personnel and replacing them with technocrats. The source estimates that these measures, combined with stronger enforcement, could have led to a decline in contraband of around 25 percent compared with 2013 levels.

## Corruption

Colombia scored 36 in Transparency International's Corruption Perception Index 2018, well below the global average score of 43 (where 100 is absolute transparency and zero is absolute corruption).<sup>31</sup> But it is not just a matter of perceptions. The Office of the Comptroller General of the Republic (CGR for its acronym in Spanish), an entity in charge of auditing public spending, estimated in 2016 that each year corruption steals from the public coffers Ps40-50 trillion (US\$13-17 billion) through different embezzlement mechanisms such as overstating procurement contracts or project costs and fraudulent contracts.<sup>32</sup>

Marcela Anzola told the EIU that the current phenomenon of corruption in Colombia responds to “an apparent decline of petty corruption, while at the same time large-scale corruption seems to be growing, or at least becoming far more visible.” Indeed, a number of factors that include cultural changes, the reduction of red tape, and lower costs for certain official procedures have reduced petty corruption, such as bribing a public administration official to process a document or for an approval. However, the country has been shaken in recent years by highly visible corruption scandals of national significance (see the case study below on the Odebrecht scandal in Colombia).

### ***The Impacts of Corruption***

Corruption has deep and lasting impacts on Colombia. Money is taken away principally from regional and local governments which would otherwise be invested in education, health, drinking water and sanitation.<sup>33</sup> For example, the US\$13 billion to US\$17 billion that the CGR estimates as lost to corruption in the public sector every year is equivalent to 60-80 percent of the national budget allocated in 2018 to education and health combined.<sup>34</sup>

However, funds generated as a result of corruption are not typically sent abroad. “Generally, the money from corruption remains in Colombia,” Ms. Anzola affirms, due to the relative ease with which the corrupt keep their fortunes locally. She estimates that more money from corruption is staying in Colombia as compared to ten years ago as “controls abroad on the origin of money invested in diverse assets is becoming stricter.” She continues: “For example, it was very common that a corrupt politician would buy an apartment in Miami in the past, but now the US authorities require real estate property buyers to demonstrate the source of their money.”

The corruption proceeds that remain in Colombia are usually invested in real estate, which is also a prime investment option for drug traffickers and other criminals, explaining the overpricing of some real estate markets in Colombia. While housing prices have been declining in recent years

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<sup>31</sup> Ibid, Transparency International 2019.

<sup>32</sup> Contraloría General de la República (CGR). 2018. Grandes Hallazgos 2014-2018. Septiembre de 2018. Accessed at: [https://www.contraloria.gov.co/documents/20181/472298/Libro\\_grandes+hallazgos+CGR.pdf/6b2543f3-4faa-40c8-900d-5f47d08180ff](https://www.contraloria.gov.co/documents/20181/472298/Libro_grandes+hallazgos+CGR.pdf/6b2543f3-4faa-40c8-900d-5f47d08180ff)

<sup>33</sup> Ibid, CGR, 2018.

<sup>34</sup> Source: EIU calculations based on the 2018 national budget allocations.

in Bogotá, especially in the high-end segment, the price per square meter of an apartment had reached some US\$7,000 in 2015, comparable to prices in Manhattan. Although there are some requirements to justify the proceeds of a real estate transaction in Colombia, these are not strictly enforced, thus facilitating the investment of corruption funds in this area.

Ms. Anzola adds that, as of late, the corrupt are also investing their proceeds in political campaigns: “They help to fund politicians so that once they are elected to office the corrupt get repaid with contracts with local or regional governments. They may take the full contract directly, or take a share of it from the actual contractor that colludes with them.” Political campaigns in Colombia can be financed by private individuals and scrutiny of donations is very poor for regional and municipal elections, perhaps except for those conducted in the larger capitals and provinces.

Official measures to curb corruption have had limited success. Save for progress in reducing the cost and time of official government procedures (which reduces the likelihood of corruption), the payment of bribes to accelerate government approvals or get a contract with the public sector is still common. Penalties for corruption have increased, but the effectiveness of custodial sentences is low, as is the likelihood of being caught and tried by the courts.

## CASE STUDY

### Corruption in Colombia: the Odebrecht case and Ruta del Sol II

Colombians have been outraged by revelations in recent years about various high-profile corruption cases involving large sums of money and the embezzlement of funds earmarked for vulnerable groups such as children and the sick. The cases demonstrate that corruption has reached what may have seemed untouchable spheres of public service, including the Supreme Court and other high tribunals, emblematic national projects, and the financing of presidential campaigns. Although evidence points to the outflow of some of the embezzled funds to tax havens like Panama, or to investments in real estate in the US, there are no confirmed figures, nor is there detailed knowledge about the financial or manual operations used to transfer the illicit funds abroad or confiscation of the foreign assets.

However, the case in Colombia of Odebrecht (the Brazilian construction multinational involved in a global scheme of bribes for public sector contracts) and the Ruta del Sol II project offers some indication of corruption money held abroad and the mechanisms to transfer it to different jurisdictions—ultimately a model of IFFs on a global scale. The Odebrecht scandal has had multiple political ramifications—hence its visibility—which have thus far in Colombia included the imprisonment on different charges of a former vice-minister of transportation, a former senator, and the general manager of the presidential campaign of Juan Manuel Santos (2010-14 and 2014-18). Ongoing investigations also involve other former top government officials, including ministers of education and transportation during the Santos administration.

Ruta del Sol II is a US\$1 billion toll road project awarded in 2010 through a public-private partnership scheme to a consortium comprising Odebrecht Colombia and local associates. The project began construction in 2011, but it was revealed in 2016 that Vice-Minister of Transportation, Gabriel García, who oversaw the awarding process in 2010, had demanded and received a US\$6.5 million bribe from Odebrecht Colombia to influence the awarding of the contract. It remains unclear which banking system the Brazilian multinational used to pay the bribe, but as part of a plea bargain with Colombian prosecutors Mr. García confessed that the company ordered him to open an account to receive the funds in Andorra (a European country that formally ended its bank secrecy legislation in 2016 through agreements within the EU). The money was deposited in the local bank Banca Privada d'Andorra (BPA) in the name of Lurion Trading Inc., a firm domiciled in Panama.

Mr. García received the help of lawyer friends in Colombia—who were in turn advised by legal firms in Panama and the US—to create Lurion Trading Inc. as a shell company in Panama with the sole purpose of receiving the bribe and distributing it. To obscure the source of the funds, the US\$6.5 million was transferred from BPA to the bank's local subsidiary in Panama, laundering the money. From there, part of the now “clean” money was transferred from Panama to Colombia to pay for the legal advice Mr. García received in Colombia. Mr. García has confessed that he invested the remaining portion in real estate in Colombia, shares in Colombian companies, and shares in the New York Stock Exchange, where he allegedly “lost US\$1 million.” Banks in Colombia and the US were used in both cases to receive the money.

## Illegal Mining—The Case of Gold

According to Colombian government data, in 2017 the country produced 43 tons of gold but exported 55 tons, worth US\$1.8 billion.<sup>35</sup> This type of discrepancy usually highlights illegal trading. Gold is the main illegally mined mineral in Colombia and a key generator of IFFs impacting the country. The illicit flows can be generated by miners operating without a license (either artisan or criminal miners), or by gold smuggled into Colombia. The government admits that 85 percent of the gold produced in 2016 was illegal, coming from both informal and criminal miners, and the Organization for Economic Cooperation and Development (OECD) estimates that criminal miners generated 15-20 percent of exports that year.<sup>36</sup> Illegally armed groups are heavily involved in illicit gold mining, the proceeds of which they transfer abroad to buy arms. Drug traffickers use illegal gold trading to launder money, one of the main methods of “legalizing” IFFs.

Frédéric Massé, an academic and lecturer in Colombia, stated that “typically, in countries where there is a conflict and there are armed groups, or there is drug trafficking and there are drug traffickers, they control and develop illegal mining. Colombia has both...” those involved in the illegal gold trade include guerrillas from the ELN, dissidents from the recently demobilized FARC, and *BACRIM*, as well as drug trafficking organizations. The activity has gained importance as a source of revenue for criminal organizations, with the government estimating that it generates US\$2 billion to US\$3 billion a year, making this illicit activity more valuable than cocaine trafficking.<sup>37</sup>

As with other IFFs, estimating illicit flows of money generated by illegal mining is difficult and subject to controversy depending on the methodology used. The United Nations Economic Commission for Latin America and the Caribbean (ECLAC) estimates that IFFs from the illegal trade in gold, silver, and ferrous nickel averaged US\$728 million a year in 2010-2014, almost seven times more than estimated at the beginning of the 2000s.<sup>38</sup> IFFs from gold totaled US\$964 million in 2000-2014, or US\$64 million a year.<sup>39</sup> The ECLAC research also found that the majority of illicit outflows from illegal mining are directed to developed economies, principally Switzerland and the US.

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<sup>35</sup> Ministerio de Minas y Energía. 2018. Análisis Mienero. Accessed at: <https://www.minminas.gov.co/en/analisis-minero>

<sup>36</sup> OECD. 2016. Due Diligence on Colombia’s Gold Supply Chain. Accessed at: <http://www.oecd.org/investment/mne/colombias-gold-supply-chain.htm>

<sup>37</sup> Ibid, OECD. 2016.

<sup>38</sup> CEPAL. 2016. Flujos Financieros Ilícitos a los Países Andinos. Una Mirada al Sector Minero. Diciembre de 2016. Accessed at: <https://www.cepal.org/es/publicaciones/40857-flujos-financieros-ilicitos-paises-andinos-mirada-al-sector-minero>

<sup>39</sup> Ibid, CEPAL 2016.

### ***The Impacts of Illegal Mining***

In measuring the manipulation of prices for Colombian gold exports, the ECLAC estimates that this mispricing generated illicit outflows of US\$1.13 billion between January 2006 and June 2016, or around seven percent of total gold exports over the period (although this percentage has been higher in recent years, suggesting that the situation is deteriorating). The tax revenue forgone due to export misinvoicing exceeded US\$75 million in 2011. It has fallen since, but was still around US\$30 million by 2016.

Mr. Massé explained that “the dynamics of illegal gold mining began to change at the start of the 2010s basically owing to stricter government enforcement against this activity.” Colombia has taken important steps to curb illegal mining since 2012, including adopting higher governance standards for the industry, better traceability mechanisms, stronger penalties for offenders, and more requirements to commercialize the gold produced. “Nevertheless, the measures have not meant the end of illegal gold mining in Colombia,” Mr. Massé claimed.

He explained that enforcement to increase the formalization of the mining industry and trading of legal gold has fostered criminal organizations to increase gold smuggling out of Colombia. The smuggled gold follows the same modalities and sometimes the same routes as drug trafficking. Some is smuggled in small quantities by individual air passengers travelling to the US, for example. Another method sees gold moved out of Colombia in small aircraft, sometimes which arrive full of weapons, destined for Panama or the Netherlands Antilles en route to its final destination in Amsterdam, where it arrives as fully legal gold. A third mechanism involves the gold being transported by boat to neighboring Ecuador or Panama. “I presume most of the money stays in Colombia when we talk about the smaller illegal producers, but it is likely that the larger networks leave the money overseas,” Mr. Massé stated.

## CASE STUDY

### Laundering illicit gold

This case shows the role of an established gold trader in laundering illicit gold. Colombian authorities discovered in 2014 that *Comercializadora Internacional Goldex* (Goldex), at the time Colombia's second-largest gold exporter, was buying gold from illegal miners but registering it as legal for later sale to international clients.

In January 2015 Colombian prosecutors announced the dismantling of "Colombia's largest gold money laundering organization ever." In cooperation with DIAN (National Directorate of Taxes and Customs) and UIAF (Unit for Financial Information and Analysis), the Prosecutor General Office ordered the arrest of more than two dozen people, including the CEO of Goldex, accusing them of laundering nearly US\$1 billion.

Goldex was established in 1985, but its exports started to grow considerably from the early 2000s. Between 2010 and 2014 the company exported 40 tons of gold, worth nearly US\$1.3 billion, chiefly to the US. An investigation that had begun in 2014 found that about 90 percent of Goldex's "registered" 6,000 gold suppliers simply did not exist, were owned by deceased persons, or operated small informal shops that were not even involved in gold transactions. Further, during the trial, Goldex executives even admitted having bought between 2007 and 2009 at least US\$7 million worth of gold from *Los Urabeños* (recently renamed as *Cartel del Golfo*), one of the largest drug trafficking organizations in the country, thus confirming the links between narcotraffickers and the gold industry.

Investigators believe that local authorities may have turned a blind eye to Goldex's activities, but no government official has thus far been tried for this. The culpability of the foreign buyers in purchasing the "clean" gold is also yet to be determined. Colombian prosecutors indicated that, between 2004 and 2014, Goldex sold 47 tons of gold to Republic Metals Corporation (RMC) and Metalor Technologies USA, both headquartered in the US. The latter company is a subsidiary of Metalor Technologies S.A., the world's largest gold refiner, based in Switzerland. RMC and Metalor USA have been cited in other investigations involving illegal mining in other Latin American countries.

## Chapter 2: GFI's Analysis of Trade Misinvoicing in Colombia in 2016

Using United Nations trade data, GFI analyzed the degree of trade misinvoicing in Colombia in 2016, finding a gap of \$10.8 billion between the values reported by Colombia and those reported by all its trading partners. Furthermore, using VAT, customs duties, and corporate income tax and royalty rates in Colombia we estimate that the Colombian government lost approximately US\$2.8 billion in revenue related to trade misinvoicing. This amount is equivalent to roughly 5.2 percent of total Colombian tax revenues collected that year. This estimate comprises losses of US\$1.5 billion from misinvoiced imports and US\$1.3 billion from misinvoiced exports.

**Table 1. Trade Misinvoicing and Estimated Potential Revenue Losses in Colombia in 2016 (in USD Millions and Percent of Actual Collections)**

	USD Millions	% of Collections
<b>Import Values Analyzed</b>	32,693 <sup>40</sup>	-
Import Under-Invoicing	3,113	-
VAT %, lost revenue	498 <sup>41</sup>	3.6%
Customs duty %, lost revenue	229 <sup>42</sup>	17.0%
Import Over-Invoicing	2,401	
Company income tax %, lost revenue	756 <sup>43</sup>	3.9%
<b>Export Values Analyzed</b>	24,755 <sup>44</sup>	-
Export Under-Invoicing	3,654	-
Company income tax %, lost revenue	1,151 <sup>45</sup>	5.9%
Royalties, lost revenue	186 <sup>46</sup>	-
Export Over-Invoicing	1,643	-
	0 <sup>47</sup>	-
<b>Total Potential Revenue Losses</b>	<b>2,820</b>	

<sup>40</sup> After starting with a total value of \$44.8 billion in officially reported imports in 2016, and then eliminating all of the “orphans,” “lost” and “others” records, this amount of about \$32.7 billion remained and was used in our trade value gap analysis (See a description of GFI’s value gap Methodology here: <https://gfintegrity.org/research/methodology/>).

<sup>41</sup> The Value-Added Tax (VAT) rate on imports in Colombia in 2016 was 16.0%. Source: E&Y, “Worldwide VAT, GST and Sales Tax Guide 2016,” [https://www.ey.com/Publication/vwLUAssets/Worldwide-VAT-GST-and-sales-tax-guide-2016/\\$FILE/Worldwide%20VAT,%20GST%20&%20Sales%20Tax%20Guide%202016.pdf](https://www.ey.com/Publication/vwLUAssets/Worldwide-VAT-GST-and-sales-tax-guide-2016/$FILE/Worldwide%20VAT,%20GST%20&%20Sales%20Tax%20Guide%202016.pdf).

<sup>42</sup> This amount was calculated using Colombian tariff data for 2016 from the World Bank’s WITS database, on a line by line basis for all trade records analyzed.

<sup>43</sup> The figure includes both the corporate income tax on profits and the CREE equality tax. The income tax rate on corporate profits in Colombia in 2016 was 22.5%. Source: PricewaterhouseCoopers (PwC) and World Bank, “Paying Taxes 2016: The Global Picture,” p. 127. <https://www.pwc.com/gx/en/paying-taxes-2016/paying-taxes-2016.pdf>. The rate for the CREE equality tax in 2016 was 9%. Source: Colombian National Tax and Customs Authorities (DIAN): <https://www.dian.gov.co/impuestos/sociedades/Cree/QueDebeSaber/Abc/Paginas/default.aspx>.

<sup>44</sup> After starting with a total of \$31.0 billion in officially reported exports in 2016, and then eliminating all of the “orphans,” “lost” and “others” records, this amount \$25.1 billion remained and was used in our trade value gap analysis (See a description of GFI’s value gap Methodology here: <https://gfintegrity.org/research/methodology/>).

<sup>45</sup> The figure includes both the corporate income tax on profits and the CREE equality tax. The income tax rate on corporate profits in Colombia in 2016 was 22.5%. Source: PricewaterhouseCoopers (PwC) and World Bank, “Paying Taxes 2016: The Global Picture,” p. 127. <https://www.pwc.com/gx/en/paying-taxes-2016/paying-taxes-2016.pdf>. The rate for the CREE equality tax in 2016 was 9%. Source: Colombian National Tax and Customs Authorities (DIAN): <https://www.dian.gov.co/impuestos/sociedades/Cree/QueDebeSaber/Abc/Paginas/default.aspx>.

<sup>46</sup> For the royalties rate on natural resources, we used a conservative estimate of 5.0%. For details of royalties rates on natural resources production in Colombia in 2016, see EY, “Colombia: Mining and metals tax guide,” May 2017, [https://www.ey.com/publication/vwLUAssets/ey-colombia-mining-and-metals-tax-guide-2017/\\$file/ey-colombia-mining-and-metals-tax-guide-2017.pdf](https://www.ey.com/publication/vwLUAssets/ey-colombia-mining-and-metals-tax-guide-2017/$file/ey-colombia-mining-and-metals-tax-guide-2017.pdf). For details of royalties rates on oil and gas production in Colombia in 2016, see EY, “Global oil and gas tax guide 2018,” pp. 145-148: [https://www.ey.com/Publication/vwLUAssets/ey-global-oil-and-gas-tax-guide/\\$FILE/ey-global-oil-and-gas-tax-guide.pdf](https://www.ey.com/Publication/vwLUAssets/ey-global-oil-and-gas-tax-guide/$FILE/ey-global-oil-and-gas-tax-guide.pdf).

<sup>47</sup> There are no estimated revenue losses on over-invoiced exports. See GFI’s value gap Methodology for further details: <https://gfintegrity.org/research/methodology/>.

## The Problem of Trade Misinvoicing

Trade misinvoicing is a way of moving money illicitly across borders and is an old and well-established practice. There are broadly four types of trade misinvoicing that include two ways of illicitly sending funds into other countries (IFF inflows) and two ways of illicitly sending funds out of a country (IFF outflows). In all such cases, the stated prices for goods on invoices of either imports or exports are manipulated in order to conceal the actual values of the transactions. Each of these four pathways is described below:

**Figure 2. The 4 Main Types and Common Purposes of Trade Misinvoicing**

IFF Outflows	Import Over-Invoicing	<ul style="list-style-type: none"> <li>– To shift money abroad (evade capital controls, shift wealth into a hard currency, etc.);</li> <li>– Overstating the cost of imported inputs to reduce income tax liability;</li> <li>– To avoid anti-dumping duties</li> </ul>
	Export Under-Invoicing	<ul style="list-style-type: none"> <li>– To shift money abroad (evade capital controls, shift wealth into a hard currency, etc.);</li> <li>– To evade income taxes (lowering taxable income levels);</li> <li>– To evade export taxes</li> </ul>
IFF Inflows	Import Under-Invoicing	<ul style="list-style-type: none"> <li>– To evade customs duties or VAT taxes;</li> <li>– To avoid regulatory requirements for imports over a certain value</li> </ul>
	Export Over-Invoicing	<ul style="list-style-type: none"> <li>– To exploit subsidies for exports;</li> <li>– To exploit drawbacks (rebates) on exports</li> </ul>

The two main types of trade misinvoicing done for the purpose of shifting money abroad include “import over-invoicing” (paying more for imports than they are actually worth and depositing the additional money into another overseas bank account) and “export under-invoicing” (falsifying an invoice to show that the price of goods being exported is lower than the actual price being paid by an importer abroad). Common reasons for illicit outflows are to evade taxes or capital controls and shift wealth from weak currency countries into hard currency countries. In all cases, however, the result is the denial of trade taxes owed to governments. This is a particularly acute problem in developing economies, which are heavily dependent on tax revenue to finance national economic development goals.

Trade misinvoicing is also used to bring illicit funds into countries, the two main types of which include “import under-invoicing” (falsifying invoices to show a lower value for the price of goods being imported so as to avoid or lower import taxes) and “export over-invoicing” (falsifying invoices to show that exports are priced at higher levels than what importers abroad are actually paying), which is used by companies seeking to benefit from government export incentives programs, such as customs duty and VAT tax drawbacks (rebates). Common reasons for illicit inflows are for evading taxes and laundering the proceeds from and/or financing illegal activities of transnational

criminal organizations. While much attention is often given to the problem of illicit outflows from developing countries, the problem of illicit inflows is often just as big a problem.

Examples of schemes detected by investigators include a case in which a front company for a Mexican cartel sold US\$1 million worth of oranges to an American importer while falsely stating on its invoice the price paid was US\$3 million, giving it a legitimate excuse to actually illicitly transfer US\$2 million from Mexico into the US. In a similar case, money launderers were caught exporting plastic buckets from the Czech Republic to the US at the stated price of cost US\$970 each.<sup>48</sup>

Trade misinvoicing is not the same thing as profit shifting/abusive transfer pricing by multinational corporations (MNCs). Transfer pricing occurs whenever two companies that are part of the same multinational group trade with each other across borders and establish a price for the transaction. The activity becomes illegal or “abusive transfer pricing” when the price established is deliberately distorted in order to minimize the overall tax bill, i.e., when transfer prices are recorded to artificially show that much of an MNC’s profit occurred in a tax haven with low or zero taxes.

While both trade misinvoicing and profit shifting/abusive transfer pricing result in a massive loss of tax revenue for developing countries, the problem of abusive transfer pricing by MNCs tends to get much more attention from the media and international institutions. However, there is evidence to suggest that the two problems are similar in scale and scope, particularly when it comes to the estimated revenue losses for developing countries. For example, the International Monetary Fund (IMF) recently estimated the revenue losses to developing country governments from profit shifting/abusive transfer pricing to be about US\$200 billion per year.<sup>49</sup> This is similar to the tax and revenue losses due to the US\$1 trillion in trade misinvoicing per year in developing countries. Despite this similar scale of revenue losses, the problem of trade misinvoicing has not received the same degree of attention as profit shifting/abusive transfer pricing by MNCs.

The need to meaningfully reduce the revenue losses that stem from trade misinvoicing is a critical issue for countries seeking to make progress on the Sustainable Development Goals (SDGs), which are the set of measurable, attainable and time-bound development objectives established by all 193 Member States of the United Nations in 2015. While the 17 multi-faceted goals range from issues on improving health and education, to fostering inclusive economic growth and addressing climate change, the need to address trade misinvoicing is included in SDG 16: “significantly reduce illicit financial flows, strengthen the recovery and return of stolen assets and combat all forms of

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<sup>48</sup> “Uncontained: Trade is the weakest link in the fight against dirty money,” *The Economist*, May 3, 2014. <https://www.economist.com/international/2014/05/03/uncontained>

<sup>49</sup> International Monetary Fund, “Corporate Taxation in The Global Economy,” March 2019, <https://www.imf.org/en/Publications/PolicyPapers/Issues/2019/03/08/Corporate-Taxation-in-the-Global-Economy-46650>

organized crime.” Given that the UN adopted the SDGs, all governments are obligated to attempt to curtail their illicit flows.

It is especially important to address the problem of trade misinvoicing given that the 2015 Report of the High Level Panel on Illicit Financial Flows from Africa, commissioned by the African Union and the United Nations Economic Commission for Africa (AUC/ECA), identified trade misinvoicing as a major form of illicit financial flows (IFFs). The Addis Ababa Action Agenda on financing for development (FfD) also called for a redoubling of efforts to substantially reduce IFFs, with a view to eventually eliminating them.

The need to address the problem of trade misinvoicing is also underscored by SDG Goal 17.1, which focuses on efforts by governments to mobilize more domestic resources. Stymieing tax revenue losses due to trade misinvoicing is a key part of such efforts. Consequently, in order for developing countries and the international community to make progress on SDGs 16 and 17, the problem of IFFs generally, and trade misinvoicing in particular, must be effectively addressed.

## CASE STUDY

### When Officials Get In on the Game: Trade Misinvoicing and Corruption

Given the massive amount of trade misinvoicing each year (GFI's global estimate for developing countries puts the value gap at close to \$1 trillion), the question might rightly be asked: why is it apparently so easy to misinvoice trade?

There are myriad answers including the fast pace of goods clearance at ports, lack of training of customs officers, and the lack of technology to detect misinvoicing in real time (although this is changing with tools like GFI's GFTrade). However, there is one reason for trade fraud that will be of little surprise: corruption.

Corruption was at the heart of a nine-year investigation by Colombian authorities into a collusion scheme in which a high-ranking Customs official coordinated with importers of alcohol, cigarettes, textiles and shoes to underreport the amount of goods coming into the country by as much as half. In doing so, the per-unit price of the goods was greatly reduced, boosting the importer's profits. Apparently, the official, Humberto Angulo Montero, received a cut of the proceeds with "his assets inexplicably increase[ing] by 580 percent between 2003 and 2009." In April 2016, Angulo, "the former tax and customs head for two of Colombia's most important port cities — Cartagena, on the Caribbean, and Buenaventura on the Pacific side — was arrested on illicit enrichment charges."

According to the reports, collusion among government officials and importers/exporters is a well-worn path to pushing goods into a country illegally, particularly in major port areas, such as the ones where Angulo was operating.

Corruption in this sector is rife. According to *InSight Crime*, "enforcement agencies have freely admitted... that the boom in contraband smuggling has been facilitated by official corruption." The combination of drug traffickers who need to launder proceeds, porous borders along the northern coast, relatively low pay for Colombian government officials, lack of internal government oversight, and the seeming impunity with which smugglers and importers/exporters operate led to a situation in which a top Customs official was able to aid, abet and profit from illicit activity for years.

Addressing the corrosive nexus of trade misinvoicing and official corruption in Colombia will require a level of political will that has yet to appear.

Source: *InSight Crime*, 'Colombia Customs Official Got Rich Off Contraband', by James Bargent, April 22, 2015, <https://www.insightcrime.org/news/brief/colombia-customs-official-corruption/>

## How Trade Misinvoicing Is Measured

Researchers have been attempting to identify, measure and monitor the amount of trade misinvoicing hidden within regular commercial trade for many decades. The Partner-Country method, in which, for example, Colombia's official reports of its imports and exports is cross referenced against the reports of all of Colombia's other trading partners in the same year, was originally pioneered by Morgenstern as early as 1950<sup>50</sup> <sup>51</sup> and Bhagwati in the 1960s.<sup>52</sup> <sup>53</sup>

This early research established the theoretical and empirical basis for analysis of this issue. Later research in the 1980s and 1990s sought to better understand the linkages between trade misinvoicing and capital flight. More recent research beginning in the early 2000s examined the linkages between trade misinvoicing and criminal activities, known as trade-based money laundering (TBML).<sup>54</sup>

An example of TBML was a scheme uncovered by a US Customs investigation in which a Colombian cartel used proceeds from drug sales to buy stuffed animals in Los Angeles, exported them to Colombia, where the toys were re-sold in pesos at a discount, thus enabling the cartel to deposit its laundered profits into the domestic banking system.<sup>55</sup> In response, international efforts to reduce TBML have so far mainly been focused on requiring greater due diligence by banks and money-transmitters, while the trade channel has not yet been the degree of scrutiny it deserves. As more attention was placed on bank and money-transfer services, TBML has become an increasingly more attractive method by which criminal organizations and terrorist financiers move money for the purposes of disguising its origins and integrating proceeds from illegal activities into the worldwide economy.<sup>56</sup>

Much of the research on trade misinvoicing has traditionally focused on estimates based on bilateral trade data published in the Direction of Trade Statistics (DOTS) of the IMF, which provides aggregate values of imports and exports between a country and its trading partners. However, more recently, researchers have been investigating trade misinvoicing at more disaggregated levels,

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<sup>50</sup> Morgenstern, O. (1950) On the accuracy of economic observations: Foreign trade statistics. *The Accuracy of Economic Observations*. Princeton University Press, Princeton, N.J.

<sup>51</sup> Morgenstern, O. (1965) On the accuracy of economic observations. Princeton University Press, 2nd Revised edition.

<sup>52</sup> Bhagwati J. (1964) "On the underinvoicing of imports," *Bulletin of the Oxford University Institute of Economics and Statistics*, 27 (4), pp 389-397.

<sup>53</sup> Bhagwati J. (1967) "Fiscal policies, faking trade declarations, and the balance of payments," *Bulletin of the Institute of Economics and Statistics*, 29 (1), pp. 61-77.

<sup>54</sup> De Boyrie M., Pak, S. and Zdanowicz, J. (2005) "The impact of Switzerland's money laundering law on capital flows through abnormal pricing in international trade," *Applied Financial Economics*, 15 (4), pp. 217-230.

<sup>55</sup> Uncontained: Trade is the weakest link in the fight against dirty money," *The Economist*, May 3, 2014. <https://www.economist.com/international/2014/05/03/uncontained>

<sup>56</sup> Mauro, J.S. (2015) "The New Economy in Financial Crimes: Understanding the Effects of Under-Invoicing, Double Invoicing and False Invoicing in Trade-Based Money Laundering and Terrorist Financing (TBML & TF) Schemes," *The Association of Certified Anti-Money Laundering Specialists*, August, <http://www.acams.org/wp-content/uploads/2015/08/The-New-Economy-in-Financial-Crimes-S-Mauro.pdf>.

at the sector and product levels, as well as the partner level. This is due to the growing recognition that some goods may be more frequently smuggled and mispriced than others and that the goods used to hide trade misinvoicing may shift over time. Therefore, researchers have a growing interest in analysis at the product and partner levels, which can be carried out more easily using the disaggregated data published in the United Nations Commodity Trade Statistics (Comtrade) database, which provides time series on imports and exports broken down by product, country and trading partner. Such data enables researchers to analyze the sources, directions and patterns of trade misinvoicing.<sup>57</sup>

Ironically, as more and better quality trade data has become increasingly available and statistical systems have improved in recent decades, the modern global economy has become increasingly characterized by the transactions of multinational corporations, the use of digitized financial transactions and an increased role played by offshore financial centers—all of which has undermined the quality of economic and trade statistics, with serious implications for economic policy and academic research.<sup>58</sup> Globalized trade and global supply chains have increased the use of “transit hubs”—or “re-exports”, i.e., when products are shipped through multiple jurisdictions between the country of origin and the final country of destination. Additionally, the role of offshore centers and “secrecy jurisdictions” has made it increasingly difficult for research to identify and track the original prices charged by exporters and the final prices paid on shipped goods by importers.

Given these data challenges, making exact estimates of the levels of trade misinvoicing between two countries is difficult. Therefore, GFI uses the available data to make the best estimates possible, which are meant to illustrate the broad magnitude of the problem. The estimates of the degrees of trade misinvoicing identified are sufficient for policymakers to grasp the severity of the problem and react accordingly.

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<sup>57</sup> UNCTAD (2016) “Trade Misinvoicing in Primary Commodities in Developing Countries: The cases of Chile, Côte d’Ivoire, Nigeria, South Africa and Zambia” United Nations Conference on Trade and Development (date of issuance: 23 December 2016).

<sup>58</sup> Linsi, L. and Mügge, D.K. (2019) “Globalization and the growing defects of international economic statistics,” *Review of International Political Economy*, 26 (3), pp. 361-383, DOI: 10.1080/09692290.2018.1560353

## Case Study

### ¿De donde eres?: Trade Misinvoicing by Falsifying Country of Origin

Trade misinvoicing is the falsification of the value, quantity, quality or origin of goods being imported or exported as a way to evade duties and taxes owed to the government. In this section, we examine a case of falsification of the country of origin for products being imported into Colombia as a way to launder proceeds of narcotics trafficking by a Mexican cartel.

According to news reports when the Sinaloa drug cartel needed to launder the proceeds of their narcotics activity, they turned to trade-based money laundering (TBML) to achieve their goals. TBML is the process of buying legitimate consumer goods with the proceeds of illegal activity (such as drug trafficking), and then shipping the goods to a target country where the individuals want to shift profits (here, Colombia). The goods are then sold in a commercial marketplace, the proceeds of such sales effectively laundering the money.

In this case, this well-known process of money laundering was made even more interesting with an added twist, as the shoes and clothing purchased by the Sinaloa cartel originated in China and were shipped to the United States prior to entering Colombian ports. When the goods entered Colombia, the country of origin on the invoice was listed as the US, rather than China.

In an article published by *InSight Crime* in July 2016, the reason for this subterfuge was “a loophole in Colombian law that establishes tariffs on imported textiles... Countries that have free trade agreements with Colombia [such as the US] are exempt from such tariffs.” So, not only was Sinaloa trafficking in narcotics and conducting TBML, they were also penny-wise when it came to importation—managing to evade tariffs, too.

Source: *InSight Crime*, ‘Sinaloa Cartel Laundered Money in Colombia Using Textiles: Report’, by Mike LaSusa, July 28, 2016, <https://www.insightcrime.org/news/brief/sinaloa-cartel-laundered-money-in-colombia-using-textiles-report/>

## Measuring Trade Misinvoicing in Colombia

In order to identify a country’s imports/exports that may have been misinvoiced, GFI conducts a “value gap” analysis in which a country’s trade with all its partners in a given year is examined in order to identify the four major types of trade misinvoicing.

For our analysis, GFI uses the UN Comtrade database, which each year collects reported data from a majority of countries on their annual imports and exports.<sup>59</sup> Drawing on the report submitted by Colombia to Comtrade for 2016, GFI used the data to cross reference Colombia’s export/imports against the corresponding reports submitted by all of Colombia’s trading partners around the world

<sup>59</sup> In earlier reports, GFI used data from the Direction of Trade Statistics (DOTS) database produced by the International Monetary Fund (IMF). In our January 2019 multi-country report, “Illicit Financial Flows to and from 148 Developing Countries: 2006-2015,” GFI drew from both the IMF DOTS database as well as the UN Comtrade database. While both databases have strengths and limitations, GFI decided use the UN Comtrade database for future reports, primarily because of the scale and depth of the detailed data it provides.

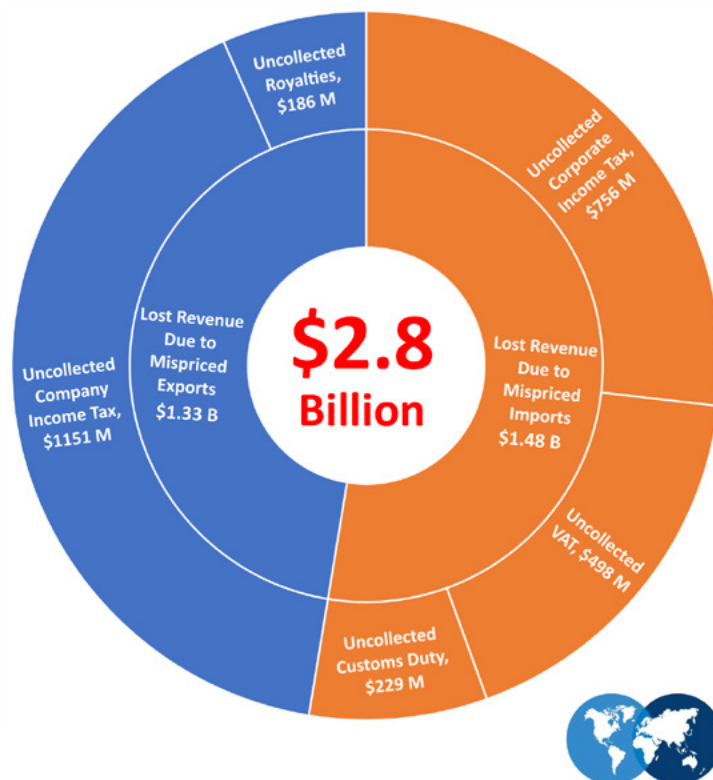
in 2016. In comparing the data sets, gaps in export and import statistics are suggestive of trade misinvoicing.

Using this data, GFI first applies a series of treatments to the Comtrade data. After compiling Colombia's official trade data and that of all of its trade partners for 2016, we eliminate three different sets of trade data from consideration. We first eliminated all cases of "orphaned" imports—meaning those records in the database for which Colombia reported a value for imports of a commodity or good from a particular country while that country reported no exports of that good to Colombia in 2016. Next, we eliminated all cases of "lost" exports—meaning records of exports reported by Colombia's trade partners as goods shipped to Colombia in 2016, but which were not reported as imported by Colombia in that year.

After eliminating all cases of "orphaned" and "lost" records from the Comtrade data for Colombia in 2016, we still needed to identify and eliminate a third category of records called "others." Among the remaining records of "matched values", i.e., trades for which both Colombia and its trading partners reported values for that year, "others" are records that do not meet three criteria: 1) non-zero values for the trade must be reported by both the reporting country and its partner; 2) non-zero volumes (quantities) for the trade must be reported by both the reporting country and its partner; and 3) the volumes must be reported in the same physical units of measurement by both the reporting country and its partner. If any of the remaining records of "matched values", did not comply with all three criteria, these were also eliminated as "others."

Finally, once all cases of "orphaned", "lost" and "others" records were eliminated, (and a few other technical treatments were applied to the data as described below), the remaining sets of "matched" trades are used in our value gap analysis. GFI has found that, on average between 2000-2015, "orphaned" "lost" and "others" records comprised about 26 percent of all relevant Comtrade records, leaving on average about 74 percent of a country's Comtrade records available as sets of "matched" trades for use in our value gap analyses. Table 2 shows the results of GFI's trade gap analysis for Colombia in 2016.

## Estimated Tax Revenue Loss Due to Trade Misinvoicing in Colombia, 2016



Source: UN Comtrade (trade data), World Bank WITS (tariff rates); numbers are rounded.



GLOBAL FINANCIAL INTEGRITY

**Table 2. Value Gap Analysis for Colombia in 2016: Identifying Matched Values (in millions of US Dollars)**

	Total Reported by Colombia	Total Adjusted by GFI <sup>60</sup>	Orphaned	Others	Lost <sup>61</sup>	Matched Values
Imports	\$44,831	41,658	2,705	6,260	4,284	\$32,693
Exports	\$31,044	29,331	4,284	292	2,705	\$24,755

In Table 2 above the first column shows the values of total imports and exports as officially reported by Colombia to Comtrade. The second column shows GFI's adjustments to those values based on a number of treatments of the data that are detailed below. The third, fourth and fifth columns show the sum of the values of trade records that were classified as "orphaned", "others" and "lost", respectively. Finally, after eliminating the "orphaned," "others" and "lost" records, the sixth column on the far right shows the sum of the values of trade records that were classified as "matched" sets, or those records in the Comtrade database for which both Colombia and its trading partner countries reported values in 2016. The matched sets are the figures used in GFI's value gap analysis.

Within Colombia's US\$44.8 billion in imports reported in 2016, GFI identified sets of matched value trades with its partners valued at approximately US\$32.7 billion. Similarly, within Colombia's US\$31.0 billion in exports reported in 2016, GFI identified sets of matched trades with its partners valued at approximately US\$24.8 billion for use in our analysis.

Using the data for the set of matched trades, Table 3 shows the next step in our value gap analysis, which identifies the estimated amounts of the four main types of trade misinvoicing for Colombia in 2016.

**Table 3. Value Gap Analysis for Colombia in 2016: Identifying Trade Misinvoicing Gaps (in millions of US Dollars)**

	US\$ Millions
Import Value Analyzed	32,693
Import Under-Invoicing	3,113
Import Over-Invoicing	2,401
Export Value Analyzed	24,755
Export Under-Invoicing	3,654
Export Over-Invoicing	1,642

<sup>60</sup> The figures in this column are somewhat different from the figures officially reported by Colombia to Comtrade because the data has been treated by GFI in a number of steps detailed below.

<sup>61</sup> Note that the figures representing "lost" exports and "orphaned" imports are mirrored reflections of one another. The "lost" figures are not included in GFI's analysis because in this case our focus is on Colombia, and by definition, "lost" refers to goods that officially never arrived, i.e. records of exports reported by Colombia's other trade partners as goods shipped to Colombia, but which were never reported by Colombia as being imported - so they do not figure into any of Colombia's official imports data. In contrast, Colombia's "orphaned" imports are records officially reported by Colombia as imports of goods from other countries, even though those countries did not report them as exports to Colombia.

Of the US\$32.7 billion in imports and the US\$24.8 billion in exports examined, GFI identified a total of approximately US\$10.8 billion in value gaps in Colombia's trade with its partners in 2016. This amounts to about 14.2 percent of Colombia's total officially reported trade of US\$75.8 billion for 2016. Within Colombia's imports, we identified gaps valued at approximately US\$5.5 billion, US\$3.1 billion from cases of import under-invoicing and US\$2.4 billion from cases of import over-invoicing. Regarding Colombia's exports, GFI identified gaps valued at approximately US\$4.8 billion, US\$3.7 billion from export under-invoicing and US\$1.6 billion from export over-invoicing. Again, these figures represent the estimated values of the differences between what was reported to Comtrade by Colombia and its trading partners for 2016.

Another way of understanding the identified value gaps is to consider the total estimated amounts of illicit inflows and outflows they represent (see Table 4). To do this, GFI combined the estimated amount of over-invoiced imports (US\$2.4 billion) and under-invoiced exports (US\$3.7 billion) for a total of approximately US\$6.1 billion in illicit outflows. Additionally, the estimated under-invoiced imports (US\$3.1 billion) were combined with over-invoiced exports (US\$1.6 billion) for a total of approximately US\$4.7 billion in illicit inflows.

**Table 4. Estimated Illicit Inflows and Illicit Outflows from Trade Misinvoicing in Colombia in 2016 (in millions of US Dollars)**

<b>IFF Outflows</b>	Import Over-Invoicing	2,401
	Export Under-Invoicing	3,654
	<i>subtotal</i>	6,055
<b>IFF Inflows</b>	Import Under-Invoicing	3,113
	Export Over-Invoicing	1,642
	<i>subtotal</i>	4,755
<b>Total</b>		<b>10,810</b>

### **Estimated Revenue Loss and Trade Breakdown— Key Partner Countries and Commodities**

In this section, GFI examines Colombia's revenue loss and trade value gap by partner countries and commodities in 2016. The following pages contain two parts: Losses from trading with particular partner countries and losses related to trade in particular goods (commodities listed by the Harmonized System product codes), in which the top 30 for each category are ranked by revenue losses, followed by in-depth profiles of selected partners and commodities.

## Ranking Method

Items are ranked using both revenue loss by value and revenue loss as a percentage of trade value for the commodity (see Table 5). The revenue loss values reveal the magnitude of loss, while the percentages indicate risk of loss for particular trading partners and goods. Items that are ranked high by both revenue loss value and percentage of trade value have been highlighted in the following pages.

## Revenue Loss Value and Revenue Loss as a Percentage of Trade Value

For these graphics, revenue loss is approximated by the sum of lost corporate income tax and lost customs duties. According to PwC's Taxes in 2016,<sup>62</sup> Colombia's corporate income tax rate was 22.5 percent in 2016 and there was a nine percent income tax for equality (CREE), both of which GFI applied to its analysis. The customs duty rates were from the World Bank's World Integrated Trade Solution (WITS)<sup>63</sup> database, which sources its tariff rates data from the UNCTAD Trade Analysis Information System (TRAINS) and the WTO Integrated Data Base (IDB). GFI used both data sources at the six-digit HS product code level for each partner country. For any discrepancies between the data sources, GFI used the TRAINS data as a default.

The trade value of an item refers to the analyzed import and export value of the item as reported by Colombia. The analyzed trade values correspond to the matched values. The revenue loss as a percentage of trade value ranges from zero percent to infinite, as the value gap as a percentage of the trade value ranges from zero percent to infinite.


On the following page, Colombia's revenue losses due to trade misinvoicing according to specific trading partners are shown. The left column shows Colombia's revenue losses by value in USD and the right column shows Colombia's revenue losses as a percent of its total trade with a particular partner. In both cases, the darker shade indicates a higher USD value. The table shows the US (US\$766.7 million), China (US\$461.2 million) and Mexico (US\$103.1 million) were among the trading partners with the highest revenue losses by value. Table 5 also shows Rwanda (at 83.1 percent), Malta (at 35.2 percent) and Azerbaijan (at 29.3 percent) were among the trading partners with the highest revenue losses as a percentage of Colombia's total trade with those partners (a more detailed breakdown of these losses follows).

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<sup>62</sup> PricewaterhouseCoopers (PwC) and World Bank, "Paying Taxes 2016: The Global Picture," p. 127. <https://www.pwc.com/gx/en/paying-taxes-2016/paying-taxes-2016.pdf>.

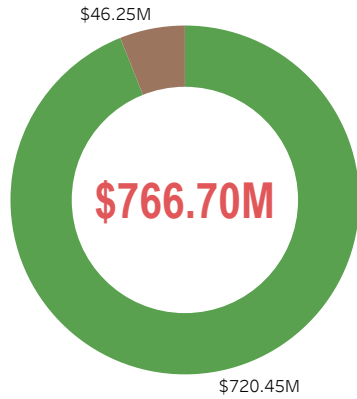
<sup>63</sup> World Bank Group, "World Integrated Trade Solutions" <https://wits.worldbank.org/>

**Table 5. Revenue Losses in Colombia due to Trade Misinvoicing by Trading Partners in USD and as a Percent of Total Trade with Each Partner in 2016**

Value in USD		% of Trade Value	
	\$7.98M  \$766.70M		5.2%  83.1%
USA	\$766.70M	Rwanda	83.1%
China	\$461.21M	Malta	35.2%
Mexico	\$103.13M	Azerbaijan	29.3%
Germany	\$83.67M	Albania	27.4%
Brazil	\$50.40M	Kazakhstan	27.0%
Belgium	\$39.53M	Armenia	24.6%
France	\$39.35M	Nepal	13.7%
Ecuador	\$36.78M	Saint Vincent and the Gre..	13.6%
Japan	\$35.78M	Croatia	13.1%
Peru	\$35.56M	Jamaica	13.0%
Chile	\$35.54M	Burundi	12.4%
United Kingdom	\$34.51M	Singapore	11.8%
India	\$31.45M	Antigua and Barbuda	9.4%
Spain	\$29.15M	Côte d'Ivoire	9.2%
Switzerland	\$27.23M	Kyrgyzstan	8.6%
Turkey	\$25.58M	Slovenia	8.5%
Rep. of Korea	\$19.61M	Kuwait	8.4%
Bolivia	\$18.83M	El Salvador	8.2%
Canada	\$18.01M	Suriname	8.0%
Portugal	\$17.57M	Qatar	7.3%
Netherlands	\$17.43M	Portugal	6.8%
Russian Federation	\$15.55M	Latvia	6.7%
Singapore	\$11.40M	Belgium	6.5%
Argentina	\$10.67M	Russian Federation	6.4%
Viet Nam	\$10.57M	Nicaragua	6.2%
Dominican Rep.	\$10.47M	Honduras	6.1%
Côte d'Ivoire	\$9.17M	South Africa	5.9%
Thailand	\$9.00M	China	5.8%
Costa Rica	\$8.68M	United Arab Emirates	5.4%
Guatemala	\$7.98M	France	5.2%

**Figure 3. Estimated Revenue Losses in Colombia due to Trade Misinvoicing with the USA**

Estimated Revenue Loss



Rank of Revenue Loss in USD

**1**

Rank of Revenue Loss as % of Trade

**44**

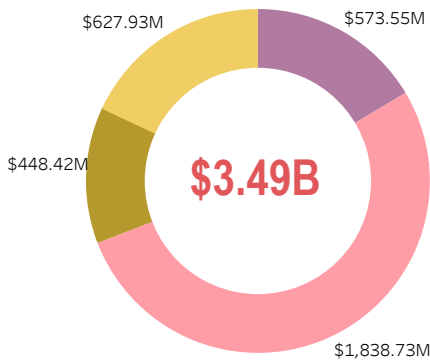
Rank of Value Gap in USD

**1**

Rank of Value Gap as % of Trade

**69**

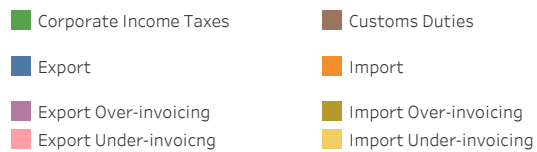
Estimated Value Gap



Top 10 Revenue Loss by HS Chapters

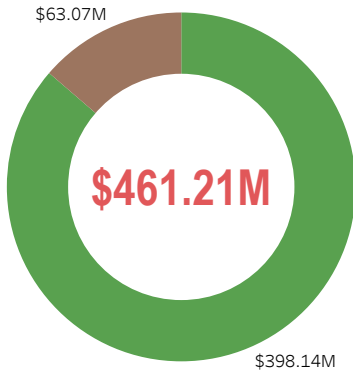
27 - Mineral Fuels	\$394.75M
71 - Precious Stones & Metals	\$132.93M
6 - Live Trees and Plants	\$35.78M
30 - Pharmaceuticals	\$28.05M
84 - Machinery	\$26.17M
39 - Plastics	\$11.41M
4 - Dairy, Eggs, Honey, Etc.	\$10.50M
87 - Vehicles	\$10.37M
85 - Electrical Machinery	\$8.21M
2 - Meats	\$7.17M

Analyzed Trade Value



**Figure 4. Estimated Revenue Losses in Colombia due to Trade Misinvoicing with China**

Estimated Revenue Loss



Rank of Revenue Loss in USD

**2**

Rank of Revenue Loss as % of Trade

**28**

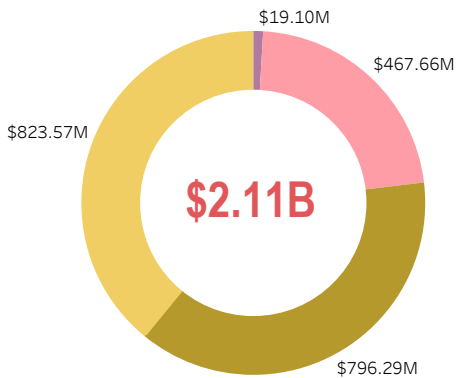
Rank of Value Gap in USD

**2**

Rank of Value Gap as % of Trade

**40**

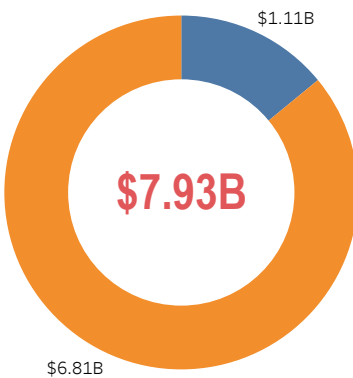
Estimated Value Gap



Top 10 Revenue Loss by HS Chapters

27 - Mineral Fuels	\$140.30M
85 - Electrical Machinery	\$89.23M
84 - Machinery	\$76.50M
29 - Organic Chemicals	\$32.06M
87 - Vehicles	\$15.05M
72 - Iron and Steel	\$8.74M
39 - Plastics	\$7.94M
42 - Leather Articles	\$7.44M
52 - Cotton	\$7.04M
90 - Optical, Medical Products	\$7.03M



Analyzed Trade Value



- Corporate Income Taxes
- Customs Duties
- Export
- Import
- Export Over-invoicing
- Import Over-invoicing
- Export Under-invoicing
- Import Under-invoicing

Next, Colombia's revenue losses due to trade misinvoicing according to specific goods are shown. The left column shows Colombia's revenue losses by value in USD and the right column shows Colombia's revenue losses as a percent of its total trade in a particular good. In both cases, the darker shade indicates a higher USD value. Table 6 shows that mineral fuels (US\$684.6 million), precious stones & metals (US\$159.9 million) and machinery (US\$155.0 million) were among the goods with the highest revenue losses by value. Table 6 also shows that precious stones and metals (at 13.7 percent), umbrellas and walking sticks (at 12.7 percent) and dairy, eggs and honey (at 12.2 percent) were among the goods with the highest revenue losses by percentage of Colombia's total trade in those goods (a more detailed breakdown of these losses follows).

**Table 6. Revenue Losses in Colombia due to Trade Misinvoicing by Commodities in USD and as a Percent of Total Trade of Each Commodity in 2016**

Value in USD		% of Trade Value	
	\$8.60M  \$684.66M		3.4%  13.7%
27 - Mineral Fuels	\$684.66M	71 - Precious Stones & Me..	13.7%
71 - Precious Stones & Metals	\$159.94M	66 - Umbrellas, Walking Sticks	12.7%
84 - Machinery	\$155.04M	4 - Dairy, Eggs, Honey, Etc.	12.2%
85 - Electrical Machinery	\$138.08M	67 - Prepared Feathers	9.2%
30 - Pharmaceuticals	\$109.71M	89 - Ships and Boats	7.8%
87 - Vehicles	\$97.20M	8 - Edible Fruits and Nuts	7.7%
8 - Edible Fruits and Nuts	\$82.42M	30 - Pharmaceuticals	5.4%
29 - Organic Chemicals	\$55.14M	14 - Vegetables, Other	5.4%
6 - Live Trees and Plants	\$54.42M	42 - Leather Articles	5.2%
39 - Plastics	\$47.60M	25 - Salt, Stone, Cement	4.9%
33 - Essential Oils	\$33.87M	27 - Mineral Fuels	4.8%
38 - Chemical Products, Misc.	\$32.65M	92 - Musical Instruments	4.5%
72 - Iron and Steel	\$24.71M	84 - Machinery	4.4%
23 - Food Residues	\$20.58M	97 - Art, Antiques	4.3%
90 - Optical, Medical Prod..	\$19.96M	36 - Explosives, Matches	4.2%
73 - Iron and Steel Articles	\$17.50M	6 - Live Trees and Plants	4.1%
21 - Misc. Edibles	\$16.71M	33 - Essential Oils	4.1%
4 - Dairy, Eggs, Honey, Etc.	\$16.58M	49 - Books and Printed Go..	4.1%
48 - Paper and Paperboard	\$16.08M	56 - Ropes, Cables	4.1%
31 - Fertilisers	\$15.67M	2 - Meats	4.0%
15 - Edible Oils, Waxes	\$14.30M	96 - Manufactures, Misc.	4.0%
10 - Cereals	\$13.65M	31 - Fertilisers	4.0%
40 - Rubber	\$12.83M	45 - Cork Products	4.0%
52 - Cotton	\$12.17M	57 - Carpets	4.0%
76 - Aluminum & Art. Ther..	\$10.96M	5 - Animal Products	3.7%
96 - Manufactures, Misc.	\$10.66M	85 - Electrical Machinery	3.7%
34 - Soaps, Waxes, Etc.	\$10.05M	54 - Man-Made Filaments	3.5%
94 - Furniture	\$9.99M	90 - Optical, Medical Prod..	3.4%
88 - Aircraft	\$8.81M	29 - Organic Chemicals	3.4%
42 - Leather Articles	\$8.60M	46 - Straw, Wicker Produc..	3.4%

**Figure 5. Estimated Revenue Losses in Colombia due to Trade Misinvoicing in Mineral Fuels**

Estimated Revenue Loss



Rank of Revenue Loss in USD

**1**

Rank of Revenue Loss as % of Trade

**11**

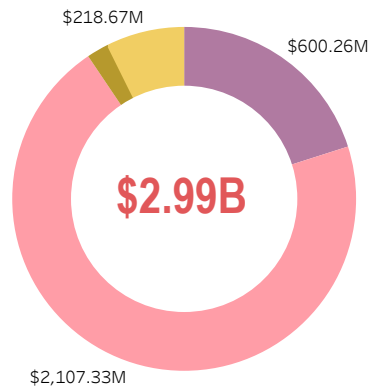
Rank of Value Gap in USD

**1**

Rank of Value Gap as % of Trade

**26**

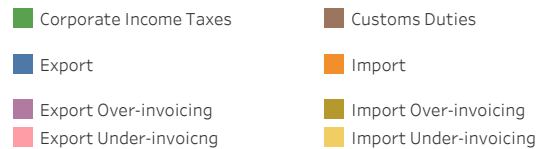
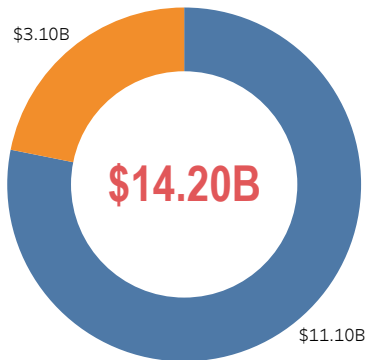
Estimated Value Gap



Top 10 Revenue Loss by Partner Countries

USA	\$394.75M
China	\$140.30M
Chile	\$19.96M
Turkey	\$18.44M
Portugal	\$14.61M
Germany	\$12.20M
Peru	\$11.51M
Singapore	\$10.18M
United Kingdom	\$9.13M
Côte d'Ivoire	\$9.06M

Analyzed Trade Value



**Figure 6. Estimated Revenue Losses in Colombia due to Trade Misinvoicing in Precious Stones & Metals**

Estimated Revenue Loss



Rank of Revenue Loss in USD

**2**

Rank of Value Gap in USD

**5**

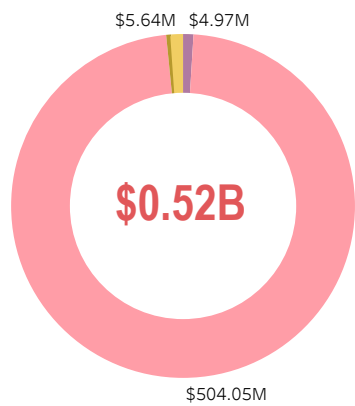
Rank of Revenue Loss as % of Trade

**1**

Rank of Value Gap as % of Trade

**3**

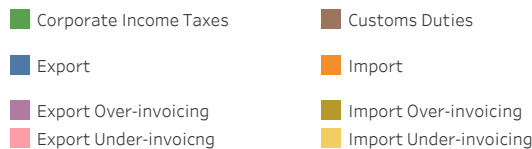
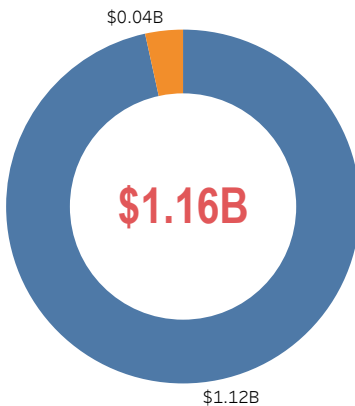
Estimated Value Gap



Top 10 Revenue Loss by Partner Countries

USA	\$132.93M
Switzerland	\$17.64M
India	\$6.02M
United Arab Emirates	\$1.39M
Panama	\$0.64M
Germany	\$0.25M
Thailand	\$0.23M
China	\$0.20M
Chile	\$0.11M
Spain	\$0.09M

Analyzed Trade Value



## Limitations of GFI's Value Gap Analysis

It should be underscored that there are several limitations of GFI's value gap analysis methodology. Firstly, even after eliminating all cases of “orphaned”, “others” and “lost” records, there are a number of reasons why value gaps may still appear in the Comtrade data for the sets of matched values we use in our analysis. These include: human error; countries that report on the same goods but use somewhat different 6-digit Harmonized System (HS) product codes for the same products in the Comtrade system; delays in reporting (shipments exported late in one year may not be reported as imports by the partner country until early in the next year); and the problem of re-exports and transit-trade, in which international cargo may temporarily be unloaded from one ship and reloaded onto another ship in one or more countries during the journey from the original exporter country to the final import destination country where consequently, goods can be mistakenly listed as imports to, or exports from, incorrect locations. All of these factors can result in measurement errors and partner misattribution that can undermine the reliability of value gaps as a proxy for misinvoicing. For detailed explanations of the treatments GFI uses to help mitigate some of these potential distortions, as well as other limitations to using official trade data, please see the description of our methodology on GFI's website.<sup>64</sup>

## Combating Trade Misinvoicing

There are important steps that can be taken by governments to address the problem of trade misinvoicing. Regarding the increased interest in TBML, while recent enforcement efforts have focused on scaled-up due diligence by banks and money-transferring services, there is considerable scope for including many other actors in efforts to identify and reduce trade misinvoicing. For example, there is much more that could be done by exporters, importers, freight forwarders, shippers, ports and customs authorities that are all interlinkages of the system that enables trade misinvoicing. Please see Chapter 4 for detailed descriptions of recommended policy actions to combat trade misinvoicing domestically and internationally.

According to a World Customs Organization survey, 62 percent of customs agencies identified a “narrow or non-existing mandate” as the biggest impediment in fighting TBML, as most agencies are simply tasked with increasing revenues from trade taxes.<sup>65</sup> Furthermore, the amount of overseas development assistance (ODA) given by advanced economies could include more resources to help developing countries improve the numbers and skills of their customs agents. But the current low level of support for such assistance reflects a lack of interest or awareness by development partners in the role of customs administrations in combating IFFs.

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<sup>64</sup> See “Value Gap Trade Misinvoicing Methodology” at: <https://gfintegrity.org/research/methodology/>

<sup>65</sup> Han, R. and Ireland, R. (2016) “A Survey of Customs Administration Approaches to Money Laundering,” WCO Research Paper No. 36, World Customs Organization, March. [http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/research/research-paper-series/36\\_han\\_money\\_laundering\\_en.pdf?la=en](http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/research/research-paper-series/36_han_money_laundering_en.pdf?la=en)

Customs agencies should be much better equipped in order to determine whether “financial transactions” between trade partners correspond to the actual value of traded goods, and should be granted an expanded mandate to investigate all types of trade misinvoicing in order to better prevent individuals from exploiting trade misinvoicing for IFFs.<sup>66</sup>

The United Nations Conference on Trade and Development (UNCTAD) has noted that because exports of primary commodities are concentrated by product and market, this could actually help researchers and customs enforcement, suggesting policy efforts focused on a limited number of products and partners could increase the effectiveness of reforms.<sup>67</sup> As GFI has in this study on Colombia in 2016, UNCTAD noted that governments and their development partners could identify which products and export destinations need to be more carefully scrutinized in the investigation of trade misinvoicing.

There is also a need for major improvements in the quality and consistency of international trade statistics, particularly data gathering at the product and partner levels, notably to ensure clarity and consistency in the classification of products over time and across partners. Additionally, it is critical to improve the international standardization of recording of the origin and destination of exports. Related steps include strengthening the coordination between national statistics and international statistical databases such as UN Comtrade and the IMF’s DOTS. In turn, these steps would require scaling up both financial and technical assistance to developing countries to help improve human capacity, as well as the technological systems for compiling and managing trade data. Finally, there is a need to increase investigations into transactions at the individual company level in order to more accurately assess the scale and scope of the problem of trade misinvoicing.<sup>68</sup>

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<sup>66</sup> Soo Choi, Y. and McGauran, R. (2018) “Chapter 1: Introduction” in “Illicit Financial Flows via Trade Mis-invoicing: Study Report 2018,” World Customs Organization, Brussels.

<sup>67</sup> UNCTAD (2016) “Trade Misinvoicing in Primary Commodities in Developing Countries: The cases of Chile, Côte d’Ivoire, Nigeria, South Africa and Zambia” United Nations Conference on Trade and Development (date of issuance: 23 December 2016).

<sup>68</sup> Ibid.

## CASE STUDY

### Money Movers: Trade Misinvoicing Up Close

The reasons for misinvoicing a trade transaction vary from case to case. Sometimes it is done to evade duties and taxes; in other situations, to launder money. In others, such as that described below during Congressional testimony by former Senior Special Agent Louis Bock of US Customs and Border Protection, it is done to move money between countries. Below, Mr. Bock details a case in which trade misinvoicing was used to move money illicitly from the US to Colombia\*:

“... we approached the Treasury Department of the country of Colombia...and set up a joint effort using both countries’ imports and exports...we were looking at all detailed U.S. import and export transactions, and Colombian data to match, for several years. The project immediately led to the discovery of major discrepancies between each country’s imports and exports. Some discrepancies were in the dollar value, and in other situations it was the quantities that were seriously misaligned. Examination of the data showed that in many cases, the imports and exports between the two countries matched nearly perfectly, which indicated to our team that the significant problems we were uncovering were not data quality issues.

“In the case of Colombia, the differences in value were mainly higher when the goods arrived in the United States. This is commonly called over-invoicing or overvaluing goods. This would usually have the effect of raising the amount of duty and taxes paid on imports. It is fairly common to see undervaluation because that would reduce the money owed in taxes. The overvaluation was, therefore, perplexing. The explanation supplied by financial investigators was that overvaluation was an illegal means of moving money out of the United States. Simply put, if you pay more for an item, money leaves the higher priced country to the lower priced country. One might say this is counter intuitive. Why pay more US taxes and duties by overstating the amount of a given transaction? The answer is the overvaluation had involved items where there was no taxes or duties.

“More was learned from that early experiment. We discovered that in the case of missing goods—where more left the United States than arrived in Colombia—it was simply smuggling that was occurring. We identified ways in which Colombia was losing significant revenue sources, which without our analysis would have been very difficult to detect. More importantly, the analysis identifies goods financed by the Black Market Peso Exchange.”

Mr. Bock closed his testimony by noting that “the financial nexus of trade is key” to helping illicit actors shift money between countries without detection.

\* Text has been edited slightly for clarity

Source: U.S. House Committee on Financial Services Hearing entitled “Trading with the Enemy: Trade-Based Money Laundering is the Growth Industry in Terror Finance”—February 3, 2016.

<https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=399585>

# Chapter 3: Illustrating the Losses from Trade Misinvoicing in Colombia

Written by  **cedetrabajo**

According to the estimate produced by GFI, Colombia lost approximately US\$2.82 billion (COP\$9.1 trillion) in 2016 due to trade misinvoicing.

In this section, we explore the implications of such revenue losses on the efforts by Colombia to achieve the stated goals of its National Development Plan 2018-2022 (NDP) and related efforts to achieve the Sustainable Development Goals (SDGs) by the 2030 deadline. For illustrative purposes, Cedetrabajo examined how much more Colombia might have been able to spend in terms of increased funding for NDP/SDGs goals if Colombia was not experiencing such considerable tax revenue losses due to trade misinvoicing.

**Figure 7. Sustainable Development Goals 2030**



Source: UNDP - UN

Colombia’s National Development Plan (NDP) 2018-22, “*Pacto por Colombia, Pacto por la equidad*” (Pact for Colombia, Pact for Equity), established regional pacts that identify and prioritize differentiated goals and focuses on inter-connecting Colombia’s nine sub-national territories. The national pact applies in all territories and seeks to strengthen governance, by promoting associations in sub-regions and developing strategic projects to support economic development.

The NDP 2018-22 is an official government document designed to help fulfill Colombia’s commitments towards the SDGs and provide guidance for allocating spending on Colombia’s economic and social development priorities. The 17 SDGs serve as the building blocks of the NDP and are a tool for promoting coherence within and among the different sections of the NDP. The SDGs also function as a key reference for setting NDP targets aligned with a long-term vision of the country.

The NDP includes three structural pacts, 13 cross-cutting agreements and nine regional agreements between the national government and the departments and municipalities. With a budget of US\$324.3 million (COP\$1.1 trillion), Table 7 shows how the financing for the NDP’s goals is projected to come from the domestic private sector, the General Budget and the General Participations System, which transfers resources from the national government to the departments. The NDP envisions compliance with the SDG 2030 Agenda by monitoring progress on a series of indicators, with each contributing to the achievement of the 17 commitments.

**Table 7. Colombia’s National Development Plan (NDP), 2018-2022: Funding**

Funding Sources	NDP Budget		
	Budget allocation		Percent of Budget
	(millions of USD)	(billions of COP)	
National General Budget	104.2	352.2	32.1
General Participations System	50.1	169.3	15.4
Territorial	34.2	115.7	10.6
State-owned industrial and commercial enterprises	17.1	57.8	5.3
General Royalty System	10.0	33.7	3.1
International Aid	1.2	4.1	0.4
Private sector	107.5	363.2	33.1
<b>Total</b>	<b>324.3</b>	<b>1,096.0</b>	<b>100%</b>

Source: Directorate of Investment and Public Finance (DNP).

Table 8 shows how the NDP currently plans to allocate the approximately US\$324.3 million (COP\$1.1 trillion) among Colombia’s main national development goals over four years.

**Table 8. Colombia’s National Development Plan (NDP), 2018-2022: Pacts, Funding, and Indicators**

NDP Pacts	Funding for NDP		% of Funding
	Millions of US Dollars	Billions of Colombian Pesos	
1. Pact for legality: effective security and transparent justice so that we all live with freedom and democracy	39.3	132.8	12.1
2. Pact for entrepreneurship, formalization and productivity: a dynamic, inclusive and sustainable economy that empowers all our talents.	8.0	27.2	2.5
3. Equity pact: modern social policy centered on the family, efficient, quality and connected to markets.	151.0	510.1	46.5
4. Pact for sustainability: produce conserving and conserving producing.	3.8	12.7	1.2
5. Pact for Science, Technology and Innovation: a system to build the knowledge of Colombia of the future.	6.3	21.2	1.9
6. Pact for transport and logistics for competitiveness and regional integration.	19.6	66.2	6.0
7. Pact for the digital transformation of Colombia: Government, companies and homes connected with the era of knowledge.	5.3	18.0	1.6
8. Pact for the quality and efficiency of public services: water and energy to promote the competitiveness and well-being of all.	13.4	45.4	4.1
9. Pact for mining-energy resources for sustainable growth and the expansion of opportunities.	29.0	97.9	8.9
10. Pact for the protection and promotion of our culture and development of the orange economy.	1.8	6.0	0.6
11. Pact for Peace building: culture of legality, survival, protection and stabilization victims.	3.1	10.4	1.0
12. Pact for equal opportunities for indigenous groups, blacks, Afro, rural and Palenqueros.	8.6	29.0	2.6
13. Pact for the inclusion of all persons with disabilities.	0.2	0.8	0.1
14. Pact for women’s equity.	1.6	5.4	0.5
15. Agreement for effective public management.	2.5	8.3	0.8
16. Pact for Decentralization: connecting territories, governments and populations.	17.0	57.5	5.2
Undefined	13.8	47.1	4.4
<b>TOTAL</b>	<b>324.3</b>	<b>1,096.0</b>	<b>100.0</b>

Source: Bases of the National Development Plan 2018 - 2022 and Law 1955 of 2019.

The national government in Colombia does not have an itemized estimate for expenditures on each of the SDGs for the 2018-2022 period. However, by taking into account Colombia’s Multi-Annual Investment Plan and its indicators, Cedetrabajo has estimated how the SDGs goals are reflected in the NDP goals, and estimated their distribution and primary contributions to the SDGs for each of the 16 pacts analyzed. Based on these estimates, Table 9 provides an approximation of what Colombia is spending in terms of the SDGs over the 2018-2022 period.

**Table 9. Funding for the SDGs 2030 as Reflected in Colombia’s NDP 2018-2022 (an approximation)**

SDGs	Funding for SDGs/NPD		% of Funding
	Funding in Millions of US Dollars	Funding in Billions of Colombian Pesos	
1. End of poverty	10.2	34.4	3.1
2. Zero hunger	6.1	20.7	1.9
3. Health and well-being	41.3	139.7	12.7
4. Quality education	30.2	102.0	9.3
5. Gender equality	1.6	5.4	0.5
6. Clean water and sanitation	6.6	22.3	2.0
7. Affordable and non-polluting energy	12.2	41.4	3.8
8. Decent work and economic growth	27.7	93.6	8.5
9. Industry, innovation and infrastructure	32.1	108.3	9.9
10. Reduction of inequalities	15.7	52.9	4.8
11. Sustainable cities and communities	31.2	105.5	9.6
12. Responsible production and consumption	28.6	96.8	8.8
13. Climate action	0.7	2.3	0.2
14. Underwater life	0.5	1.8	0.2
15. Life of terrestrial ecosystems	1.4	4.7	0.4
16. Peace, justice and strong institutions	43.3	146.4	13.4
17. Partnerships to achieve the objectives	5.2	17.4	1.6
Undefined	29.7	100.4	9.3
<b>TOTAL</b>	<b>324.3</b>	<b>1,096.0</b>	<b>100.0</b>

Source: Cedetrabajo elaboration based on data from Law 1955 of 2019.

To underscore the high costs of trade misinvoicing to Colombia—and to illustrate how much more Colombia could be spending on its SDGs/NDP goals if it successfully reduced tax revenue losses from trade misinvoicing, the following hypothetical scenario was developed. In Table 10, Cedetrabajo used Colombia’s current spending on its SDGs/NDP goals over the four-year period (2018-2022) to estimate how much more additional spending on those same indicators Colombia could have spent from just the savings from the lost revenues from trade misinvoicing in one year (2016).

The hypothetical scenario is meant to illustrate the large “opportunity costs” of not addressing the problem of trade misinvoicing in Colombia. In so doing, the point is to underscore how much more Colombia could be spending on the goals if Colombia could stop the problem of trade misinvoicing and capture the trade revenues currently being lost.

**Table 10. Hypothetical Additional Funding if Estimated Tax Revenues Lost to Trade Misinvoicing in 2016 were Made Available to Funding for the SDGs/NDP 2018-2022**

SDGs	Funding for SDGs/NDP		% of Funding	With hypothetical additional funding	
	Funding in Millions of US Dollars	Funding in Billions of Colombian Pesos		Funding in Millions of US Dollars	Funding in Billions of Colombian Pesos
1. End of poverty	10.2	34.4	3.1	87.4	295.2
2. Zero hunger	6.1	20.7	1.9	53.6	181.1
3. Health and well-being	41.3	139.7	12.7	358.1	1,209.7
4. Quality education	30.2	102.0	9.3	262.3	886.1
5. Gender equality	1.6	5.4	0.5	14.1	47.6
6. Clean water and sanitation	6.6	22.3	2.0	56.4	190.6
7. Affordable and non-polluting energy	12.2	41.4	3.8	107.2	362.2
8. Decent work and economic growth	27.7	93.6	8.5	239.7	810.0
9. Industry, innovation and infrastructure	32.1	108.3	9.9	279.2	943.4
10. Reduction of inequalities	15.7	52.9	4.8	135.4	457.5
11. Sustainable cities and communities	31.2	105.5	9.6	270.7	914.7
12. Responsible production and consumption	28.6	96.8	8.8	248.2	838.7
13. Climate action	0.7	2.3	0.2	5.6	18.9
14. Underwater life	0.5	1.8	0.2	5.6	18.9
15. Life of terrestrial ecosystems	1.4	4.7	0.4	11.3	38.2
16. Peace, justice and strong institutions	43.3	146.4	13.4	377.9	1,276.9
17. Partnerships to achieve the objectives	5.2	17.4	1.6	45.1	152.4
Undefined	29.7	100.4	9.3	262.3	886.3
<b>TOTAL</b>	<b>324.3</b>	<b>1,096.0</b>	<b>100.0</b>	<b>2,820.1</b>	<b>9,528.4</b>

Source: Cedetrabajo elaboration based on data from Law 1955 of 2019.

Table 10 suggests that if Colombia could stop the problem of trade misinvoicing, it could realize USD billions in additional tax revenues. It also suggests that if just the estimated lost tax revenues from trade misinvoicing in 2016 (US\$2.8 billion) were made available for funding the SDGs/NDP goals, more than eight times its projected spending over four years could be realized for additional funding. In other words, Colombia is estimated to have lost in tax revenues in one year (2016) more than eight times what is projected to be spent on its SDGs/NDP goals over four years.

All this shows that substantial resources to finance different expenses of Colombia's national budget, the NDP, and therefore, the SDGs, could be earned if Colombia takes steps to effectively curtail the practice of trade misinvoicing.

### **SDG 5: Gender equality**

Women are critical contributors to the economic and social health of nations. One important way to reduce poverty among women is the prevention of adolescent pregnancy in women under the age of 19. SDG indicator 5.6.1 is the proportion of women who make their own informed decisions about sexual relations, contraceptive use and reproductive health care. In 2017, approximately 67.3 per 1,000 women in Colombia aged 15-19 years old had a child or were pregnant.<sup>69</sup>

Examining contraception, the US-based Guttmacher Institute estimates providing modern contraception and newborn care would cost US\$8.56 per person a year.<sup>70</sup> In 2017, there were 3.9 million girls aged 15-19 in Colombia, meaning the total cost to the government would be a little under US\$33.5 million to cover the targeted population group. If the US\$2.82 billion in estimated revenue lost to trade misinvoicing was put towards addressing gender equality in Colombia, the government could meet the needs of these girls 84 times over.

<sup>69</sup> National Department of Planning, "5. Gender Equality", accessed 16 September 2019. <https://www.ods.gov.co/en/goals/gender-equality>

<sup>70</sup> Guttmacher Institute, "Adding It Up: Investing in Contraception and Maternal and Newborn Health, 2017", December 2017, <https://www.guttmacher.org/sites/default/files/factsheet/adding-it-up-contraception-mnh-2017.pdf>

## Chapter 4: GFI's Policy Recommendations

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The estimates presented in this report indicate Colombia lost approximately US\$2.8 billion in tax revenues to trade misinvoicing in 2016. This is intended to illustrate not just the magnitude of the problem of trade misinvoicing, but also the massive social costs of such revenue losses to Colombia's national plan and its commitment to the SDGs. Such high levels of revenue loss highlight the need for policymakers to curtail revenue losses and reduce the associated social costs. As trade misinvoicing is a major type of illicit financial flow, any steps Colombia takes to curtail trade misinvoicing can help support national efforts to mobilize more domestic resources towards achieving the SDGs.

Specifically, GFI recommends that Colombia and other world leaders take pro-active steps to support ongoing international efforts on the following issues:

**Customs Reform:** Linkages between trade in drugs, illegal gold and the resulting profits to armed groups are not unique to Colombia, but the systemic risks these challenges present, especially in border areas, can complicate import and export procedures even for legitimate traders. Therefore, any risk assessment program carried out by the Colombian government has to balance these seemingly opposite considerations—one of trade facilitation to bring in more investment and grow Colombia's reputation as a regional trade hub, and alternatively to protect the very same trade channels from abuse by illegal armed groups, criminal organizations, and other entities and individuals trying to avoid paying appropriate customs duties and taxes.

What further compounds this paradox are global indices such as the World Economic Forum's Global Enabling Trade Report, the most recent version of which was published in 2016.<sup>71</sup> According to that report, one of the issues that continues to plague Colombia's role as a trade facilitator are lengthy compliance bottlenecks along Colombia's borders on both the import and export side. What is perhaps concerning is that there is no contextualization provided of whether these bottlenecks and involved compliance procedures exist to offset any security or other customs vulnerability that might exist along the border areas. Colombia's history at different times has provided sufficient evidence that there is a systemic and pressing issue of customs vulnerability along its borders.<sup>72</sup> Reports produced by international bodies such as these can put undue pressure on governments to simplify procedures in areas where a prudent risk assessment might dictate otherwise.

GFI urges both the World Economic Forum and the Colombian government to assess the risks to trade misinvoicing, security and the overall abuse of trade channels before streamlining any compliance procedures along customs areas that may be classified as high risk or vulnerable.

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<sup>71</sup> World Economic Forum, "The Global Enabling Trade Report 2016" [http://www3.weforum.org/docs/WEF\\_GETR\\_2016\\_report.pdf](http://www3.weforum.org/docs/WEF_GETR_2016_report.pdf)

<sup>72</sup> United Nations Office on Drugs and Crime "Violence, Crimes and Illegal Arms Trafficking in Colombia, UNODC (2005)", <https://www.insightcrime.org/news/brief/colombia-flooded-with-black-market-cigarettes>

As this report indicates, Colombia's biggest sectoral and jurisdictional trade misinvoicing threats come from the US and China. Similarly, the largest areas of vulnerabilities in terms of commodities are mineral fuels and precious stones and metals. GFI recommends DIAN (Colombia's national taxes and customs bureau) utilize the results of this report to flag these commodities and countries as high risk for trade misinvoicing, ideally allowing DIAN to better target limited resources to its most vulnerable areas.

Having stated this, there are other indicators within the same report that merit consideration; for example, corruption and integrity issues remain a problem in customs enforcement. As evidenced by the case study provided in this report, corruption continues to plague Colombia's ability to adequately capture trade misinvoicing. Such corruption adds complexity and inefficiencies to customs procedures relating to the importing and exporting of goods. Irregular payment procedures and payments of bribes further affect Colombia's ability to adequately identify and target trade misinvoicing.<sup>73</sup> GFI recommends that in line with recent membership to the Organization for Economic Co-operation and Development, the Colombian government incorporate the following best practices in customs integrity as a way of strategically targeting trade misinvoicing risks from corruption: promoting and enforcing adequate whistleblower communication channels to enhance internal audits; strengthening and enforcing control environments through clear legislative mechanisms that govern customs enforcement.

One area of particular relevance is the many bilateral agreements Colombia has signed with countries and multilateral bodies such as CARICOM<sup>74</sup>, MERCOSUR<sup>75</sup>, Central-America Triangle<sup>76</sup>, EFTA<sup>77</sup>, European Union, Alianza Pacífico<sup>78</sup> and for exchange of customs information COMALEP<sup>79</sup>. While these efforts are laudable, no adequate internal procedures currently exist to ensure confidentiality of information and data, nor guidelines on how requests for assistance should be prioritized and how they should be responded to. Anomalies and asymmetries across trade and data systems provide conditions for trade misinvoicing to flourish. DIAN, as of July 2019, has not fully adopted the WCO Data Model, which provides harmonization of customs procedures and information needed for cross-border regulatory agencies and cross-border release<sup>80</sup>, though reports indicate that the Colombian government is working on modifying its standards.<sup>81</sup> Adopting a model such as the WCO would strengthen DIAN enforcement capabilities not only domestically, but also within its own customs union—the Andean Community and other regional trade blocks and customs unions that Colombia has either signed bilateral agreements with or has associate membership.

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<sup>73</sup> World Economic Forum: "Colombia 85th /136 Enabling Trade Index 2016" <http://reports.weforum.org/global-enabling-trade-report-2016/economy-profiles/#economy=COL>

<sup>74</sup> Caribbean Community

<sup>75</sup> Southern Common Market that has as its full members Argentina, Brazil, Paraguay, Uruguay and Venezuela

<sup>76</sup> Customs Union for Guatemala, Honduras and El Salvador

<sup>77</sup> European Free Trade Association

<sup>78</sup> A Latin American Trade Bloc formed by Chile, Colombia, Mexico and Peru

<sup>79</sup> Convenio Multilateral de aduanas de América Latina, España, y Portugal - the Multi-lateral Customs Agreement of Latin America, Spain and Portugal

<sup>80</sup> World Customs Organization, "WCO Data Model" <http://www.wcoomd.org/>

<sup>81</sup> World Customs Organization, Global adoption of the WCO Data Model (1 July 2019)", [http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/facilitation/instruments-and-tools/tools/data-model/global-adoption-of-the-wco-data-model\\_en.PDF?la=en](http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/facilitation/instruments-and-tools/tools/data-model/global-adoption-of-the-wco-data-model_en.PDF?la=en)

On July 6, 2015, the Colombian government enacted its new law on Customs—Law No. 1762 of 2015 to strengthen the enforcement against money laundering, tax evasion and trade misinvoicing. The law represents an important milestone, because it recognizes legal and institutional factors as the main drivers of illicit trade and provides tools for extending law enforcement activities in order to improve control of illicit trade in border areas.<sup>82</sup> As per the strengthening amendments to the law, trade misinvoicing (“fraude aduanero” or “customs fraud” in English) is considered as a predicate offence of money laundering and violations have a prison sentence of ten to thirty years and a fine of 1,000-50,000 units of the monthly minimum wages.<sup>83</sup> However, free trade zones (FTZs) do not feature heavily within the legislation. This is particularly concerning, as the special economic zones of La Guajira, Macaio, Norte de Santander, and Urabá have been shown to have serious governance and institutional challenges, leading to issues of corruption and increased illicit trade activity. While improved IT infrastructure has been deployed to address some of these concerns,<sup>84</sup> it is unclear if the larger systemic issues in this area have been addressed.

In this context, GFI recommends Colombia take steps to streamline procedures and improve oversight, transparency and accountability mechanisms in its customs administration. This could include scaling up the resources needed to strengthen regulatory enforcement, invoice audits and reviews. GFI also recommends Colombia consider adopting its online tool—GFTrade<sup>85</sup>—designed by GFI to build the capacity of customs authorities to better detect misinvoicing as transactions are occurring and take corrective steps in real time. By drawing upon the most up to date price data for traded goods as reported by over 43 major economies including China, the US, EU and Japan, the GFTrade tool enables customs officials to quickly and easily use real-time price comparisons to determine if the prices for goods listed on invoices submitted by local importers or exporters are priced outside the typical ranges for comparable products as declared by their trade partner within the last year. Using the tool, customs officials can identify invoices with unusually higher or lower prices and flag such invoices for further investigation when warranted. GFTrade is an essential tool to assist governments in maximizing domestic resource mobilization and tackling the problem of trade misinvoicing.

In terms of tackling the problem of IFFs more broadly, GFI recommends Colombia use its diplomatic clout in the international arena to support a number of policy initiatives that require international cooperation to curtail IFFs. Of particular importance are international efforts to increase transparency in the global financial system, measures related to reducing the secrecy of tax havens and anonymous companies and efforts to curtail money laundering techniques.

**Tax Information Exchange:** Colombia commenced its first exchange under the automatic exchange of information (AEOI) for tax information with partner countries as of 2017.<sup>86</sup> Peru and Ecuador, both

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<sup>82</sup> World Bank Group “Confronting Illicit Tobacco Trade: A Global Review of Country Experiences” (pp. 310-311) <http://pubdocs.worldbank.org/en/614721548434799087/WBG-Tobacco-IllicitTrade-Colombia.pdf>

<sup>83</sup> Law 1762 of 2015

<sup>84</sup> KPMG, “Flash Informativo Mayo 8” <https://home.kpmg/co/es/home/insights/2018/05/flash-informativo-mayo-8.html>

<sup>85</sup> For more information on GFTrade, please visit <https://gfintegrity.org/gftrade/>

<sup>86</sup> Organization for Economic Co-operation and Development, “AEOI: Status of Commitments” <https://www.oecd.org/tax/transparency/AEOI-commitments.pdf>

members of the Andean Community have committed to starting exchanges in 2020. Bolivia, also a member of the Andean Community is yet to sign the standard.<sup>87</sup> For greater strength, cohesion and financial transparency within the trade bloc and customs union as a whole, Colombia should encourage Bolivia to adopt the measure as well.

**Country-by-Country-Reporting:** Colombia implemented Country-by-Country-Reporting (CbCR) in June 2017.<sup>88</sup> Currently, Colombia has 55 bilateral agreements that allow the exchange of information from Colombia to other countries<sup>89</sup> and 67 bilateral agreements allowing the Colombian government to receive tax information from other governments.<sup>90</sup> Colombia should encourage all governments to require multinational companies to publicly disclose their revenues, profits, losses, sales, taxes paid, subsidiaries and staff levels on a country-by-country basis and extend this agreement to all 80 signatory jurisdictions.

**Beneficial Ownership:** Colombia has continued problems in identifying beneficial ownership for complex legal structures, particularly when foreign ownership involved.<sup>91</sup> Trade by its very nature is a cross-border activity and the difficulties that supervisory authorities have in identifying foreign ownership poses significant risks in addressing and curtailing trade misinvoicing. Currently, UIAF—Colombia’s Financial Intelligence Unit—does not have timely access to information collected by DIAN.<sup>92</sup> An integrated system that would allow real time access is critical for a holistic government approach to tackling trade misinvoicing. In Colombia, information on beneficial information is updated on a yearly basis.<sup>93</sup> This however is inadequate as those seeking to use legal entities and arrangements to mask their true identity can exploit the system by having lawyers or other nominees assume ownership at the time of reporting, but transfer ownership as soon as the reporting requirement is complete.

It is recommended that Colombia require changes to be immediately processed and the relevant authorities to be notified, and that failure to do so would warrant stringent administrative penalties or criminal sanctions depending on the nature and purpose behind failing to report. GFI additionally recommends Colombia consider introducing the requirement of beneficial ownership as part of its customs law. GFI also recommends Colombia should take steps to create a public registry on beneficial ownership information that is accessible to all relevant agencies with supervisory and oversight authority, especially DIAN. Estimates show that 88 percent of all Colombian gold is

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<sup>87</sup> Ibid

<sup>88</sup> Organization for Economic Co-operation and Development, “SIGNATORIES OF THE MULTILATERAL COMPETENT AUTHORITY AGREEMENT ON THE EXCHANGE OF COUNTRY-BY-COUNTRY REPORTS (CbC MCAA) AND SIGNING DATES” <https://www.oecd.org/ctp/exchange-of-tax-information/CbC-MCAA-Signatories.pdf>

<sup>89</sup> Organization for Economic Co-operation and Development, “Country-by-Country exchange relationships,” <https://www.oecd.org/tax/beps/country-by-country-exchange-relationships.htm>

<sup>90</sup> Ibid

<sup>91</sup> Infra

<sup>92</sup> Colombia, Financial Sector Assessment Program (IMF 2018), p. 13, <https://www.imf.org/en/Publications/CR/Issues/2018/11/15/Colombia-Financial-Sector-Assessment-Program-Detailed-Assessment-Report-on-Anti-Money-46351>

<sup>93</sup> GAFILAT, “Mutual Evaluation Report of Republic of Colombia,” 2018, <http://www.fatf-gafi.org/media/fatf/documents/reports/mer-fsrb/GAFILAT-MER-Colombia.pdf> at p.98

produced illegally.<sup>94</sup> This statistic is exacerbated by the fact that the regulations governing beneficial ownership for Designated Non-Financial Businesses (DNFB), which include the gold sector, are inadequate in Colombia.<sup>95</sup> It would be prudent for Colombia to review its laws on collection, identification and verification of beneficial ownership information as applicable to the DNFB sector and other legal arrangements.

**Anti-Money Laundering:** Colombia's most recent assessment by the Latin American Financial Action Task Force (GAFILAT) published in November 2018 pointed towards many positive reforms and changes within the anti-money laundering/counter-terrorist financing legal and regulatory environment of Colombia. However, some of the gaps identified in the assessment are of particular relevance in strengthening the overall regulatory framework on trade misinvoicing. Colombia's most recent National Risk Assessment while addressing the main risks of money laundering from criminal activities failed to include agencies like DIAN.<sup>96</sup> Similarly, the FATF has cited that money lost due trade-based money laundering far exceeds revenue losses through the banking system.<sup>97</sup> Our case studies in this report show that the abuse of trade channels continues to be a significant source of revenue loss to Colombia. Therefore, any meaningful National Risk Assessment must involve DIAN and the systems and measures required to mitigate the abuse of land, air and sea trade channels for the purpose of trade misinvoicing.

The integration of former FARC members into the formal financial system in Colombia has remained a challenge.<sup>98</sup> Given, the FARC's long history of using trade channels to fund their operations,<sup>99</sup> the Colombia government needs a meaningful and coherent policy approach to account for these risks and how supervisory methods should account for these changes to the financial and trade landscape. To truly address the problems from trade misinvoicing, an integrated approach is required at all levels of government. GFI would recommend policy cohesion, information sharing, and collaboration between the UIAF, DIAN, Central Bank, law enforcement, and Colombian banks that process trade finance, so the Colombian government is better able to track, tackle and curtail the risks, entities, commodities and illicit flows of money.

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<sup>94</sup> InSight Crime, "Experts say 88% of Colombian Gold produced illegally" (August 4, 2016) <https://www.insightcrime.org/news/brief/88-of-colombia-gold-produced-illegally-expert/>

<sup>95</sup> *Infra* at p.21

<sup>96</sup> GAFILAT, "Mutual Evaluation Report of Republic of Colombia," 2018, <http://www.fatf-gafi.org/media/fatf/documents/reports/mer-fsrb/GAFILAT-MER-Colombia.pdf> at p.19

<sup>97</sup> *Ibid.*

<sup>98</sup> International Monetary Fund, "Colombia, Financial Sector Assessment Program (IMF 2018)" at p. 13, <https://www.imf.org/en/Publications/CR/Issues/2018/11/15/Colombia-Financial-Sector-Assessment-Program-Report-on-the-Observance-of-Standards-and-Codes-46352>

<sup>99</sup> Reuters, "Colombia's FARC rebels say assets worth \$324 million" (August 25, 2017) <https://www.reuters.com/article/us-colombia-peace/colombias-farc-rebels-say-assets-worth-324-million-idUSKCN1B522G>; Organization for Economic Co-operation & Development, "Due Diligence in Colombia's Gold Supply Chain—Where does Colombian gold go?" (2018), <https://www.oecd.org/corporate/Where-does-Colombian-Gold-Go-EN.pdf>; Wilson Center, "The FARC and Colombia's Illegal Gold Trade" (2014), [https://www.wilsoncenter.org/sites/default/files/Otis\\_FARCDrugTrade2014.pdf](https://www.wilsoncenter.org/sites/default/files/Otis_FARCDrugTrade2014.pdf); InSight Crime, "The FARC's Riches: Up to \$580 Million in Annual Income" (September 6, 2017), <https://www.insightcrime.org/news/analysis/farc-riches-yearly-income-up-to-580-million/>



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## About GFI

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Global Financial Integrity (GFI) is a Washington, DC-based think tank, producing high-caliber analyses of [illicit financial flows](#), advising developing country governments on effective policy solutions and promoting pragmatic transparency measures in the international financial system as a means to global development and security.

Every year, roughly US\$1 trillion flows illegally out of developing and emerging economies due to crime, corruption, and tax evasion—more than these countries receive in foreign direct investment and foreign aid combined. Many developing countries have failed to grow past the point where foreign aid is no longer necessary. For years, development economists were puzzled by the lack of growth in developing economies despite large inflows of aid. By drawing attention to the problem of illicit financial flows, GFI has contributed to solving this puzzle. Today, GFI is committed to constructively engaging with policymakers worldwide to develop effective, pragmatic policy solutions to address illicit financial flows.







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