# ILLICIT FINANCIAL FLOWS
## IN THE ARAB REGION

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# ILLICIT FINANCIAL FLOWS

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*"I am convinced that today there is more money leaving due to money-laundering, tax evasion and illicit financial flows than the money that goes in through official development aid."*

António Guterres

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# EXECUTIVE SUMMARY

This report provides insight into the scope and scale of illegal cross-border movement of money or capital, earned and transferred surreptitiously, across the Arab region. It responds to the call of the Third International Conference on Financing for Development (FfD) for "regional organizations to publish estimates of the volume and composition of illicit financial flows (IFFs)".

The report identifies trade misinvoicing as a key conduit and a major component of IFFs. IFFs associated with trade misinvoicing pose severe structural, socioeconomic, governance and security complications for Arab economies. They constitute substantial leakages to domestic revenues that could otherwise have been harnessed to create the fiscal space to sustainably finance development. Misinvoicing is driven by country/regional idiosyncrasies and can provoke "beggar-thy-neighbour" dispositions. Trade fraud exacerbates income inequalities: trade-based money-laundering erodes tax revenues, impairs government expenditure eligibility requirements and undermines the rule of law as well as a country's perception-based governance and corruption standings.

The conduits of IFFs are constantly evolving, outpacing detection at every corner. Measuring IFFs is a challenge, not least since no tool or process can effectively measure the clandestine nature of the underlying activity. Precision in this field remains unachievable. Beyond deliberate collusion, several factors explain why gaps in trade statistics exist.[1] Some argue that trade gaps or mirror approaches may not be a useful entry point to estimate misinvoicing.[2] Others demonstrate that gaps in reported trade statistics are neither erratic nor a statistical fiction, and that deliberate misinvoicing is a significant component of gaps in reported trade statistics.[3]

By building on the methods employed by the United Nations Economic Commission for Latin America and the Caribbean (ECLAC) as well as those of the High-Level Panel on Illicit Financial Flows from Africa, the report finds that Arab economies fall prey to at least \$60.3 billion–\$77.5 billion per year in damages due to IFFs associated with four conduits of trade misinvoicing. Misinvoicing appears more pervasive for non-resource-based economies and for non-oil product categories at the HS 6-digit level, in both regional percentages and dollar figures, which have followed a general upward trend. Variability in the scope of misinvoicing has also been found to permeate both preferential and non-preferential trade.

By 2015, IFF outflows had exceeded the combined aggregates of both official development assistance and foreign direct investments flowing into Arab countries. Further, when placed in the broader context to assess net cross-border positions of prime FfD channels (since the onset of political change in 2011 up to the adoption of the new global FfD framework in 2015), the report finds that for every dollar gained from prime FfD inflow sources, Arab countries correspondingly lost 50 cents in IFF.[4] The report is nonetheless conceptualized to offer a baseline for IFFs, as estimates are run for commodity trade misinvoicing (since detailed data across the four modes of services supply are scarce for all Arab economies) and given that misinvoicing is one piece of a much larger picture within illicit finance.

In the Arab region, regional insecurity remains a daily source of and provocation for IFFs and misinvoicing, be it a direct implication of occupation, terrorism, corruption, transnational crime or militant activity. The recommendations presented in the report are meant to reconcile regional security with sustainable development imperatives. Some of the recommendations, beyond commercial considerations, touch on a broader stream of actions to ensure that pathways remain open for deeper forms of Arab developmental regionalism and structural transformation in support of the 2030 Agenda for Sustainable Development, including the Sustainable Development Goals in their entirety, rather than being confined to Goal 16.

## Top Misinvoiced Categories in the Arab Region between 2008 - 2015

(Million US$)

| Mineral Fuels | Machinery | Electical Machinery | Vehicles | Plastics | Precious Stones & Metals | Organic Chemicals | Iron & Steel Articles | Pharmaceuticals | Non-Knitted Apparel | Iron & Steel |
|---|---|---|---|---|---|---|---|---|---|---|
| 137,197 | 58,086 | 52,903 | 49,440 | 34,149 | 22,802 | 21,399 | 17,525 | 12,785 | 12,402 | 11,391 |

AVERAGE TRADE MISINVOICING FOR OIL AND NON-OIL CATEGORIES PER YEAR

**USD 77.5 BILLION**

ON AGGREGATE OIL TRADE MISINVOICING BETWEEN 2008- 2015 REACHED

**USD 137.2 BILLION**

AVERAGE NON-OIL TRADE MISINVOICING PER YEAR

**USD 60.3 BILLION**

8.2% of non-oil trade

Export over-invoicing was the most common type of misinvoicing practice in oil trading with an average of

**USD 9.5 BILLION**

between 2008 and 2015

Import under-invoicing was the most common type of misinvoicing practice in non-oil trading with an average of

**USD 25.1 BILLION**

between 2008 and 2015

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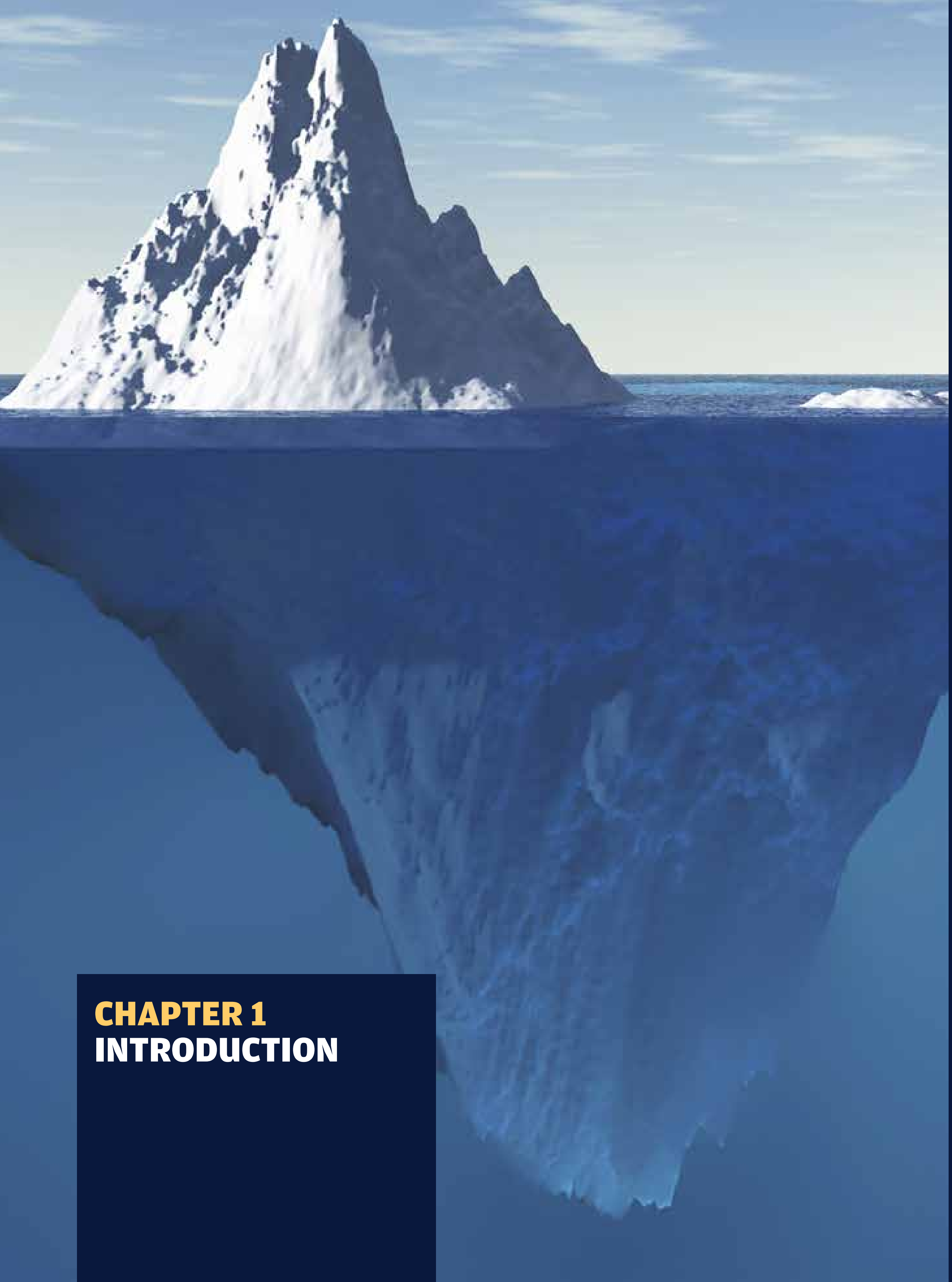
# ABBREVIATIONS AND ACRONYMS

| | |
|---|---|
| ACCESS | Arab Citizens Common Economic Security Space |
| BACI | International Trade Database (Base pour l'Analyse du Commerce International) |
| ECA | Economic Commission for Africa |
| ECLAC | United Nations Economic Commission for Latin America and the Caribbean |
| ESCWA | United Nations Economic and Social Commission for Western Asia |
| FfD | financing for development |
| GAFTA | Greater Arab Free Trade Area |
| GCC | Gulf Cooperation Council |
| GDP | gross domestic product |
| GFI | Global Financial Integrity |
| HS | Harmonized Commodity Description and Coding System |
| IFF | illicit financial flow |
| IMF | International Monetary Fund |
| OECD | Organisation for Economic Co-operation and Development |
| RTAs | regional trade arrangements |
| SDG | Sustainable Development Goals |
| SPS | sanitary and phytosanitary |
| VAT | value-added tax |
| WTO | World Trade Organization |



# CHAPTER 1
# INTRODUCTION

***Trade-based illicit financial flows in the Arab region exceeded half a trillion dollars on aggregate, and this is only the tip of the iceberg.***

The 2030 Agenda for Sustainable Development, with all its high ambition centred on the 17 Sustainable Development Goals (SDGs), was warmly embraced by the United Nations General Assembly in 2015. But maintaining that global enthusiasm has become challenging amid fierce competition over the trillions of dollars needed to close the SDG financing gap. The traditional dividing lines between the financing needs of developed countries and their developed counterparts, including those of the newly industrialized and emerging economies, have blurred in the wake of a global quest to finance sustainable development. It is no surprise that all countries, pursuing common goals but with different capacities and responsibilities, are weighing their options on how best to benefit from the array of financing channels offered by the new global Financing for Development (FfD) framework.

Through mutual normative assurances, the Addis Ababa Action Agenda leaves no stone unturned in seeking to finance the breadth of ambition embodied in the 2030 Agenda, and where best to start but at home. Domestic resource mobilization has become a central component for financing across both the 2030 and Action Agendas. Yet, increased capacities to collect revenue is contingent on ending illicit financial leakages that continue to undermine effective tax administration, rule of law, governance and anti-corruption efforts. The elimination of illicit financial flows (IFFs) by 2030, as called for by SDG 16 and the Action Agenda, is a critical ingredient to safeguard the integrity of domestic revenue mobilization. Eliminating IFFs has cross-cutting systemic implications for the global FfD framework, notably to: ensure adequate mobilization of public and private domestic and international finance; foster enhanced forms of international development cooperation; ensure trade continues to be a source and engine for growth; and preserve sustained paths to debt management.

The growing literature on IFFs sheds light on the magnitude of the damage to developing countries. The developing world is estimated to have lost $7.8 trillion in IFFs between 2004 and 2013, and the losses are said to be increasing at a rate of 6.5 per cent per year or nearly twice as fast as growth in global output.[5] The Organisation for Economic Co-operation and Development (OECD) estimates that for every dollar in official development assistance there are three dollars in illicit outflows from developing countries.[6] Today, authorities seize less than 1 per cent of global IFFs, with the shadow economy estimated to be worth $650 billion and the cost to the global economy from counterfeiting reaching $1.7 trillion by 2015.[7] Progressive advances in blockchain technology and cryptocurrencies alongside trade facilitation mean these figures are expected to rise exponentially.

The Panama Papers[8] and the Bahama leaks,[9] among others, provide compelling evidence of how detrimental IFFs can be for sustainable development. Their impact on the Arab region remains more severe given the scope and scale of prolonged conflicts, civil wars, reconstruction needs, development challenges and deficits. With significant amounts of illicit capital moving across borders undetected, capital controls, trade and income taxes and other fiscal charges are circumvented, thereby stripping governments of legitimate revenues (direct and indirect taxes and fiscal charges) that could have been harnessed for sustainable development. Without these public domain resources, it becomes difficult to carve the necessary fiscal space to achieve the SDGs or to cover the costs of implementing nationally adapted 2030 frameworks.

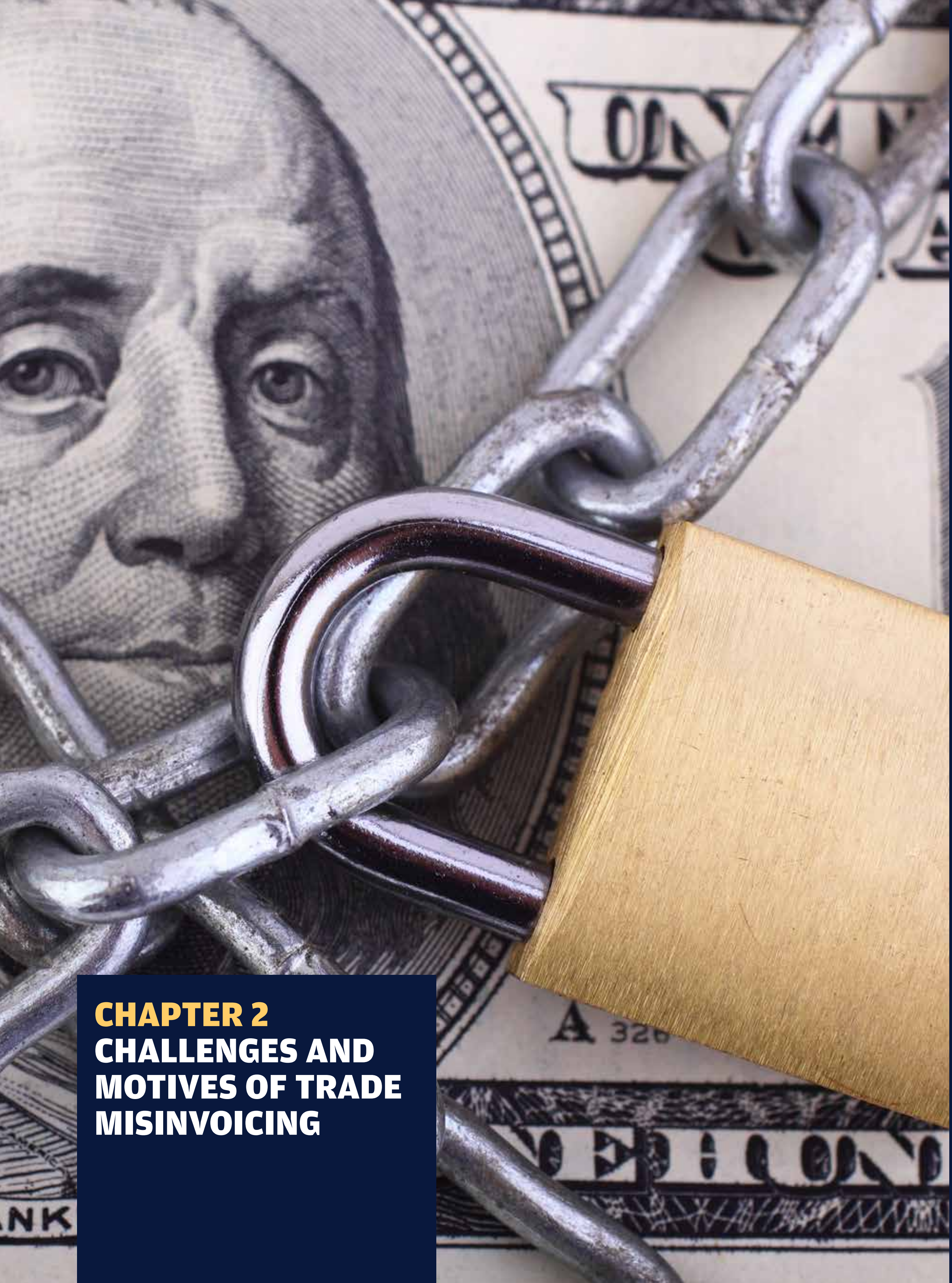
To date, there is no agreed conceptual definition of IFFs, or multilateral consensus on their elements or scope. Bribery, public embezzlement, tax evasion and aggressive tax planning and treaty shopping, for example, have been found to adversely affect domestic investments and erode the tax base.[10] Criminal earnings impact primarily on domestic investment, while profit shifting by multinational corporations erode tax revenues. IFFs facilitate tax avoidance and illegal tax evasion and can be associated with base erosion and profit shifting practices, depriving Arab countries of crucial domestic resources for development. In contrast, the “de-risking” global processes used to combat money-laundering and terrorist financing may disproportionally affect legitimate financing channels available to economies.

There have been few studies on the development impact of IFFs on Arab economies. Though there have been many studies on related issues from a security perspective, development has been broadly ignored.[11] This report seeks to fill this gap in literature and responds to calls[12] to international and regional organizations to measure the volume and composition of IFFs. However, measuring IFFs remains challenging, due in part to the clandestine nature of the underlying activities, be they: transnational crime (money-laundering, proceeds of crime and stolen assets); corruption-based (evasion of capital account restrictions, exploitation of expenditure eligibility requirements among others); or associated with commercial activity (transfer pricing, undeclared offshore wealth to name a few).

The report, therefore, limits its quantitative examination to the measurable components of IFFs, namely trade-based misinvoicing or the illicit manipulation and/or movement of money across borders involving the deliberate misreporting of price (values), quantity (volumes) and quality of commodities. Several studies[13] have recognized trade misinvoicing as a major component of measurable IFFs at the global level; more reason to focus on it and interrogate its dynamics from a regional perspective. The quantitative estimates in this report are conceptualized to offer a low-end baseline for IFFs as it captures the measurable components. Physical bulk cash smuggling does not show up in any official statistics, so it is not quantitatively estimated. Such cash smuggling can be a particularly acute issue when the industries generating the cash operate in the underground economy of transnational crime, such as the global illicit trade in drugs, small arms/light weapons and cultural property, and crude oil theft.

The other measurable component of IFFs are hot money leakages from the balance of payments (referred to by the International Monetary Fund (IMF) as “net errors and omissions”). The implications of such unrecorded flows are complicated in some Arab countries due to the presence of sovereign wealth funds.[14] Idiosyncratic recording or uncoordinated data compilation of transfers to sovereign wealth funds can lead to unduly large net errors and omissions in the balance of payments.[15] As such, in the interest of keeping the quantitative estimates as accurate and conservative as possible, these flows are not considered in this report. Beyond these measurable components, other mechanisms are relevant. Hawala transfers,[16] for example, are not necessarily illicit. However, to the extent that they cannot be monitored, there may be a security or tax-relevant illicit component.[17] Furthermore, when an imbalance inevitably arises between hawala brokers in different countries, they need to find some way to settle accounts. One way these brokers transfer money to correct this imbalance is through trade misinvoicing. In this sense, estimations of trade misinvoicing using trade statistics do provide a quantified piece of a hawala network.[18]

The report begins by examining the motives and challenges associated with IFFs (section II). More specifically, it delineates the methods and practices as well as the conduits for trade misinvoicing that facilitate and/or provoke IFFs (section III). Quantitative underpinnings associated with non-oil misinvoicing are presented thereafter to provide a picture of the magnitude of the problems facing non-resource-based Arab countries and resource-based economies (section IV), followed by the dynamics of trade misinvoicing including oil commodities (section V). Trade misinvoicing implications for selected regional integration agreements are addressed (section VI). Finally, an itinerary of recommended actions and elements for a regional road map to curb IFFs is outlined (section VII).



# CHAPTER 2
# CHALLENGES AND MOTIVES OF TRADE MISINVOICING

Trade fraud is constantly evolving and remains ahead of the curve, both in sophistication and use of technology, outstripping detection. The forces driving global interconnectivity in trade, finance, communications and transport are the same as those that are making trade and financial systems vulnerable to trade-based IFFs.[19]

Trade fraud exploits and thrives on gaps in regulation and policy. It undermines the integrity of domestic resource mobilization efforts and the sustainability of development finance. Neither international trade law nor its current practice are sufficiently geared to disassociate the motives for misreporting (the misclassification of products and services and/or misdeclaration of their values and destinations,[20] which may not necessarily manifest fraudulent trade) from misinvoicing practices that are predominantly associated with illicit cross-border trade and financial activity.

The interplay between these practices not only poses considerable challenges to establish the magnitude of trade distortions and financial leakages arising from each, but also frustrates the ability to establish why one form or the other continues to elude multilateral and regional rule-based trading systems. Motivations for misreporting and misdeclaration may not always be assimilated to illicit behaviour. Yet they tend to equally circumvent national policies and border restrictions through misinvoicing. The situation can be perplexing when estimates of such leakages are undertaken at high levels of data aggregation. Misreporting and/or misinvoicing may be concealed as the overstated and understated transactions cancel each other, thereby underestimating the value of illicit capital flows.

As international trade is increasingly taking place within complex supply and value chain networks, much of today's trade in commodities is trans-shipped and warehoused before being split or combined, repackaged, re-labelled, subjected to substantial transformation or a change in tariff-heading before being delivered to their destination. Under such conditions of production fragmentation, misreporting and misinvoicing can take place at any stage, and while the source of a component (and not necessarily its origin) may be known, the final product and its destination may change several times, creating multiple data mismatches. As such, the accuracy of trade statistics is compromised to unknown degrees.[21]

In this section, the report examines in detail the drivers and conduits for misinvoicing commodity trade; that is, the manipulation of export and import prices, quantities and quality of goods. Motives for commodity trade misinvoicing can be classified according to the strand of trade (multilateral, preferential, plurilateral), type of misinvoicing (export/import overinvoicing and underinvoicing), product category, trading partners and mediums involved (global/regional value chains). For Arab economies, incentives for misinvoicing can be grouped according to four categories, anchored to mirror their distinct trade and fiscal profiles.[22]


A. MACROECONOMIC FACTORS

Macroeconomic policies, by direct implication or indirect rejection, act as drivers to misinvoicing. Trade misinvoicing can stem from exchange controls, including multiple exchange rate practices, export restrictions (for example, export taxes and voluntary export restraints), trade bans/sanctions and export surrender requirements. While multiple exchange rates have declined in recent years, currency controls and quantitative limits on the amount of foreign exchange that can be acquired or transferred abroad have been found to create incentives for misinvoicing.

Export restrictions may provoke fraudulent traders to evasion by lowering export values and volumes. Commodity bans and sanctions have been associated with deliberate misinvoicing of prices, volumes, classification and destination. The Islamic Republic of Iran, for example, is reported to have circumvented various sanctions by using third-party countries as re-export hubs.[23] Non-tariff measures may cause misinvoicing when they are associated with high ad valorem tariff equivalents. They are also caused by surrender requirements that oblige traders to give up a portion of their foreign exchange proceeds for domestic currencies that are anticipated to devaluate.

Trade misinvoicing can be driven by expenditure eligibility requirements, including fiscal benefits such as state aid, export guarantees and/or tax incentives provided as part of export promotion strategies. Import-processing and cumulation of origin schemes offered through special economic zones and regional trade agreements (RTAs) may provide motives for misinvoicing. Traders may overstate the value of the local content of their manufactured products to qualify for preferential treatment or understate the value and quantities of imported components that benefited from duty suspension/drawback. In this case, overstating and understating trade activity undermines the integrity of both direct and indirect taxation systems.

Other related macroeconomic drivers to misinvoicing include tariff escalation and asymmetrical domestic subsidies between trading partners.[24] Prohibitive tariffs, such as those imposed on health and religious grounds, have been found to provoke trade fraud and misinvoicing. Generally, protectionist trade practices may provide incentives for misinvoicing, as trade remedies, including anti-dumping, price undertakings and countervailing measures, can dampen the motivation for misinvoicing. Trade liberalization and regulatory convergence may reduce misinvoicing, though not necessarily where agriculture produce remains protected by so-called entry prices and precautionary sanitary and phytosanitary (SPS) measures that are not supported by scientific evidence. Applying precautionary SPS measures may motivate misinvoicing as it leads to inequality and underdevelopment, and in broad terms, such measures may adversely influence sustainable development.[25]

B. GOVERNANCE-RELATED CONDITIONS

Governance drivers include red tape, bureaucratic hurdles, weakness in regulatory oversight (deficient customs enforcement, for example), long judicial delays, bribery and kickbacks. These drivers act as mark-ups that provide incentives for misinvoicing. Berger and Nitsch (2012) found that trade misinvoicing between trading partners rises when levels of corruption increase.[26] Fisman and Wei (2007) reviewed cultural goods and antique items exported from Egypt to the United States of America from 1996–2005 and found large volumes of illicit trade taking place,[27] with the level of underinvoicing predominantly attributed

# Motives for trade misinvoicing

**ECONOMIC FACTORS**

1. Exchange controls
2. Export restrictions
3. Trade bans / sanctions
4. Expenditure eligibility requirements

**GOVERNANCE CONDITIONS**

1. Regulatory oversight
2. Judicial delays
3. Bribery & kickbacks
4. Environmental controls
5. Political captures

**STRUCTURAL DRIVERS**

1. Income distribution
2. Tax evasion
3. Inequality

**SECURITY AND STABILITY**

1. Political instability
2. Armed conflicts
3. Terrorism
4. Criminal activity

# Types of Trade Misinvoicing

**FINANCIAL IMPACT**

1. Duty drawback
2. Tax evasion

**ECONOMIC IMPACT**

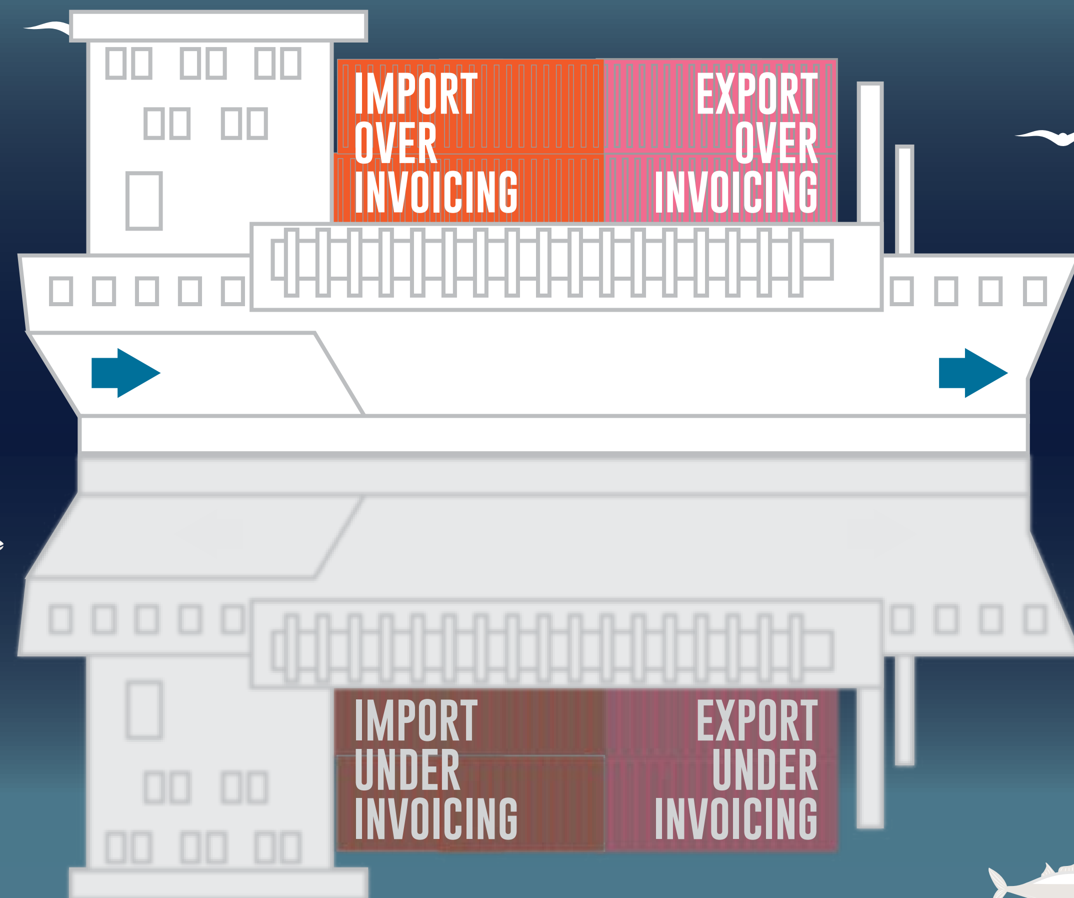
1. Foreign currency control
2. Shift undeclared income

**FINANCIAL IMPACT**

1. Tax break rebates
2. Export subsidy

**ECONOMIC IMPACT**

1. Foreign currency allotment
2. Money laundering




**FINANCIAL IMPACT**

1. Evade import duties and VAT
2. Repatriate undeclared capital

**ECONOMIC IMPACT**

1. Current account distortions

**FINANCIAL IMPACT**

1. Tax evasion

**ECONOMIC IMPACT**

1. Exploit currency controls
2. Evade export restrictions
3. Shift undeclared income

to governance deficiencies.[28] According to the United Nations Education, Scientific and Cultural Organization, from 2002 onwards, Egypt recuperated thousands of objects of illicit provenance.

According to the World Bank Ease of Trading Across Border (2017), more than half of Arab countries rank among the worst 100 performing economies in this area. On average, the cost of border compliance associated with the importation of one shipment runs as high as $1,209 in Djibouti, and takes 209 hours to satisfy documentary requirements in Algeria. Shepherd (2009) shows that a 10 per cent increase in trade time can lead to a fall of up to 15.3 per cent in bilateral trade in a country with high levels of corruption.[29]

Governance factors are not confined to national systems but can also be rooted at the multilateral level. World Trade Organization (WTO) agreements on customs valuation, anti-dumping, countervailing duties, pre-shipment inspection, trade-related intellectual property rights and, more recently, the trade facilitation agreement, hold evident disincentives for misinvoicing and counterfeiting. Through the WTO Customs Valuation Agreement, for example, harmonizing valuation practices was found to lower tariff evasion elasticity.[30] Yet multilateral trade rules are not fully geared to balance between preventing illicit trade and sanctioning countermeasures, as some of these measures may be challenged for inconsistency under WTO rules.[31]

Systemic misinvoicing may constitute grounds for a nullification or reduction of trade benefits. Yet certain countermeasures may irritate multilateral disciplines (tax stamps and consular verification, for example) or require prior approval by relevant WTO bodies. The capacity to prevent the abuse of legitimate trade flows to hide illegitimate trade remains limited, especially as the burden of proof oscillates between claimants and respondents within the WTO dispute settlement body. The former WTO Director-General conceded that further multilateral trade regulation could be of great value to curb IFFs, but in the absence of such agreements, the next best option to achieve this is through RTAs.[32] Empirically, RTAs have been associated with fewer gaps in trade statistics, likely due to increased collaboration and oversight.[33] This does not, however, constitute a rule of thumb, as this finding is contingent on several factors, including the depth and nature of RTAs (free trade areas, single markets, customs or economic unions), the regulatory migration/harmonization arising from each RTA, and the trade and fiscal requirements imposed on their members.

Lack of environmental controls in supply chains also have implications for misinvoicing. The dumping and illegal transport of hazardous waste provokes misinvoicing, taking advantage of regulatory loopholes, lack of appropriate controls and lax enforcement of environmental measures. Weak adherence to and enforcement of international agreements and protocols are both a cause and effect of illicit trade. For example, enforcing the protocol on eliminating illicit trade in tobacco could deliver $30 billion a year in tax revenue gains, according to World Health Organization estimates.[34] Upholding obligations to prevent illicit trade in conflict diamonds, small arms and light weapons, including the comprehensive Arab strategy for combating human trafficking and the Arab Model Law on Weapons, Ammunitions, Explosives and Hazardous Materials, also have the potential to combat IFFs and misinvoicing.

Governance conditions are negatively impacted by so-called political capture: crony capitalism or the private use of public interests. The World Bank has shown that politically connected firms under the former Ben Ali regime in Tunisia were evading import tariffs by underreporting.[35] This type of tax evasion is tantamount to an anti-competitive practice that leads not only to fiscal losses to the state, but also creates broad market distortions because it provides a cost advantage to politically connected firms, even when they are not the most efficient firms in the domestic market.

### C. STRUCTURAL AGENTS AND DISTORTIONS

Structural drivers may include a skewed distribution of income. The vicious cycle of rising income of high net-worth individuals, non-inclusive growth exacerbated by tax fatigue among the wealthy (due to a narrow tax base), and subsequent tax evasion exacerbates the inequality. Tax evasion can be facilitated by trade misinvoicing, allowing elites to hide their money offshore. The Panama Papers revealed compelling evidence on how the rich and powerful hide their wealth.

Illicit capital flight remains "at the heart of rational asymmetric development between rich and poor countries," leaving developing countries unable to catch up through traditional development strategies.[36] The vicious cycle described above indicates that inequality may be as much a cause as an effect of IFFs associated with trade misinvoicing. Inequalities in the level of development may also provoke misinvoicing. Gupta and Shah (2010) find that trade misinvoicing has been a driver for capital flight and is correlated to structural and cyclical current account deficits. It is said that a one percentage point increase in the ratio of current account deficit to gross domestic product (GDP) tends to raise capital flight through misinvoicing by 0.15 to 0.26 percentage points. In such a situation, trade misinvoicing, which constitutes the largest component of IFFs, exacerbates inequality across countries and regions.

#### D. INSECURITY AND INSTABILITY

Regional insecurity and armed conflict pose another provocation for IFFs and trade misinvoicing, be it driven by foreign occupation, unsanctioned blockades, terrorism, organized crime, piracy, or money-laundering associated with criminal and militant activity. The-so called Islamic State of Iraq and the Levant (ISIL/Da'esh), for example, is considered the world's richest terrorist organization, funding itself not only through illicit trade but also through the illicit sale of "blood antiquities". Contraband purchases have flourished due to the crisis in the Syrian Arab Republic, where only four of the 72 crossing points that stretch along the 260 km border with Lebanon are official. The dire humanitarian situation in the Syrian Arab Republic has prompted new trade routes and markets where many commodities are smuggled, including foodstuffs, electrical appliances, natural gas and petrol. The stalled Middle East peace process and Israel's continued blockade of Gaza have prompted a lucrative tunnel trade in contraband.

The region's abundant militant groups have exploited banking correspondent relations and commercial transactions to launder billions in drug money through the sale of second hand and used car parts.[37] Illicit gold trade can be subject to misinvoicing when converted into cryptocurrencies in some of the gold souks, leaving no trace in the world's formal financial system.[38] The award of public procurement and defence contracts in exchange for commodity barter deals have been associated with allegations of illicit behaviour and billions of dollars being placed in slush funds. In a region where the map of alliances is being sharply redrawn by proxy wars, sectarian conflicts and the fight against terrorist networks, the use of new technologies, including digital currencies, to finance a myriad of traditional criminal activity is a growing concern. The same is true for the illegal trade of goods in the digital space.

Non-state actors and militant organizations pose a double problem for Arab countries. According to a recent study by OECD, "countries facing significant security threats may be unable to implement comprehensive measures to combat IFFs, but could face a worsening security situation if they do not address the specific financial flows which support militant groups".[39] Nation-states are grappling to adjust to rapid geopolitical changes where adaptation is slow, and wrestling with open debates and intransigence at national, regional and international levels. Trade misinvoicing tends to fall during periods of relative political stability.[40] As such, the scope and drivers of IFFs and trade-based money-laundering, including misinvoicing, have extended their sphere of influence beyond traditional commercial concerns to become key considerations in efforts to maintain peace and security, achieve development and sustain its financing.

***Box 1. Cracking down on illicit trade***

*Lebanon held its first nationwide conference on illicit trade on 28 March 2018. The conference, organized by the Régie Libanaise des Tabacs et Tombacs, adopted a multi-stakeholder approach towards combatting trade-based money-laundering, be it associated with counterfeiting or contraband trade. According to the Regie, Lebanon fell prey to LB 300 billion in annual lost revenues due to illicit trade and tobacco smuggling.[a] The Lebanese Minister of Finance stressed the need for borders to be tightened and for more border controls to crack down on clandestine crossings. Trade-based, money-laundering, and Illicit trade were criminals acts that deserved equal attention alongside combatting terrorist financing, money-laundering, corruption, kickbacks and tax evasion. Several speakers indicated the penal code tackled some of these activities but was deemed neither exclusive nor exhaustive to combat illicit trade in all its evolving aspects. Participants called for the adoption of several legislative packages to deal with tax evasion, public embezzlement and other crimes arising from the irregular administration of public procurement contracts, and also urged a new law to uphold accountability.*

*One prime recommendation from the conference was for Lebanon to regain control over its borders and establish the necessary monitoring mechanisms to enhance border management and thwart contraband trade. The conference raised public awareness of the security aspects that continue to drive illicit financial flows and adversely affect the Lebanese economy by eroding its public revenues.*

*Speakers stressed the need to promote international standards, namely those enshrined in the United Nations Convention on Transnational Organized Crime and its protocol on migrant smuggling, the protocol on eliminating illicit trade in tobacco products, and the International Convention for the Suppression of the Financing of Terrorism, among others. Strict enforcement of judicial provisions and accelerated judicial rulings were paramount to curb illicit financial flows and support national industries by providing disincentives to smuggling and illicit trade.*

*NB: Declaration and recommendations of the First National Conference against Illicit Trade can be found at: http://www.rltt.com.lb/ExtImages/Recommendations_English_Final.pdf.*

a See http://www.rltt.com.lb/ExtImages/Report%2029.pdf.

# CHAPTER 3
# CONDUITS FOR ILLICIT FINANCIAL FLOWS AND TYPES OF MISINVOICING

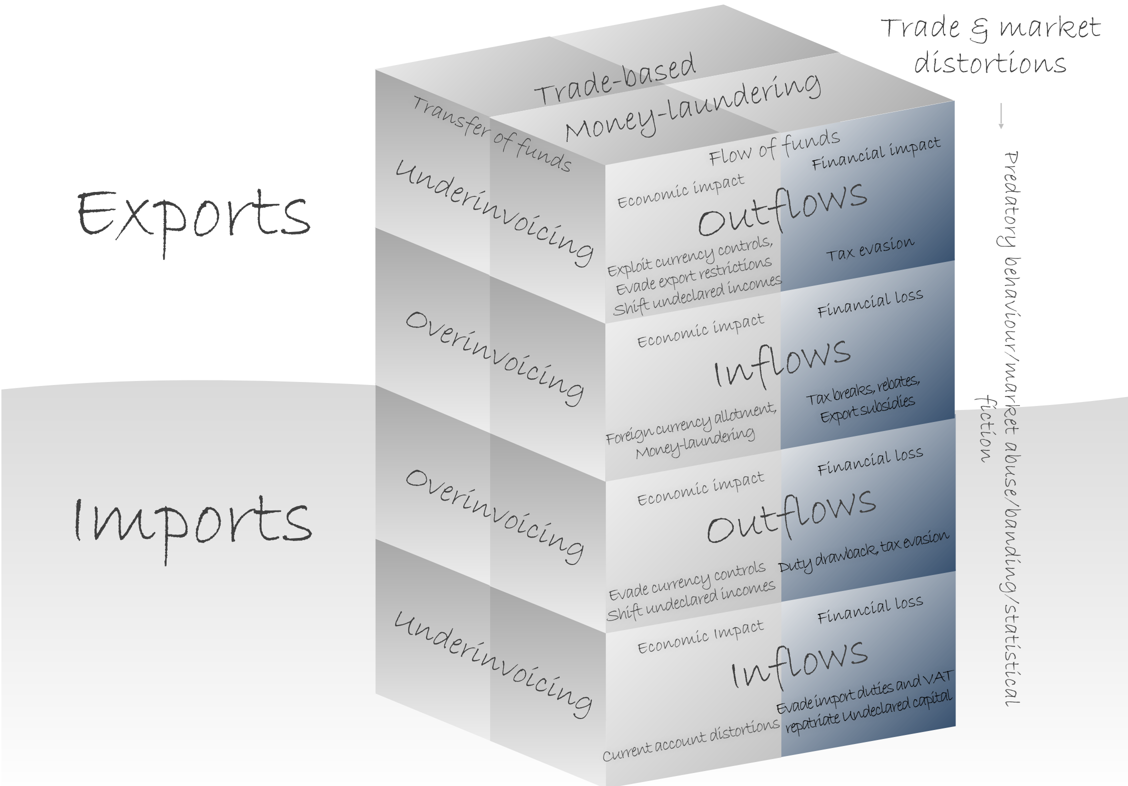
***"[Illicit financial inflows and outflows are of equal concern]. There is no such concept as net crime, flows in both directions are illicit."***

Kar and Freitas, Illicit Financial Flows from Developing Countries: 2001–2010

When considering the types of conduits for misinvoicing, a basic assumption is made: that private agents do not make decisions that adversely affect their personal wealth and self-interest or run against their perceived ideologies. At the same time, those activities motivated by self-interest create significant costs that are borne by society, not by the individuals profiting from the illicit activities. Whatever the incentives may be, these costs are a concern for governments as they fall within the public good domain.

International efforts to combat trade-based money-laundering have targeted "banks and money-transmitters, and the smuggling of bulk cash. But as the front door closes, the back door has been left open. Trade is the next frontier in international money-laundering enforcement."[41] The relative importance of the conduits for trade misinvoicing, listed in figure 1, may well evolve over time in response to attempts by governments to regulate them. Incentives to misstate trade flows may be operating to both overstate and understate trade flows.[42]

Fig 1.
**Conduits of misinvoicing, by cause and effects**




#### A. UNDERINVOICING EXPORTS

Fraudulent exporters resort to this practice to evade export restrictions and bans, or to circumvent sanction regimes. Restrictions on oil trading imposed by the United Nations Oil-for-Food Programme, for example, placed a ceiling on the volume of oil that could be sold on the world market under-priced. At one extreme, the regime created incentives for oil to be sold at market value without the proceeds showing on United Nations escrow accounts, but the mark-up in proceeds were channelled to Iraqi-controlled banks in Jordan and Lebanon.[43] A more prevalent example is when exporters underreport the value of their goods and have the importers deposit the difference between the declared price and the actual price in a foreign or offshore account. This long-documented practice of underinvoicing exports[44] has been noted – along with import overinvoicing – as a means to circumvent capital controls opening pathways for both tax avoidance and plausible tax evasion.

#### B. OVERINVOICING IMPORTS

Import overinvoicing allows traders to shift value abroad by overpaying foreign exporters. This may be for the simple reason of circumventing capital controls.[45] There may, however, be other incentives at play. For example, the overinvoicing of imports allows importers to gain access to more foreign exchange than required for the transaction itself.[46] If this foreign exchange is provided at a preferential rate – for supposedly essential pharmaceutical imports, for example – the government faces an exacerbated loss of foreign exchange, damaging crucial reserves.

Import overinvoicing, like export underinvoicing, may be used to reduce declared profits subject to corporate tax. By increasing the firm's reported production costs, profits assessed for corporate income taxes decrease. Following the assumption that private agents will not make decisions against their own interest, the tax incentive for overinvoicing imports requires that the tariff rate in the imported good be lower than the corporate income tax rate. If the import duty rate is lower than the corporate tax rate (for example, an ad valorem import duty rate of 15 per cent and a corporate income tax rate of 25 per cent), firms can come out ahead even when they overpay on import duties.

#### C. OVERINVOICING EXPORTS

Export overinvoicing occurs when exporters receive more for their exports than they are worth. The foreign importer does not pay more than the actual price of the goods; instead, the correct payment can be supplemented with funds from the exporter's foreign account. One incentive to overinvoice exports is to collect government subsidies designed to encourage legitimate exports of those goods, including export tax rebates, subsidized export credits, and preferential allotment of foreign exchange and duty-free imports. These incentives were documented empirically in the case of Turkey, where a link was found between these incentive conduits and export overinvoicing.[47]

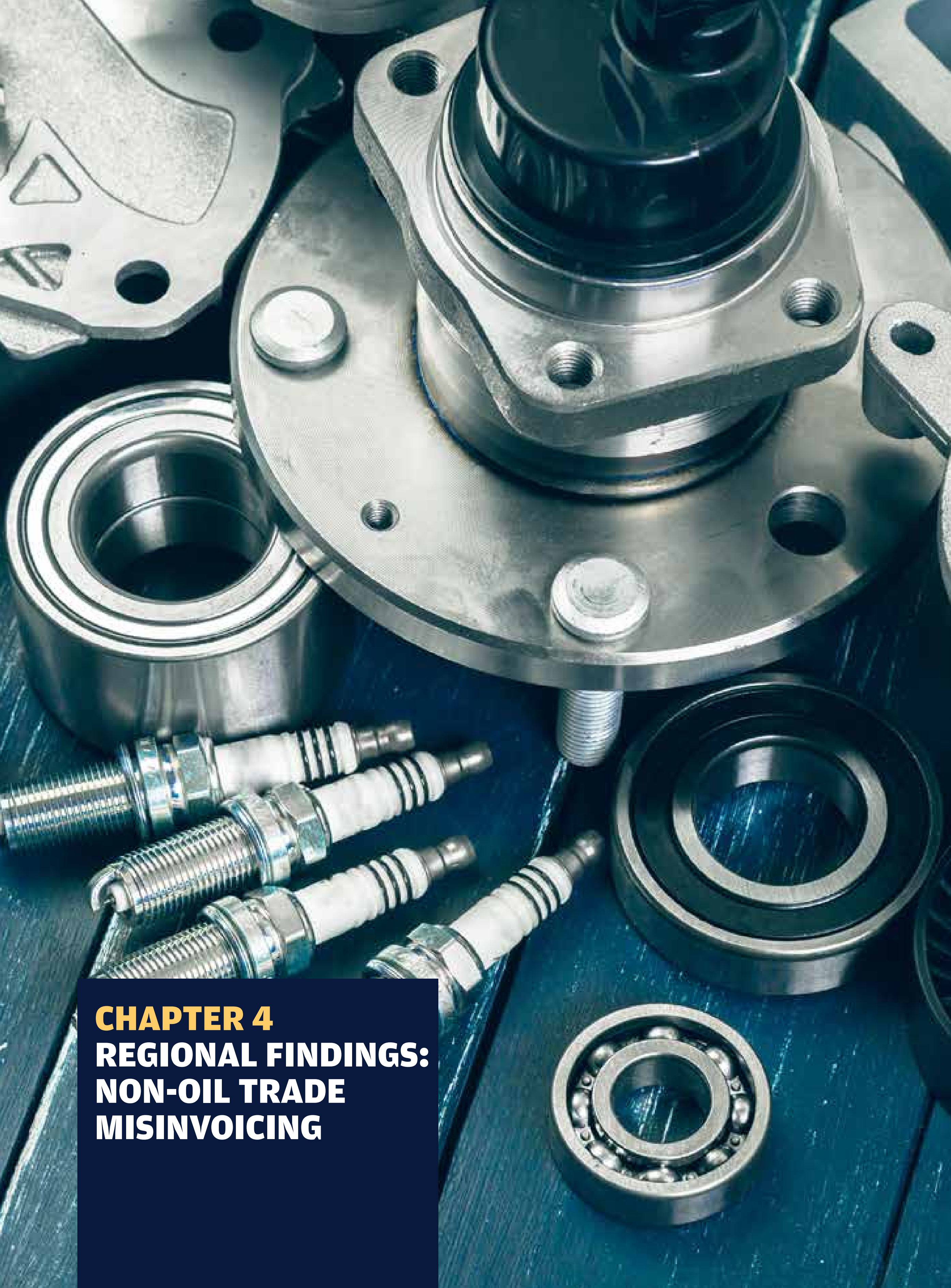
In other cases, firms may overinvoice exports if they wish to reclaim overpaid value-added tax (VAT) on overinvoiced imports of intermediate inputs or machinery. For example, some VAT legislation stipulates that the government must refund VAT revenues collected on imports that were subsequently exported as in the case of duty suspension schemes. This situation was noted in Pakistan,[48] where a link was found between export overinvoicing and the duty buyback rate (import duty refunds on imported content of the exported commodity).

#### D. UNDERINVOICING IMPORTS

Import underinvoicing is a particularly pervasive form of illicit capital movement (inflow). This report shows that it is the dominant channel for illicit inflows, outstripping both export overinvoicing and underinvoicing. Import underinvoicing is a form of tax evasion that adversely affects both direct and indirect taxes via underpayment of import duties and/or VAT. Dodging customs duties, VAT and other fiscal charges having equivalent effect means a substantial share of a country's imports do not show up in national statistics. It also amounts to a substantial opportunity lost in public revenues. The literature on underreporting of imports is quite broad, with one fact standing out from the rest: as tariff rates for imports of specific goods increase, so does the propensity to evade the relevant import duties.[49] The degree to which evasion occurs is also influenced by commodity characteristics, such as the number of close commodity substitutes with low tariff rates. In this case, rather than directly understate the value of the correctly classified import, the importer may instead pursue "banding", whereby they misclassify the high tariff band import as a close substitute with a lower tariff band.

Beyond direct and indirect tax, and duty evasion, import underinvoicing represents a form of "technical smuggling". That is, more goods are brought into the country through formal border posts than is officially declared. This could allow traders to avoid quantitative restrictions on imports, for example. This technical smuggling differs from informal trade and physical smuggling,[50] which occur away from formal border posts and may include illicit goods. Israeli restrictions and closures, for example, mean the Palestinian economy has nowhere to turn for its survival, except to countervailing trade. Fuel, food and people have found, for a number of years, an alternative in the tunnels under the Gaza-Egypt border. Unsanctioned embargos and illegal measures can provoke illicit trade and cause crime to shift to other states across the Arab region, undermining regional initiatives and national policies destined to curb IFFs.

Before presenting the findings and estimations of trade misinvoicing, it should be noted that the methodology employed follows a long line of evolving scholarship, beginning with Bhagwati.[51] It remains closely aligned to the methods recently used by the Economic Commission for Latin American and the Caribbean (ECLAC),[52] though it introduces variations to those and the methods used by the High-Level Panel on Illicit Financial Flows from Africa[53] as well as to the IMF Direction of Trade Statistics (DOTS)-based trade misinvoicing model.[54] For further information on the methodology and related technical issues, readers may refer to the methodology note at the end of the report. This report dismisses the application of net resource transfers, or 'netting' IFFs for a given product and country, as "there is no such concept as net crime – flows in both directions are illicit. Hence, illicit inflows which cannot be used productively and are much more likely to end up in the underground economy provide little or no benefit to governments".[55]



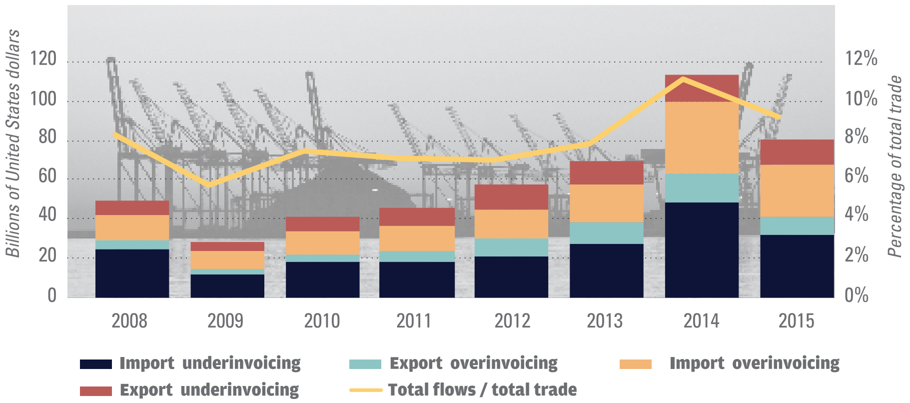
# CHAPTER 4
# REGIONAL FINDINGS: NON-OIL TRADE MISINVOICING

***The top six misinvoiced categories in the Arab region are mineral fuels, machinery, electrical machinery, vehicles, plastics, precious stones and metals, and organic chemicals. These categories make up to 50% of total misinviocing between 2008 and 2015.***

In this section, estimations of trade misinvoicing for the Arab region are presented. Figures are first calculated to exclude trade in mineral fuels and derivative products falling under the Harmonized Commodity Description and Coding System (HS 27). This exclusion is denoted as non-oil trade and delineates the relationship between misinvoicing and economic diversification/transformation.

Fig 2.

**Total trade misinvoicing, by type, Arab region, 2008 - 2015**




Between 2008 and 2015, nearly half a trillion dollars ($482.7 billion) were lost in public revenues due to trade misinvoicing, the equivalent of a fifth of the region's GDP in 2016 or $60.3 billion per annum on average. Trade misinvoicing has followed an upward trend in both dollar volume and as a percentage of non-oil trade, though the trend for dollars is steeper, averaging 8.2 per cent of total non-oil trade with the rest of the world.

During this period, illicit financial outflows associated with misinvoicing amounted to $27.8 billion per annum on average (more than half the value of foreign direct investment inflows received by Arab economies in the period 2008–2015) and were mostly dominated by import overinvoicing ($17.8 billion per year on average). Illicit inflows amounted annually to $32.5 billion (17 per cent more than outflows and more than double the average official development assistance inflows (excluding intraregional ODA) into the region in the period 2008–2015) and were, in turn, dominated by import underinvoicing practices ($25.1 billion per year on average).

The top six countries adversely affected by IFFs are Saudi Arabia, the United Arab Emirates, Egypt, Tunisia, Algeria and Jordan, accounting for 80 per cent of the region's IFFs associated with misinvoicing. In seven Arab economies, trade-based illicit financial outflows exceeded inflows. The findings resonate with those of the High-Level Panel on Illicit Financial Flows from Africa, which found that four of the top 10 countries in the African continent adversely affected by misinvoicing are Arab economies.

Trade misinvoicing in the region peaked in 2014 when it stood at 11.1 per cent of total non-oil trade, or $112.8 billion (figure 2). Trade misinvoicing as a percentage of total non-oil trade held relatively steady between 2010 and 2013, with sharper increases in 2009–2010 and 2013–2014. Drops occurred both in value and as a percentage of total non-oil trade in 2008–2009 and 2014–2015. The first downward movement can be attributed to the global financial crisis, when economic activity of all types declined. The latter is due to data vintage effects. At the time of writing, 2015 trade data at the HS 6-digit level (the level of specificity at which this analysis is conducted) were not yet reported as comprehensively as they were for earlier years. As more data vintages become available, it is expected that misinvoicing figures for 2015 will increase to some degree.[56]

Quantitative findings for country and resource-based variations[57] are presented in figures 3 and 4. Figure 3 provides a heat map of total trade misinvoicing as a percentage of total non-oil trade; Tunisia tops the list at 16.2 per cent, followed by Lebanon at 13.2 per cent, and Jordan and Egypt at 11.7 per cent. Figure 4 breaks down misinvoicing and finds that non-resource-based economies (green) are more affected by misinvoicing than resource-based economies (orange), with scaled misinvoicing at 10.4 per cent and 7.4 per cent respectively.[58]

Fig 3.

**Heat map, total misinvoicing by country as a share of total non-oil trade, 2008 - 2015**

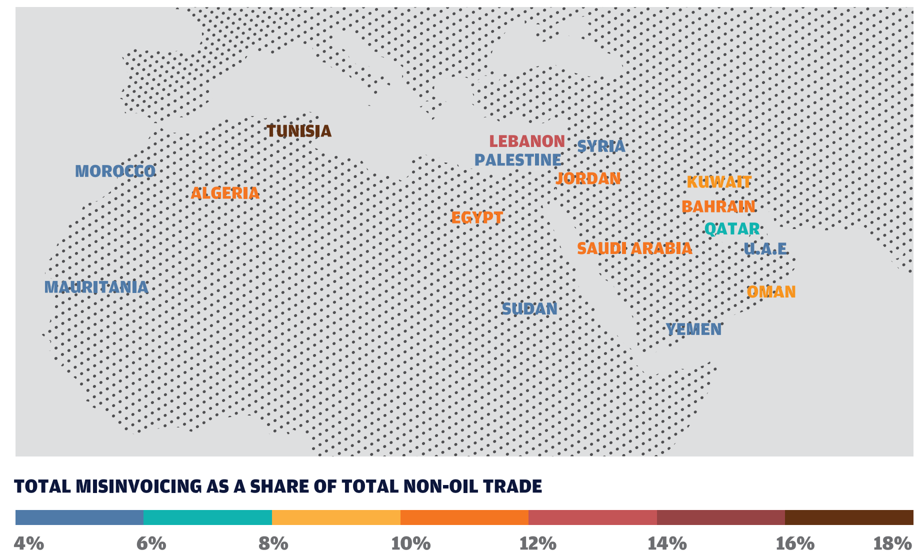



Fig 4.

**Heat map, total trade misinvoicing by resource-based and nonresource-based economies as a share of total non-oil trade, 2008 - 2015**

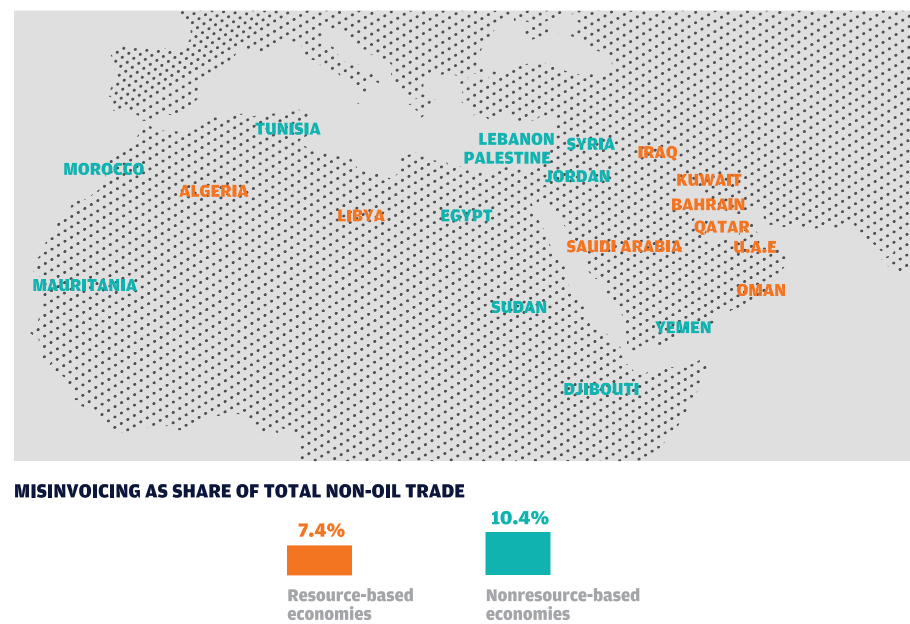


Figure 5 provides a visual representation of the product categories that are most misinvoiced in the region. The largest non-oil categories subject to misinvoicing are machinery and mechanical appliances (HS 84), electrical equipment (HS 85), vehicles (HS 87) and plastics (HS 39). These are closely followed by precious stones and metals (HS 71) and organic chemicals (HS 29).

Figure 6 identifies the commodities that make up the bulk of misinvoicing in each of these categories, providing further insights at the 6-digit product level. In the machinery category, the top misinvoiced commodities appear as laptop computers (847130). Electrical machinery is dominated by mobile telephones (851712), parts (851770) and machines for receiving, converting and transmitting voice, images and data (851762). Passenger vehicles 1500cc–3000cc, accessories and part make up nearly half the misinvoicing in HS 87. Like machinery, vehicles, particularly used vehicles, can be easily misinvoiced, as accurate prices cannot easily be verified. Trade flowing through processing zones is not systematically recorded in national trade statistics and can result in significant underrecording of trade and vice versa. Within the precious stones and metals category (HS 71), jewellery, unwrought gold and diamonds are responsible for the vast majority of trade gaps. This aligns with the perceived appeal of these items, especially gold, among money-launderers.[59] According to a recent IMF report, gold was used to launder proceeds of other illegal activities by militant groups in the region through refineries in the Arabian Peninsula.[60]

Fig 5.
**Total misinvoicing for all HS 2-digit commodities, Arab region, 2008 - 2015**

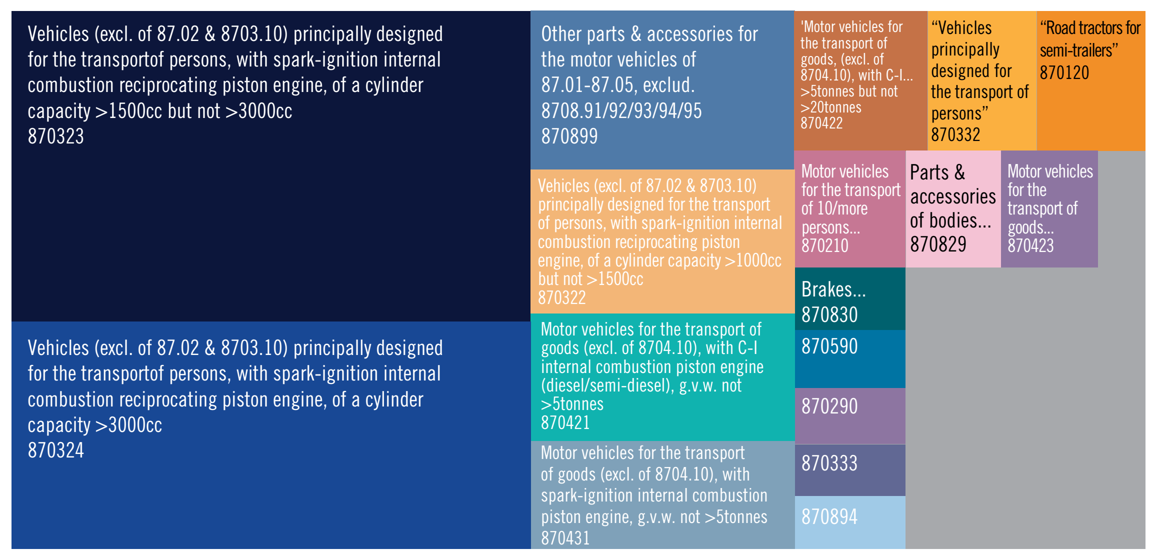
Fig 6.

**Total misinvoicing for HS 6-digit commodities, Arab region, 2008 - 2015**

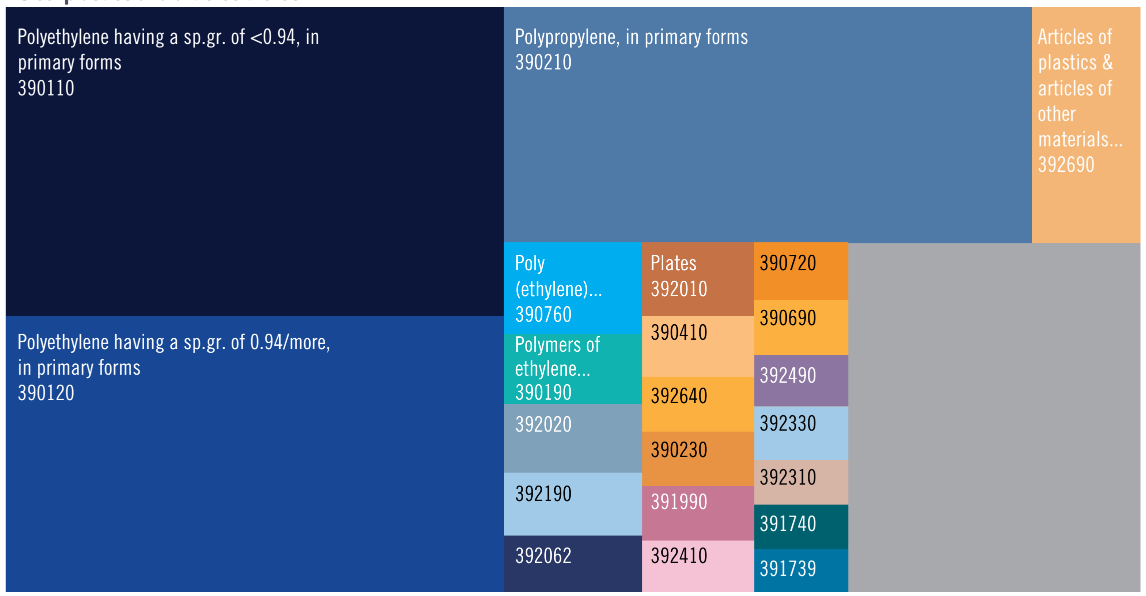
**HS 84: nuclear reactors, boilers, machinery and mechanical appliances; parts thereof**


**HS 85: electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, and parts and accessories of such articles**

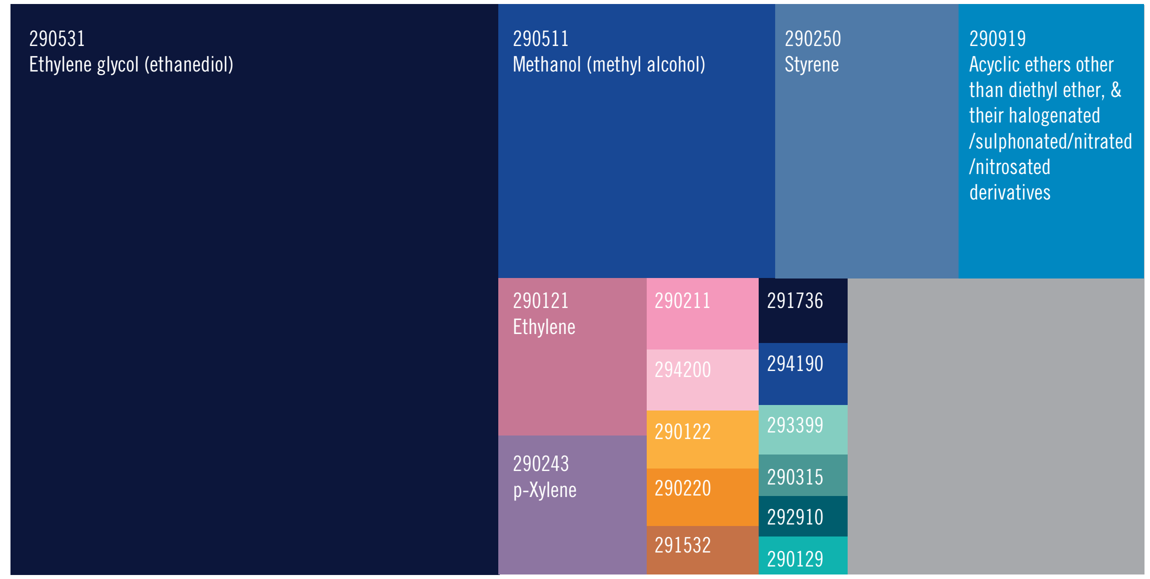

**HS 87: vehicles other than railway or tramway rolling-stock, and parts and accessories thereof**



**HS 39: plastics and articles thereof**




**HS 29: Organic chemicals**




**HS 71: natural or cultured pearls, precious or semi-precious stones, Precious metals, metals cladwith precious metals, and articles thereof; imitation jewellery; coin**

***Box 2. Illicit financial flows and the case of misinvoicing exports from Israeli settlements***

*Commodities produced by Israel in occupied Palestinian and Syrian territories, particularly in illegal settlements, pose a peculiar anomaly to tracking trade-based illicit financial flows.*

*Israel's total exports to the world amounted to about $60 billion–$70 billion in recent years[a]. A portion of these exports are produced in illegal Israeli settlements. Estimates of the exact value of exports from these settlements are difficult to determine, since Israel does not report separate trade data for them. In 2012, however, Israel's Ministry of Foreign Affairs reported to the World Bank an estimate of the value of goods produced in settlements and exported to the European Union (EU) at $300 million per year.[b] Another report, which analysed products partially produced in the settlements, estimates that exports to the EU that include settlement-produced components totalled $5.4 billion in 2008.[c] Though figures for Israel's other trading partners are generally not available, the data on EU trade is nonetheless indicative as it provides a useful baseline, being Israel's top trading partner and its second largest export destination, receiving more than 20 per cent of Israel's exports in the past decade.[d]*

*Several of Israel's trading partners require that specific origin information be provided with exports to assess whether the product is sourced from a settlement area. For example, the EU-Israel Technical Arrangement[e] requires that the postal code and the name of the city, village or industrial zone of production be included on all proofs of preferential origin issued by Israel. This requirement was established to ensure that exports originating in Israel's settlements do not receive the preferential tariff treatment conferred to Israel's other exports to the EU, as these products receive preferential access to EU markets through a different standalone Interim Association Agreement on Trade and Cooperation concluded between the EU and the Palestine Liberation Organisation (PLO) on behalf of the Palestinian Authority in 1997. Individual European governments have stated their support for separately labelling settlement products.[f] Similarly, United States Customs requires that goods produced in the West Bank or Gaza Strip be labelled as such.[g] Failure to comply with this requirement would lead to a 10 per cent ad valorem duty on the product.[h] The South African Department of Trade and Industry similarly requires importers, producers, retailers and suppliers to specifically label Israeli settlement goods.[i]*

*To the extent that such labelling requirements are not followed, a form of deliberate misinvoicing – misrepresenting the origin – takes place. Incentives for misinvoicing in this case include benefitting from preferential treatment/duty suspension and market access. This issue may also permeate to countries with special export processing zones where some imports for use exclusively in these zones have instead ended up in the domestic market.[j]Anecdotal evidence indicates the presence of incorrect labelling of Israeli settlement exports[k]. No comprehensive data are currently publicly available to estimate the degree to which such misinvoicing occurs.*

a GFI calculations based on United Nations Comtrade data.
b World Bank, 2012.
c Derived from figures noted in: Spiegel Online, EU court allows duties on products from the settlements (accessed 25 February 2010).
d GFI calculations based on United Nations Comtrade data.
e EU-Israel Technical Arrangement, European Commission, Taxation and Customs Union (accessed 22 March 2017).
f Liphshiz, 2013.
g United States, Government Publishing Office, 1995. Country of origin marking of products from the West Bank and Gaza, Federal Register, vol. 60, No. 66
h United States, Government Publishing Office, 1997
i Republic of South Africa, 2013. Labelling of goods originating from East Jerusalem, Gaza, or West Bank wrongly labelled as originating from Israel in terms of section 24 of the Consumer Protection Act, 2008 (Act No. 68 of 2008). Government Gazette, vol. 574, No. 36364. Available at http://www.gpwonline.co.za/Gazettes/Gazettes/36364_12-4_TradeIndustry.pdf.Government Gazette Staatskoerant, 2013.
j Rose-Ackerman, ed. 2006. International Handbook on the Economics of Corruption (Northampton, Edward Elger Publishing), pp. 522–527.
k Starkey, 2010

Fig 7.
**Top flow categories by misinvoicing type, Arab region, HS 2-digit category (excluding HS 27), 2008 - 2015**

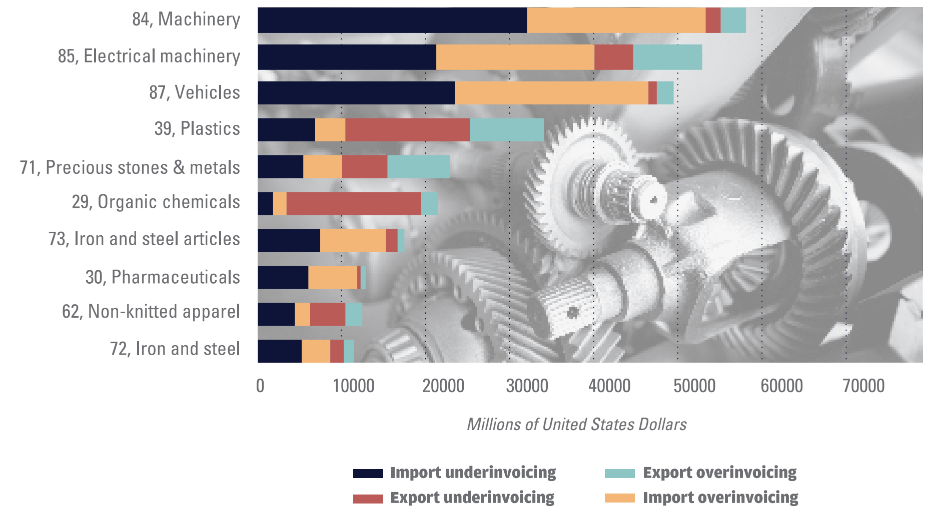
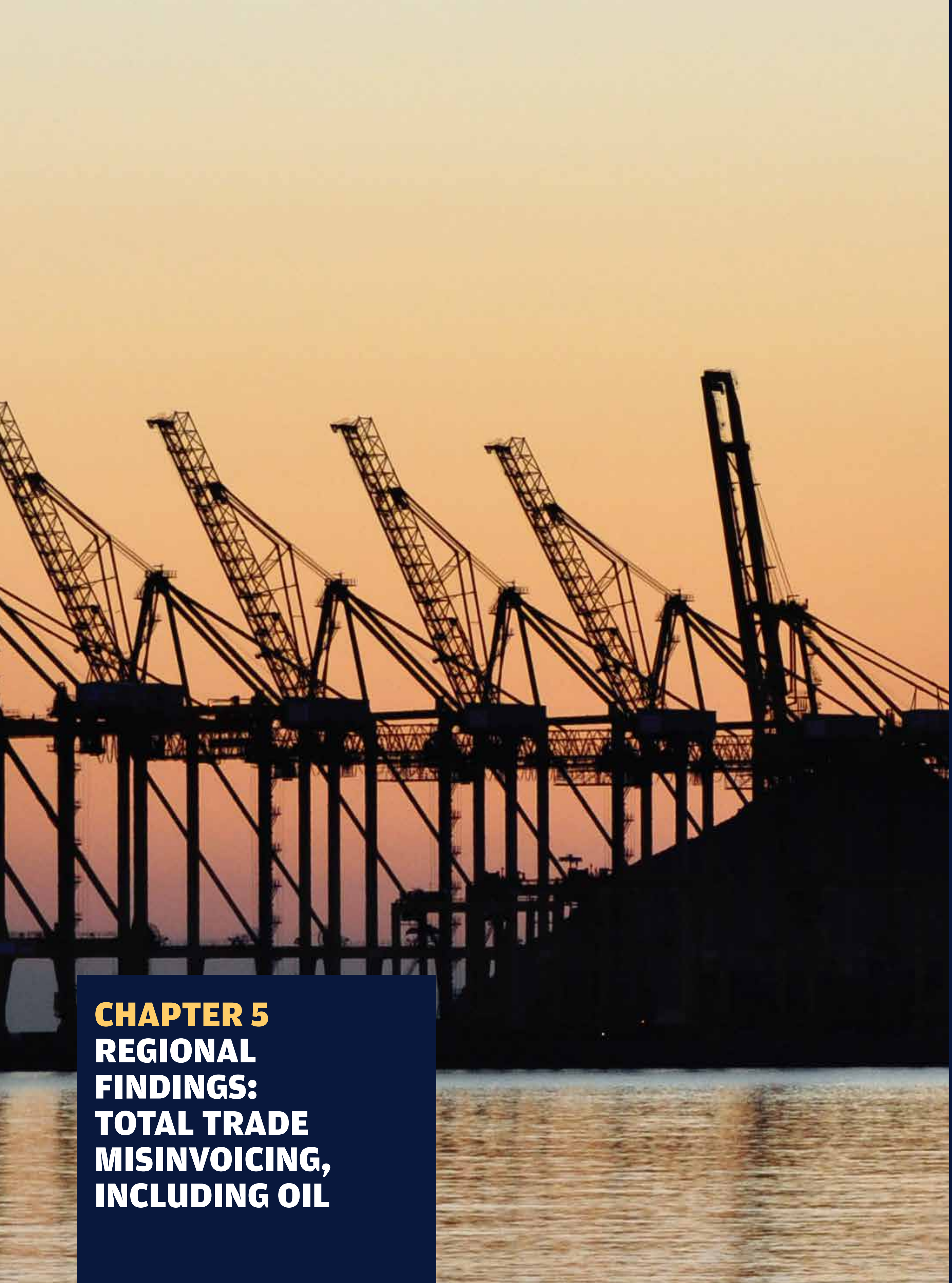



Figure 7 provides a visualization of the commodity groups typically misinvoiced in the Arab region. It brings together the information presented in figure 5 with that of figure 2 to demonstrate not only the relative size of the flows by HS category, but also the breakdown between the types and conduits of misinvoicing.

The report finds that misinvoicing of vehicles (the third top category of goods imported by the region) is evenly split between overinvoicing and underinvoicing of imports; both of these far outweigh either type of export misinvoicing. Electrical machinery (the second top category of goods imported by the region) and precious stones and metals (second top export category) are more evenly split between the four types of misinvoicing, indicating varying incentives by country and product subcategories. Plastics (third top export category) and organic chemicals are routinely overinvoiced and underinvoiced as exports. Machinery (the top import category for the region) is dominated by import underinvoicing; given the complicated nature of most machinery, it can be quite easy for importers to misstate the value of a product without raising any red flags. The results resonate with the findings of the High-Level Panel on Illicit Financial Flows from Africa, which indicated that 70.9 per cent of the continent's misinvoicing in the machinery category was attributed to Morocco and Tunisia.

The results indicate that overinvoicing of these commodity categories has been a predominant source of illicit capital movement. The results hold considerable implications for countries both for the accuracy of their export statistics and the efficacy of measures taken to curb IFFs.

The overall picture on non-oil trade misinvoicing is not surprising as both outflows and inflows continue to permeate Arab preferential and non-preferential intra/extra-regional trade activity. The quantitative findings reveal that two of the top six categories that are often misinvoiced are representative of downstream industries in the oil sector. Plastics are dominated by polyethylene and polypropylene. Potential misinvoicing in organic chemicals seems primarily derived from ethylene glycol, methanol, styrene and acrylic ethers. Estimations of upstream oil and gas commodity trading is examined in the next section.

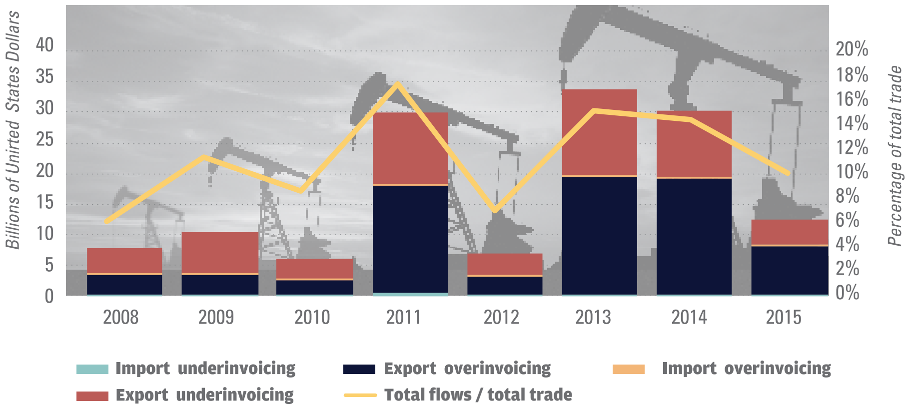


# CHAPTER 5
# REGIONAL FINDINGS: TOTAL TRADE MISINVOICING, INCLUDING OIL

***Trade misinvoicing amounts to $77.5 billion in annual losses and is dominated by import underinvoicing practices.***

In this section, oil and mineral fuels misinvoicing is factored into the analysis. The findings indicate that HS 27 is the largest 2-digit commodity category for trade gaps within the region, in dollar levels and as a percentage of trade within the 2-digit commodity (Appendix tables A.2 and A.3).[61] This is a particular concern for liquefied natural gas.

Fig 8.
**Total oil trade misinvoicing by type, Arab region, 2008 - 2015**




The quantitative findings show trade misinvoicing may have been undertaken in the oil and gas sector, dominated by apparent export misinvoicing despite numerous Arab States being mineral fuel importers (figure 8). Analysis at HS 6-digit level reveals that the vast majority of potential misinvoicing in this sector was driven by overinvoicing exports of liquefied natural gas (HS-27111), crude oil (HS-270900), natural gas (HS-271121) and liquefied propane (HS-271112).

Cumulatively, when oil trade is included, total trade misinvoicing (oil and non-oil) for Arab economies between 2008 and 2015 is $620 billion, or $77.5 billion on average per year; misinvoicing in the region has been driven predominantly by trade in non-oil commodities.[62]

On aggregate, total trade misinvoicing led to illicit financial outflows worth an annual $35.3 billion, shared between export underinvoicing and import overinvoicing practices. Import underinvoicing was the dominant practice (average $25.2 billion per year), driving misinvoicing in almost half of the countries, as opposed to export overinvoicing practices that motivated misinvoicing in Qatar and Tunisia only. In this case, 10 countries had a higher incidence of inflows associated with trade misinvoicing, while the others registering higher outflows.

Each source of variation presented in figures 2 to 7 provides government officials in the region with some idea of the scope and nature of trade misinvoicing. Working with other governments, multilateral institutions and international experts, plus their own civil society, young people and academics, they can choose whether to take steps to curtail the problem. As a starting point, this report suggests an itinerary of initiatives, policy reforms and international cooperation channels to combat trade-based IFFs.

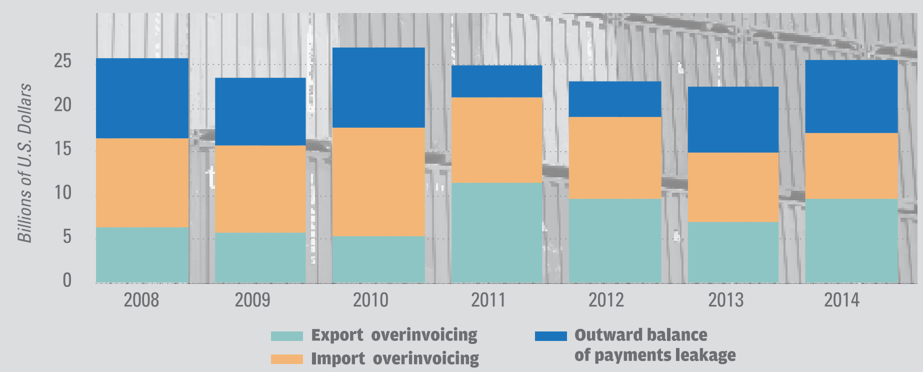
***Box 3. Alternative ways to measure illicit financial flows and oil-trade misinvoicing in Iraq***

*The data and method employed in this report provides a lower-bound baseline for IFFs in the Arab region. Iraq is a clear case study of this limited view; in this report, almost no trade misinvoicing is detected for the country. This is despite numerous press reports of illicit or undeclared trade in oil by the Islamic State of Iraq and the Levant (ISIL/Da'esh), among others,[a] taking place through different routes, including Turkey, the Syrian Arab Republic and from Iraqi-Kurdistan via Israel, which according to reports imported three quarters of its supplies.[b]*

*Using alternative sources and methods can result in different estimates of IFFs, as demonstrated in the chart below. A persistent level of about $25 billion in IFFs associated with trade misinvoicing in Iraq is evident, due primarily to the methodology employed and data available. In its analysis of oil-trade misinvoicing by Global Financial Integrity[c], trade data was sourced from the IMF DOTS, rather than the United Nations Comtrade database or International Trade Database (BACI, Base pour l'Analyse du Commerce International).*

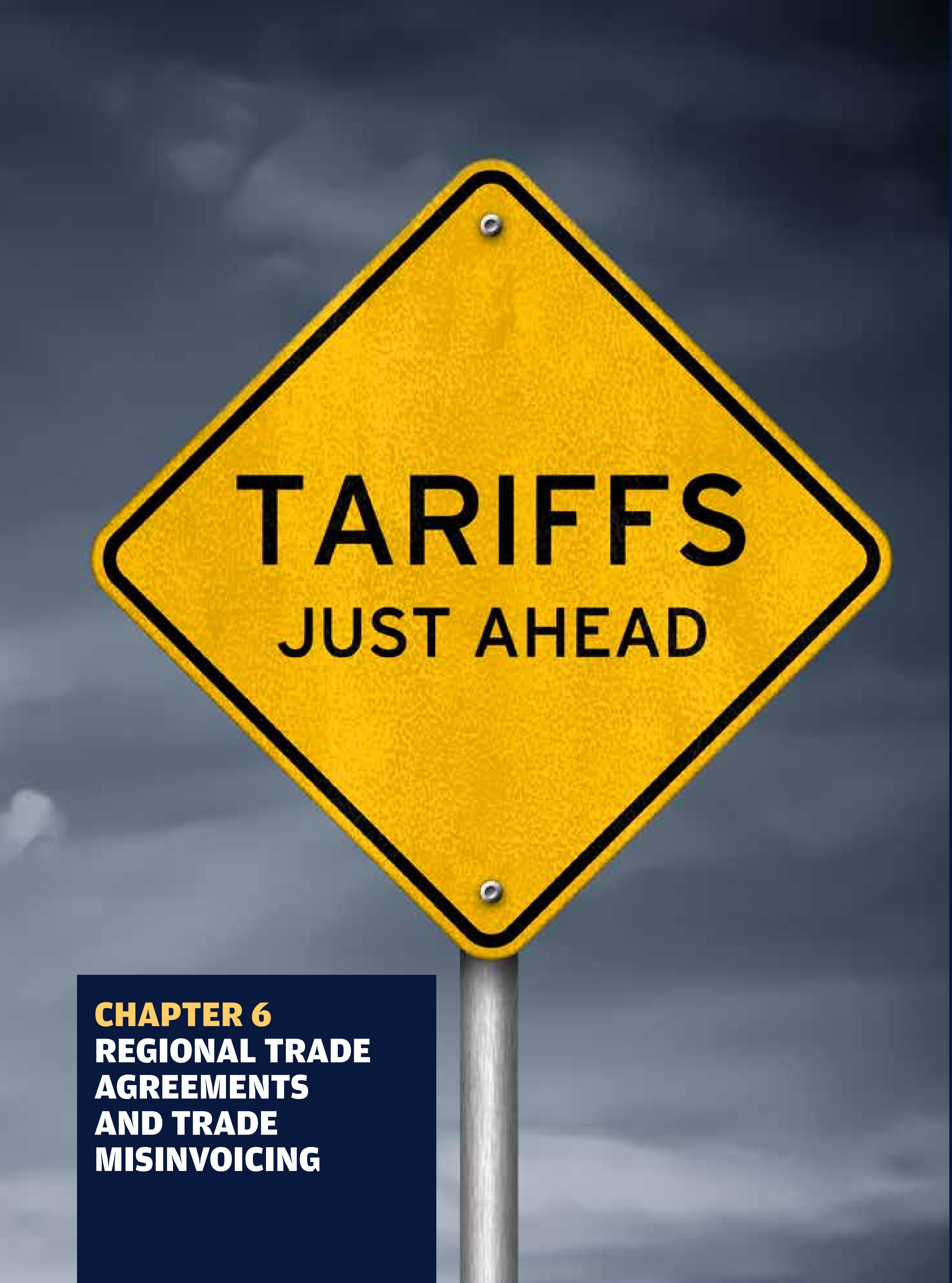
*Though in this case coverage is improved, it comes at the cost of any commodity detail. It also only allows a binary choice between export overinvoicing and export underinvoicing (and import overinvoicing and underinvoicing) in any given year; over the period, Iraq did not switch away from export overinvoicing and import overinvoicing at macro level. Further, this report went beyond trade misinvoicing, supplementing trade misinvoicing figures with estimates of leakages from the balance of payments, which may represent collusion over undeclared wire transfers, among other explanations.*

**Iraq: total measurable illicit flows**
(in billions of U.S. dollars, 2008-2014)




*Source: Global Financial Integrity (2017). Illicit financial flows to and from developing countries: 2005–2014 (Washington, D.C.).*

a Daragahi and Solomon, 2014; Hawramy and others, 2014; Zhdannikov, 2015; Lendman, 2016.
b Sheppard and others, 2015.
c Global Financial Integrity, 2017.




# CHAPTER 6 REGIONAL TRADE AGREEMENTS AND TRADE MISINVOICING

***"[Deep, comprehensive and] robust RTAs are critical to curtail trade misinvoicing and IFFs. There is substantially more misreporting of trade activity among non-RTA members than RTA members."***

Kellenberg and Levinson, Misreporting trade: tariff evasion, corruption, and auditing standards

Trade has long been considered a vehicle to achieve Arab regional integration and stimulus for economic growth. Up until the early twentieth century, the Arab region was moulded, at least in terms of commercial activity, by the Ottoman Empire customs union. Modern efforts to deepen Arab regional integration began in the 1950s through the Economic Unity Agreement of the League of Arab States followed by the charter for joint economic action in 1980. Regional and subregional trade integration followed, including the Greater Arab Free Trade Area (GAFTA), the Gulf Cooperation Council (GCC) Customs Union and the Agadir Agreement.[63] In 2009, the League of Arab States announced plans to press ahead with the creation of a Pan-Arab Customs Union by 2021, and subsequently an Arab Common Market by 2025.[64]

There is ample literature on Arab integration and estimations of how regional integration initiatives perform, qualitatively and quantitatively. The assessment is that intra-Arab RTAs have not lived up to their potential. Despite ambitious aims, trade integration in the region remains underdeveloped.[65] Arab countries, including many which have yet to accede to the WTO, have excessively pursued preferential trade agreements with non-Arab States, but there has not been the same enthusiasm for intraregional trade.[66] If current trajectories are maintained, by 2030 the region will become host to preferences from five continents covering at least 110 countries. Most, if not all, imports will be granted duty-free access or receive some form of preferences in Arab markets, though this remains contingent on the nature of the technical adaptations to extraregional trade agreements prior to the launch of the Arab Customs Union.[67] To revamp regional efforts, ESCWA proposed a framework to recalibrate the trajectories of Arab integration to serve sustainable development imperatives and achieve developmental regionalism, and curtail trade misinvoicing through an Arab Citizens Common Economic Security Space (ACCESS).[68]

Improving RTAs and their enforcement would prove beneficial to growth potential, and to achieving the SDGs. Beyond the conventional view that trade is good for growth,[69] although contested by some,[70] empirical analysis validates intraregional trade among Arab countries as a greater source of per capita growth than extraregional trade.[71] Empirical assessments also point out that the benefits of RTAs outweigh the costs and pose a source of lower growth volatility.[72] Lower growth volatility would diminish the vulnerability of member countries in the region to external shocks, allowing more stable economic development than might have been the case without RTAs. ESCWA notes that liberalized trade fosters the development of regional value chains.[73]

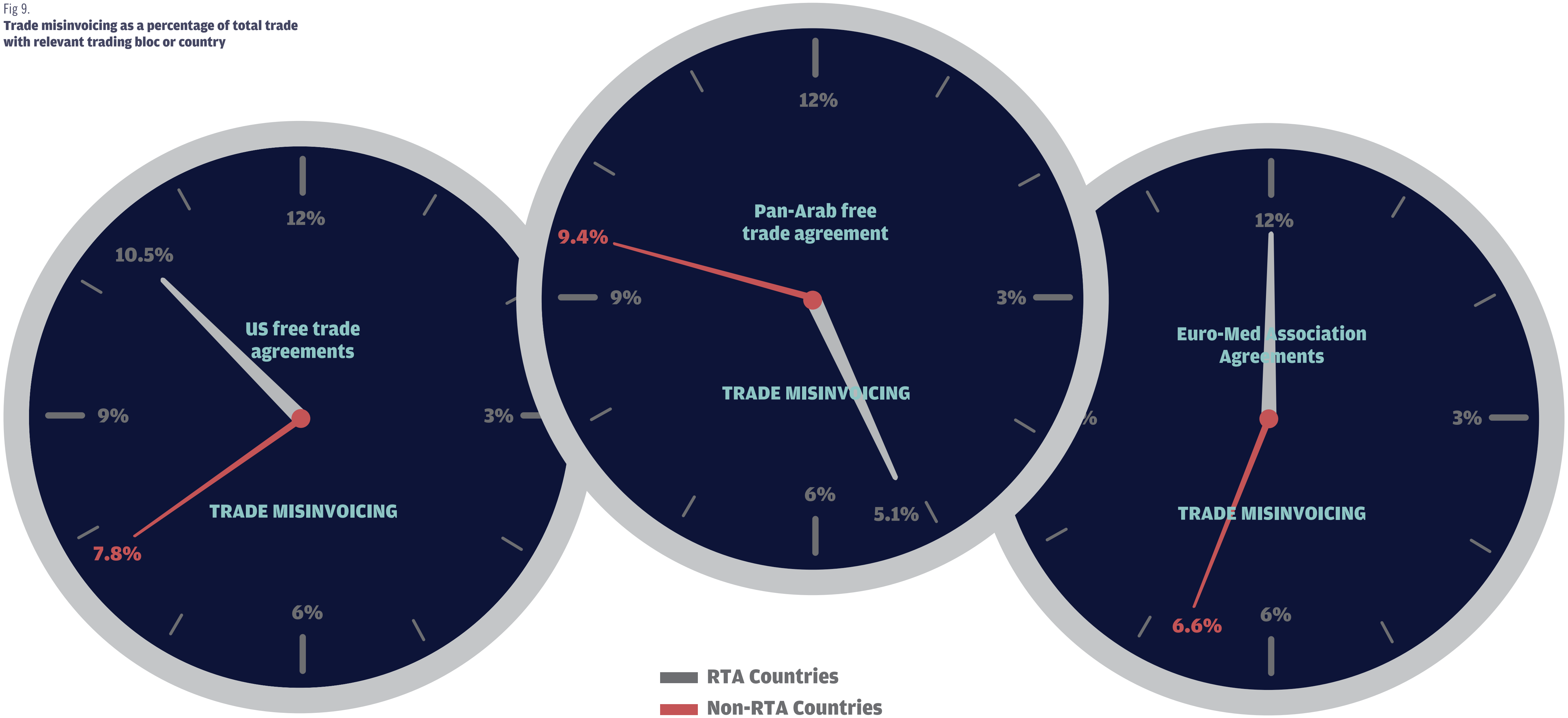
Of particular note, robust RTAs are critical to curtail trade misinvoicing and IFFs. Research by Kellenberg and Levinson (2016a) finds substantially more misreporting of trade activity among non-RTA members than RTA members. Using a panel data set, the report finds that tariff evasion (a direct revenue loss due to import underinvoicing) is lessened between members of an RTA. The findings resonate with those of Carrere and Grigoriou (2015), that countries part of the same RTA have a significantly lower percentage of orphan imports – instances where the country reports an import, but export data is missing – which is often associated with tax evasion, among other illicit activities. Reducing inconsistencies in trade statistics, evidenced by fewer misclassifications, could be due to increased collaboration and subsequent relief in administrative burdens on customs departments as well as diminished incentives for tax evasion. A similar reduction in asymmetries in trade valuation is evidenced by WTO accessions, though this is not a safeguard in itself to witness other types of tariff evasion related to underreporting of quantities and product misclassification.[74]

An exception is provided in the case of the Israeli-Palestinian customs union. Goods produced in illegal settlements and Israeli-occupied territories in East Jerusalem, Gaza, the Golan Heights and West Bank are a daily source of misinvoicing, sanctioned neither under international law nor by the terms of the European Union-Israel Association Agreement or United States-Israeli free trade agreement. Estimates of misinvoicing intercepted by the European Union have been reported in the range of €230 million a year,[75] or multiples of that figure (box 2). The motives transcend governance factors to constitute a category of their own. Misinvoicing in this situation is distinct from other claims of clandestine trade taking place in contravention to international commercial law.[76]

Misinvoicing can also result from situations where one RTA offsets that of another region. The United States free trade agreements with Bahrain and Oman, for example, are said to have upset the operation of the GCC Customs Union. With trade preferences granted to the United States not recognized by the entire union, traders in these two countries have been unable to reclaim duties collected on their imports trans-shipped via other members of the union. While no perceived manipulation of misinvoicing takes place at the first border entry, the anomaly can arise when traders attempt to reclaim the import duties or when United States products are shipped directly with duty-free access and freely circulated within the GCC market without requiring a certificate of origin or customs declaration.[77]

An examination of this issue within RTAs produces mixed results for RTAs as being associated with lower levels of trade misinvoicing in the Arab region. While GAFTA countries have a lower level of misinvoicing in trade with each other than with external trade (intra-Arab trade misinvoicing at 5.1 per cent of total non-oil regional trade compared with 9.4 per cent of non-oil external trade),[78] the same does not hold true for Arab countries maintaining RTAs with the United States or the European Union. These countries have higher levels of trade gaps, a plausible sign of misinvoicing, than those not party to such agreements (see figure 9).

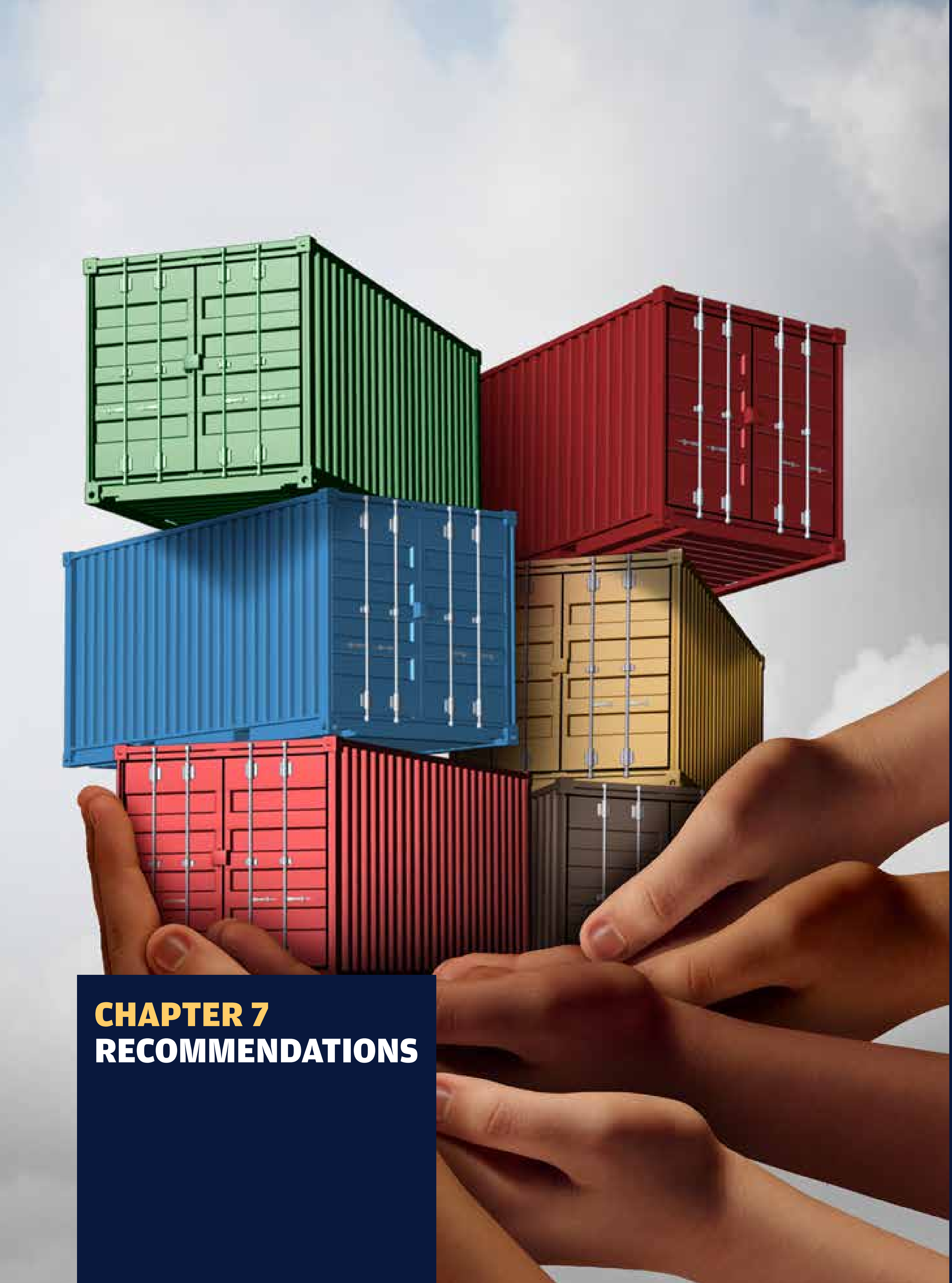
Fig 9.
**Trade misinvoicing as a percentage of total trade with relevant trading bloc or country**




The results, nevertheless, need to be put in context. The categories misinvoiced can influence cross-sectional comparisons. Bias can result when extraregional preferential trade differs from that of intraregional in terms of one or more of the major product categories being misinvoiced. Moreover, misinvoicing in that category will vary relative to its total trade from one region/trading partner to another, but when calculated as a percentage of aggregate misinvoicing out of total trade, the result for a certain region may deteriorate.

As a substantial share of extraregional trade taking place within RTAs is covered by reciprocal preferences, misinvoicing may be driven by factors beyond the border. It should be noted that although several Arab countries do not maintain RTAs with the European Union or the United States, this does not preclude the benefits accrued from more surveilled non-reciprocal preferences offered through the European Union's Generalised Scheme of Preferences and trade within the 'Everything But Arms' initiative.

To the extent that the so-called Rotterdam effect (some exports being classified based on the port from which they are shipped rather than their final destination) occurs under the GCC customs union, incorrect or incomplete reporting of intraregional re-exports from trade entrepôt hubs will exacerbate estimates of trade misinvoicing using the methodology employed in this study.[79] Further, the overall regional estimation is at times dependent on variation in individual countries. For example, by excluding the United Arab Emirates from the sample, a reproduction of figure 2 produces a smooth upward trend. Yet, some argue that if gaps, and therefore trade statistics, are distorted due to errors or transit trade, then the trade misinvoicing should not be correlated to tariffs or perception-based corruption indices, or to whether they have strict auditing and accounting standards.[80]



# CHAPTER 7 RECOMMENDATIONS

***"We can choose to bemoan the lack of financing for the 2030 Agenda in a world awash with so much unproductive and unrewarding finance. Or we can grasp the opportunity to reshape finance according to our urgent, collective needs".***

António Guterres

The analysis presented demonstrates IFFs are a significant complication for the Arab region. This report provides a sequence of policy measures to curtail IFFs. Each intervention can occur at country level, paving the way for concerted regional action. Coordinated action to curb IFFs and trade misinvoicing would be most effective, particularly in the context of the proposed Arab Customs Union. Though some elements may have been implemented by countries, they are of little influence if not enforced and monitored, or appraised at national, regional and international levels. Each policy can be implemented independently of the others, in varying forms and degrees. Countries making progress on these recommendations will be rewarded by greater domestic revenue mobilization; the ability to stop financial leakages and mobilize resources that could prove critical in advancing progress on the SDGs and the 2030 Agenda.

While considering this menu of policy options, two aspects must be noted. First, they should not be considered an all-or-nothing agenda, and second, multi-stakeholder involvement in implementing many of these actions could be of great benefit in elaborating a new social contract and advancing the role of the state in fighting IFFs and trade-based money-laundering. Civil society organizations, academics, youth and other segments of society have a vested interest in curbing IFFs. Working with national and regional stakeholders, chambers of commerce, business associations, banking and non-financial institutions, among others, can enhance the effectiveness of government efforts, as well as build confidence with international investors and the development community at large, and among and between citizens of the region.

### A. CREATE NATIONAL AND REGIONAL IFF MECHANISMS AND POLICIES

**Establish national bodies (councils/commissions) supported by multi-agency units and regional bodies led by the League of Arab States to track and curb IFFs.** Effective approaches to curtailing IFFs should spread across three tiers, involving collaboration at agency (operational), government (executive) and regional (intergovernmental) levels to coordinate and develop policy. Governments should consider establishing supreme or national autonomous councils/commissions to combat IFFs and corruption, and complement efforts with a network of multi-agency units at operational level for those that maintain such bodies.[81] Their mandate should avoid overlaps with other national entities involved in policymaking, legislative change, law enforcement and prosecution.

For such councils and units to function effectively, countries should ensure that laws are in place allowing officials from different agencies to share information, understand mutual requirements, and scrutinize in-country and regional data. Hence, the third tier of intervention (regional) would involve establishing a ministerial council within the League of Arab States to promote trade and curb trade-based money-laundering.

### B. INCREASE ENFORCEMENT EFFORTS AND POWERS

**Adopt regional and national stand-alone laws prohibiting IFFs and trade misinvoicing rather than settling for non-exhaustive or intermittent regulations/decrees.** Trade misinvoicing is more than a matter of corruption. The manipulation of the price, value or quantity of goods on international invoices to avoid taxes, move money or evade capital controls affects people's lives and the potential to achieve sustainable development. Misinvoicing represents the largest portion of measurable IFFs. Though it is a relatively simple technique, it is exceedingly difficult to identify.

The widespread, routine and customary nature of its use makes enacting prohibitive laws essential, to put business persons on notice and to empower prosecutors to act rather than apply fines and penalties that may not be sufficient to discourage violations. Even when detected, the rate of prosecution and judgement of trade crimes may encourage launderers and smugglers to continue through proxies. It is important that laws strengthen mechanisms to deter criminal activity and protect witnesses, experts, victims and whistle-blowers.

**Enhanced accountability in fighting IFFs.** Countries party to the Arab convention on combatting corruption may consider broadening the scope of criminal offences covered by the convention (Article 4), to capture the conduits for IFFs associated with trade misinvoicing. Given the cross-border nature of transnational crimes, provisions on jurisdiction in the convention may require review. Arab countries that are part of the Open Government Partnership (a multilateral initiative to secure commitments from governments to promote transparency) should include in their national action plan commitments to carry out the actions identified in this report. Countries that are not yet members should consider actions to improve their eligibility scores.

A region-wide road map for enhanced engagement between anti-corruption bodies should also be considered, including with the Arab Anti-Corruption and Integrity Network. Arab countries subscribing to European Neighbourhood Policy action plans may wish to consider broadening their scope to include combating trade-based IFFs by strengthening cooperation between law enforcement agencies and promoting best practices, methods, data and standards as well as capacity-building partnerships.

**Establish specialized asset forfeiture and recovery units.** Such efforts deprive all criminal types of the proceeds of their crime, providing a powerful disincentive from the outset. However, to be effective efforts must be consistent and efficient. As they involve funds found in other jurisdictions, asset recovery efforts require specialized knowledge of foreign legal systems and mutual legal assistance treaties. Establishing units specializing in asset forfeiture and recovery ensures all offenders face the loss of their criminal proceeds and improves the odds that a country will recover the funds.

### C. PROMOTE FINANCIAL TRANSPARENCY

**Disclosure of beneficial ownership information from all government procurement contract bidders and in political asset declarations.** Countries should require beneficial ownership disclosures of all bidders for and recipients of government contracts to help prevent sham bidding, bidding by persons barred from government procurement for past actions, and other forms of corruption in bidding processes. Governments should also consider acceding to the WTO plurilateral agreement on procurement, which establishes rules requiring open, fair and transparent conditions of competition (bearing in mind these rules do not necessarily apply to all procurement activities). Further, conflicts of interest may not be readily identifiable in income and asset declarations of public officials unless the beneficial owners of the entities are known. Adding this to asset declaration requirements can help identify where potential conflicts may arise in an individual's political work.

**Establish government/independent measurement mechanisms for extracted natural resources.** Governments should independently determine or verify the volume of natural resources extracted by mining and oil companies and not rely on their reports. Without independent verification, it is impossible to determine if companies have paid the correct royalties under their contracts or abided by agreed export volumes.

**Require public country-by-country reporting by multinationals.** Public country-by-country reporting helps focus transfer pricing investigations. By requiring companies to provide basic financial information for corporate groups, disaggregated by country, tax administrators are better able to identify the risk of potential abuse and jurisdictions of concern, aiding the establishment of more sensitive risk management frameworks within tax administrations. Foreign multinational corporations operating within an Arab country should be required to provide country-by-country reports with their local tax returns, with information made publicly available. This would inevitably require broadening the scope of international and regional collaboration to create open databases that include agreed upon thresholds of the turnover that multinational corporations make.


### D. TACKLE TAX EVASION AND AVOIDANCE

**Accede to tax information sharing networks.** Several Arab countries[82] have signed the OECD-led Common Reporting Standard for the international exchange of information about bank accounts held abroad by citizens. Access to information is critical in identifying and pursuing cases of individual tax evasion; without the information provided by the foreign countries, the home country has no way of knowing which citizens hold taxable bank accounts abroad and must instead rely upon self-reporting.

***Box 4. Trade misinvoicing and trade-based money-laundering risk assessment***

*Governments could maximize domestic resource mobilization by boosting customs enforcement through enhanced training and equipment to better detect intentional misinvoicing of transactions. It has proved impossible for customs agents to monitor, control and secure borders by themselves. Advancing technologies, including sensors, next-generation surveillance cameras, X-ray technologies and robotics have aided customs authorities and border agencies in deterring the flow of illicit trade and smuggling operations, as in the case of European Union assistance to the Palestinian border management mission.*

*Several tools can help in curbing trade misinvoicing, including the United Nations Automated System for Customs Data (ASYCUDA)* and the Advance Cargo Information System. Access to real-time, commodity-level world market pricing information is particularly important in stopping trade misinvoicing as it happens, allowing customs officials to gauge whether goods are significantly under or overpriced compared with the prevailing world market norm.*

*Detection of significant variance would then trigger an audit or another form of review for the transaction. One example of such a tool is GFTrade™, a proprietary risk assessment system that enables customs officials to determine if goods are priced outside typical ranges for comparable products. It provides price comparisons for goods at the port with price ranges for the same product, based on the latest available global trade information, which can be used to determine if further investigation is warranted.*

*It should be remembered that according to international chambers of commerce, customs valuation databases that set reference and/or minimum prices are inconsistent with Article 7 of the WTO agreement on customs valuation. Despite offering a means by which to identify misinvoicing, concerns have been raised over their potential misuse. It has been argued, however, that the expanded use of post-clearance audit controls, as prescribed in the revised Kyoto Convention, can provide another effective way to manage customs compliance. The WTO Trade Facilitation Agreement, however, does not require its members to use preshipment inspections in relation to tariff classification and customs valuation.*

** Detailed information on ASYCUDA is Available at www.asycuda.org.*

**Establish transfer pricing units within tax authorities.** Financial arrangements within corporate groups or among related entities are almost impossible to observe from the outside and consequently are at high risk of manipulation. Transactions among these parties, referred to as transfer pricing, warrant special attention. Given the complexity of arrangements and transactions, it has been found that forming units with trained officials to monitor transactions yields the most consistent and effective results for tax administrations; tax havens and multinational profit-shifting practices tend to erode public revenues. Artificial arrangements used by permanent establishments or transnational corporations, and/or the financial centres hosting them, which circumvent taxation systems, remain central to the IFF agenda. Abusive tax practices should be considered part of IFFs, and there are several synergies that can be exploited by addressing base erosion and profit shifting (BEPS) and other IFFs together, including improving customs administration and tax policy administration. There may be economies of scale if efforts are coordinated through a single and coordinated process. Currently, there is no such mechanism at global level. Finally,

treating BEPS as separate to other IFFs perpetuates the view that BEPS are not illicit, reducing political pressure on those responsible for them.

### E. Prevent financial crime

**Mandate rigorous customer due diligence and programmes for reporting suspicious activity within banks.** The Financial Action Task Force has set the bar for customer due diligence and suspicious transactions, reporting on them in its 2012 recommendations document on international standards (recommendations 10 and 20).[83]

**Empower or create strong and effective financial intelligence units.** Financial intelligence units (FIUs) are bodies that collect and coordinate intelligence on financial crimes that result in IFFs. Creating financial intelligence units where none exist and giving them power to collate information from different arms of government (possibly in a lead role in a multi-agency IFF unit, see point 1 above) is critical to organizing and putting counter-IFF measures into operation. Connecting to the international Egmont Group can facilitate cooperation between financial intelligence units of different countries.

### F. Recalibrate RTAs and establish an intact Arab Customs Union

The significant implications IFFs and trade misinvoicing can have on RTAs and pursuing deeper forms of regional integration are among the main findings of this report. Should current trends continue, several countries initially subscribing to the establishment of the Arab Customs Union are likely to pursue membership of other customs or trade agreements, creating legal and operational uncertainties that may exacerbate trade misinvoicing in the region. If this is added to the probability of continued misinvoicing within and outside preferential trade arrangements, any potential benefits of the union or other deep form of regional integration would be eroded.

There is an urgent need to attend to IFFs and trade misinvoicing in the ongoing negotiations regarding the establishment of the Arab Customs Union. Revenue collection and clearance mechanisms within customs unions may be influenced (as much as they can be distorted) by leakages associated with trade misinvoicing and trade-based money-laundering. This, along with other considerations involving skewed or biased setting of a customs union’s common external tariffs, transshipment, re-exports from free zones, and asymmetries in derogations and the variations in the real effective rate of protection provided for by the common external tariff, have been found to create frictions to a point where the viability of a customs union can be compromised.

### G. Prohibiting trade with illegal entities and settlements

The United Nations has developed a database of companies doing business with illegal Israeli settlements in the occupied territories in defiance of international law. A broader, anteceding database/list was operated to administer the Arab boycott on Israel. Though the United Nations list is considered a normative moral and legal framework, its operation or influence on curbing IFFs and trade misinvoicing taking place in the settlements remains ambiguous.

It is suggested that within the ambit of institutional coherence between the United Nations and WTO, a similar démarche be added within the WTO by issuing a ministerial declaration to combat IFFs and trade misinvoicing, particularly in a situation where the cause, source and direction is known. In 2014, ESCWA proposed that a prohibition be maintained, along the lines of European Union guidelines, on the circulation and/or importation of Israeli settlement products from Occupied Palestinian Territories and the Golan Heights, especially if they were not accompanied by verifiable proofs of origin. In tandem, products originating in Israeli settlements need to be labelled as products from Palestine, emulating the terms of the Oslo Accords and the 1994 Paris Protocol.

### H. Embedding sustainable development considerations in the multilateral trade rule book

Sustainable development does not loom large in the WTO rule book. It is dealt with obliquely and does not appear to pose a binding legal rule. It is captured as a broad principle in the Marrakech Agreement establishing the WTO.[84] The WTO agreements themselves are not a concrete legal premise to invoke sustainable development considerations or curb illicit trade,[85] which continues to distort multilateral, international and regional trading systems, and tends to erode preferential and non-preferential trade arrangements. Efforts to address this multitiered problem are partial and insufficient and remain outside the sphere of the WTO negotiating agenda. Contraband and trade-based money-laundering require a comprehensive review of multilateral regulations. At the WTO, illicit trade should be explicitly addressed; its scope and concept require a workable multilateral definition beyond the measures covered by the General Agreement on Tariffs and Trade Article XX on security exceptions, which have not always been successful in curbing such trade. Measures by states to combat illicit trade have proved to be unsuccessful, considered as impeding trade liberalization and violating existing WTO-obligations and norms.

# APPENDIX
# METHODOLOGY

Quantifying IFFs and trade misinvoicing is meant to provide insight into associated time, country, conduits and commodity variations, and place IFFs at the forefront of finance and trade policy discourse. The method used to estimate trade misinvoicing in this report follows an evolution of scholarship, beginning with Bhagwati.[86] The method relies on mirror trade statistics that in principle provide two estimates of the same trade transaction to establish a direction to IFFs, though the magnitude of total trade misinvoicing – outflows plus inflows – remains unaffected.

The methodology is aligned to that recently used by the Economic Commission for Latin American and the Caribbean[87] but departs from it, and from that used by the High-Level Panel on Illicit Financial Flows from Africa[88] and IMF DOTS-based trade misinvoicing model,[89] in a number of aspects.

This report introduces two variations to capture the dynamics in intraregional and extraregional preferential and non-preferential trade misinvoicing, while a third involves estimating IFFs and misinvoicing in terms of gross values by supplementing illicit outflows with measures of inflows to capture the four conduits associated with over and underinvoicing of imports and exports. In doing so, it dismisses the application of net resource transfers or 'netting' IFFs for a given product and country as, according to Kar and Freitas (2012), "there is no such concept as net crime – flows in both directions are illicit. Illicit inflows which cannot be used productively are much more likely to end up in the underground economy provide little or no benefit to governments".[90] As such the four conduits of misinvoicing are assumed to constitute leakages to domestic revenue mobilization and undermine the other relevant pillars of the new global Financing for Development (FfD) framework.

A fourth variation relates to the consideration of product categories under the 6-digit HS 2007 coding system to avoid situations where overstated and understated misinvoicing cancel each other out, underestimating the true value of illicit trade-based capital movement. The use of this relatively recent HS classification requires that trade misinvoicing results be limited to 2008–2015, to remain consistent across the period of consideration and avoid any amplification of misinvoicing due to subsequent changes to the Harmonized System. Detailed statistics for services are unavailable to allow for estimating misinvoicing given by the four modes of services supply.

Calculations are run at country level for 22 members countries of the League of Arab States. Some lower figures for Comoros, Djibouti, Iraq (for reasons explained in box 3) Libya and Somalia were excluded because of limited or inexistent data. Due to the security situation in each of these countries, it is would appear likely that much of the IFF problem takes place through channels that would be unrecorded regardless of data availability, such as physical bulk cash smuggling.

Estimations for commodity trade misinvoicing are based on the United Nations Comtrade database[91] and capture export dynamics, while data from the International Trade Database (BACI)[92] are used to extract import values where, based on an econometric model, their values undergo reconciliation in terms of cost, insurance and freight/free on board (international shipping agreements) values. Insurance, transport and freight mark-ups are discounted to derive actual mirror flows in terms of free on board prices for each product category while accounting for distance and sectoral specialization.

To provide a measure of control for relative size, estimations are presented as percentages of total trade in goods and non-oil commodity trade with the world. This allows for the size of the individual economies, enabling the extent of trade misinvoicing to be directly comparable.[93] It also allows for the relationship between misinvoicing and economic diversification to be extracted in terms of commodities produced and traded. To mitigate the impact of trade value gaps where the trade volumes also do not match, gaps are weighted to give less prominence to those values where wide volume gaps exist.[94] Discrepancies in mirror trade statistics are calculated for the reported exports and imports of Arab countries. These discrepancies are calculated for each Arab country with each partner country for each 6-digit HS product category for a number of observations each year. To mitigate the impact of trade value gaps where the trade volumes also do not match, the value gaps are weighted to give less prominence to those value gaps where wide volume gaps also exist.

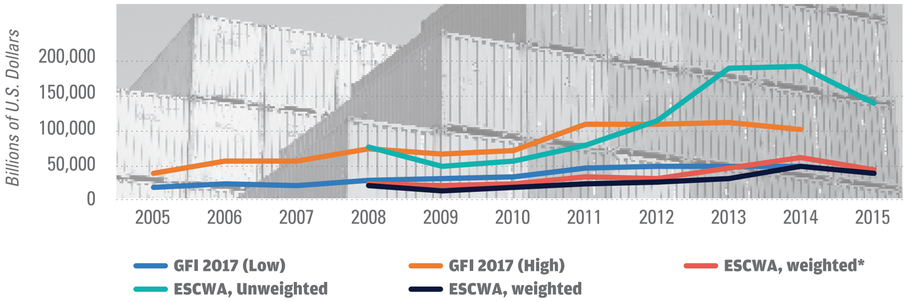
The findings of this report remain highly sensitive to the quality of data available. The results therefore present a true lower-bound for misinvoicing. For comparative purposes, the aggregate regional outflow figures have been cross-checked with Global Financial Integrity (GFI) as they appear lower than the results of a recent study[95] on trade misinvoicing that revealed this discrepancy is mainly due to the following:

- GFI relies on data from the IMF DOTS whereas United Nations Comtrade and BACI provide data sources for this report;
- The volume discrepancy weighting mechanism used in this report mitigates the impact of value discrepancies that have large volume discrepancies and generates missing values for value discrepancies where volume information is not available;
- The requirement that commodity-country pair-year gaps be larger than $1 million in value to be recorded as misinvoicing in this report. This statistical noise is filtered out in this report where discrepancies that are less than $1 million in value are excluded from observations between countries and products;
- To avoid double counting, intraregional trade between two parties in two directions for a given product line as highlighted by some experts,[96] the trade reporting gap is halved. For example, were an export to be underinvoiced from Jordan to Lebanon, this would show up as export underinvoicing from the Jordanian perspective, but import overinvoicing from the Lebanese perspective. Since both of these, equal in magnitude, are outflows and possibly in quantities of trade involved, it would lead to a double counting. Therefore, intraregional flows are halved after calculation of the trade gaps.

For reference purposes, a comparison of the outflow results is presented below in Appendix figure A.1.

In addition to the GFI figures, outflow estimates include: without weighting and including HS 27; with weighting and including HS 27; and with weighting and excluding HS 27 (the latter reflecting the baseline estimates presented in this report, in yellow). The effects of the weighting scheme in eliminating outliers and/or data points without quantity information are particularly evident in estimates for the Arab region, including HS 27. The comparison demonstrates that the weighted version is significantly less volatile than the unweighted estimate. The comparison displayed in Appendix figure A.1 underscores that the results in this report represent a true lower-bound for trade misinvoicing in the region. Any reasons for overestimation using 6-digit commodity level data seem to be mitigated by the factors noted above.

Fig A.1.
**Evolution of trade misinvoicing outflows from Arab States, 2005 - 2015**




Note: * Includes HS 27.

Finally, when interpreting the results of quantitative estimations, it should be noted that trade misinvoicing is difficult to quantify when there is collusion in misreporting in both the exporting and the importing country, and/or when banding takes place, and/or when both the value and volume of the transaction are misreported in two directions, including through transfer pricing. The Center for Global Development concludes, "given that an unknown fraction of all misreported trade activities is identified from official statistics, the accuracy of trade misinvoicing estimates may also be unknown". Until mirror data is supplemented and can be matched against data at firm and transaction levels, misinvoicing estimates will remain a matter of faith.[97] Any subsequent measure of IFFs in the Arab region would require incorporating various approaches to arrive at something closer to a comprehensive composite measure. However, this would not necessarily be free from contention, since composites typically suffer from oversimplification, assumption bias and less-than-ideal data to measure actions designed to remain intentionally hidden.

**Appendix Table 1. Annual total misinvoicing as a share of total non-oil trade with the world, Arab countries and the region, 2008 - 2015 (Percentage)**

| Country | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | Cumulative |
|---|---|---|---|---|---|---|---|---|---|
| Algeria | 10.9 | 13.5 | 13.0 | 11.5 | 9.3 | 10.2 | 10.5 | 11.8 | 11.2 |
| Bahrain | 0.0 | 11.8 | 12.7 | 11.9 | 10.4 | 11.8 | 11.0 | 11.9 | 10.8 |
| Comoros | 10.3 | 11.9 | 9.2 | 15.5 | 13.1 | 15.2 | . | . | 9.3 |
| Djibouti | . | 0.3 | 0.1 | 0.1 | 0.0 | . | . | 0.2 | 0.1 |
| Egypt | 11.1 | 10.8 | 11.7 | 11.4 | 10.8 | 11.8 | 11.9 | 13.3 | 11.7 |
| Iraq | 0.0 | 0.0 | 0.1 | 0.1 | 0.0 | 0.0 | . | 0.0 | 0.0 |
| Jordan | 10.8 | 13.3 | 11.8 | 12.1 | 11.6 | 12.0 | 11.2 | 10.7 | 11.7 |
| Kuwait | 0.0 | 0.0 | 2.2 | 2.6 | 0.0 | 15.0 | 14.1 | 15.2 | 8.3 |
| Lebanon | 14.6 | 14.2 | 14.4 | 14.3 | 13.0 | 15.9 | 16.1 | 0.0 | 13.2 |
| Libya | 0.0 | 0.0 | 0.1 | 0.4 | 0.0 | 0.0 | . | 0.0 | 0.0 |
| Mauritania | . | 0.0 | 0.1 | 13.3 | 10.1 | 4.5 | 4.4 | 0.0 | 5.6 |
| Morocco | 0.0 | 0.0 | 0.0 | 0.2 | 0.0 | 0.0 | . | 28.7 | 5.8 |
| Oman | . | 0.0 | 0.1 | 0.0 | 9.6 | 12.2 | 14.1 | 11.0 | 8.5 |
| Palestine | 5.4 | 4.4 | 6.5 | 6.4 | 4.6 | 5.0 | 6.2 | 7.1 | 5.8 |
| Qatar | 0.0 | 1.2 | 0.0 | 2.3 | 0.0 | 14.4 | 11.8 | 10.2 | 6.2 |
| Saudi Arabia | 7.4 | 6.8 | 14.6 | 13.9 | 12.3 | 11.6 | 10.5 | 10.7 | 11.2 |
| Somalia | . | . | . | 0.1 | 0.0 | . | . | 0.0 | 0.0 |
| Sudan | . | . | . | . | 5.9 | . | . | 10.1 | 4.6 |
| Syria | 6.9 | 7.1 | 7.5 | 0.2 | 0.1 | . | . | . | 4.4 |
| Tunisia | 14.8 | 16.1 | 16.1 | 16.8 | 17.0 | 15.6 | 16.6 | 16.4 | 16.2 |
| United Arab Emirates | 11.9 | 0.0 | 0.1 | 0.0 | 3.2 | 3.0 | 14.1 | 2.8 | 5.4 |
| Yemen | . | 6.2 | 6.3 | 5.6 | 6.2 | 6.0 | 6.1 | 6.3 | 5.6 |
| **Region** | **8.3** | **5.7** | **7.4** | **7.1** | **7.0** | **7.8** | **11.1** | **9.2** | **8.2** |

Note: A single dot "." indicates missing data. This may be the case even if trade statistics are filed by the country with the United Nations Comtrade database.

**Appendix Table 2. Cumulative total misinvoicing in the Arab region by HS 2-digit code, 2008-2015**

| HS 2-digit code | HS 2-digit code description | Total flows (Millions of US dollars) | Total flows / total trade (Percentage) |
|---|---|---|---|
| 1 | Live animals | 986 | 5.5 |
| 2 | Meat and edible meat offal | 2,080 | 3.5 |
| 3 | Fish and crustaceans, molluscs and other acquatic invertebrates | 2,258 | 11.6 |
| 4 | Dairy produce; birds' eggs; natural honey; edible products of animal origin, not elsewhere specified or included | 4,321 | 5.7 |
| 5 | Products of animal origin, not elsewhere specified or included | 264 | 17.2 |
| 6 | Live trees and other plants; bulbs, roots and the like; cut flowers and ornamental foliage | 178 | 7.0 |
| 7 | Edible vegetables and certain roots and tubers | 3,086 | 6.8 |
| 8 | Edible fruit and nuts; peel of citrus fruit or melons | 3,752 | 7.8 |
| 9 | Coffee, tea, maté and spices | 1,790 | 6.8 |
| 10 | Cereals | 5,134 | 3.2 |
| 11 | Products of the milling industry; malt; starches; inulin; wheat gluten | 228 | 2.1 |
| 12 | Oil seeds and oleaginous fruits; miscellaneous grains, seeds and fruit; industrial or medicinal plants; straw and fodder | 1,873 | 6.1 |
| 13 | Lac; gums, resins and other vegetable saps and extracts | 166 | 6.1 |
| 14 | Vegetable plaiting materials; vegetable products not elsewhere specified or included | 32 | 6.8 |
| 15 | Animal or vegetable fats and oils and their cleavage products; prepared edible fats; animal or vegetable waxes | 4,062 | 6.4 |
| 16 | Preparations of meat, of fish or of crustaceans, molluscs or other aquatic invertebrates | 778 | 6.3 |
| 17 | Sugars and sugar confectionery | 1,799 | 3.3 |
| 18 | Cocoa and cocoa preparations | 1,258 | 8.5 |
| 19 | Preparations of cereals, flour, starch or milk; pastrycooks' products | 2,671 | 7.6 |
| 20 | Preparations of vegetables, fruit, nuts or other parts of plants | 1,824 | 6.7 |
| 21 | Miscellaneous edible preparations | 3,019 | 10.4 |
| 22 | Beverages, spirits and vinegar | 1,549 | 6.6 |
| 23 | Residues and waste from the food industries; prepared animal fodder | 1,042 | 4.2 |
| 24 | Tobacco and manufactured tobacco substitutes | 2,676 | 7.4 |
| 25 | Salt; sulphur; earths and stone; plastering materials, lime and cement | 4,187 | 8.3 |
| 26 | Ores, slag and ash | 2,787 | 5.7 |
| 27 | Mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral waxes | 137,197 | 12.3 |
| 28 | Inorganic chemicals; organic or inorganic compounds of precious metals, of rare-earth metals, of radioactive elements or of isotopes | 3,570 | 8.6 |
| 29 | Organic chemicals | 21,399 | 16.6 |
| 30 | Pharmaceutical products | 12,785 | 11.3 |
| 31 | Fertilisers | 3,824 | 8.6 |
| 32 | Tanning or dyeing extracts; tannins and their derivatives; dyes, pigments and other colouring matter; paints and varnishes; putty and other mastics; inks | 1,950 | 7.6 |
| 33 | Essential oils and resinoids; perfumery, cosmetic or toilet preparations | 5,561 | 9.9 |
| 34 | Soap, organic surface-active agents, washing preparations, lubricating preparations, artificialwaxes, prepared waxes, polishing or scouring preparations, candles and similar articles, modelling pastes, "dental waxes" and dental preparations with a basis o | 2,327 | 8.6 |
| 35 | Albuminoidal substances; modified starches; glues; enzymes | 575 | 8.5 |
| 36 | Explosives; pyrotechnic products; matches; pyrophoric alloys; certain combustible preparations | 62 | 4.3 |
| 37 | Photographic or cinematographic goods | 268 | 8.4 |
| 38 | Miscellaneous chemical products | 4,691 | 9.2 |
| 39 | Plastics and articles thereof | 34,149 | 12.4 |
| 40 | Rubber and articles thereof | 5,005 | 8.0 |
| 41 | Raw hides and skins(other than furskins) and leather | 1,043 | 16.6 |
| 42 | Articles of leather; saddlery and harness; travel goods, handbags and similar containers; articles of animal gut (other than silk-worm gut) | 2,131 | 11.2 |
| 43 | Furskins and artificial fur; manufactures thereof | 154 | 11.0 |
| 44 | Wood and articles of wood; wood charcoal | 3,814 | 7.3 |
| 45 | Cork and articles of cork | 27 | 8.1 |
| 46 | Manufactures of straw, of esparto or of other plaiting materials; basketware and wickerwork | 53 | 9.8 |
| 47 | Pulp of wood or of other fibrous cellulosic material; recovered (waste and scrap) of paper or paperboard | 435 | 8.8 |
| 48 | Paper and paperboard; articles of paper pulp, of paper or of paperboard | 5,755 | 8.0 |
| 49 | Printed books, newspapers, pictures and other products of the printing industry; manuscripts, typescripts and plans | 1,527 | 11.5 |
| 50 | Silk | 119 | 7.2 |
| 51 | Wool, fine or coarse animal hair; horsehair yarn and woven fabric | 252 | 9.2 |
| 52 | Cotton | 3,338 | 11.9 |
| 53 | Other vegetable textile fibres; paper yarn and woven fabrics of paper yarn | 158 | 9.8 |
| 54 | Man-made filaments; strip and the like of man-made textile materials | 4,324 | 11.7 |
| 55 | Man-made staple fibres | 2,616 | 10.8 |
| 56 | Wadding, felt and nonwovens; special yarns; twine, cordage, ropes and cables and articles thereof | 728 | 9.1 |
| 57 | Carpets and other textile floor coverings | 1,444 | 10.8 |
| 58 | Special woven fabrics; tufted textile fabrics; lace; tapestries; trimmings; embroidery | 1,077 | 10.0 |

| HS 2-digit code | HS 2-digit code description | Total flows (Millions of US dollars) | Total flows / total trade (Percentage) |
|---|---|---|---|
| 59 | Impregnated, coated, covered or laminated textile fabrics; textile articles of a kind suitable for industrial use | 901 | 14.3 |
| 60 | Knitted or crocheted fabrics | 1,730 | 12.6 |
| 61 | Articles of apparel and clothing accessories, knitted or crocheted | 10,180 | 10.9 |
| 62 | Articles of apparel and clothing accessories, not knitted or crocheted | 12,402 | 13.6 |
| 63 | Other made up textile articles; sets; worn clothing and worn textile articles; rags | 3,069 | 11.0 |
| 64 | Footwear, gaiters and the like; parts of such articles | 4,279 | 11.0 |
| 65 | Headgear and parts thereof | 185 | 9.3 |
| 66 | Umbrella, sun umbrellas, walking-sticks, seat-sticks, whips, riding-crops and parts thereof | 65 | 6.6 |
| 67 | Prepared feathers and down and articles made of feathers or of down; artificial flowers; articles of human hair | 258 | 16.8 |
| 68 | Articles of stone, plaster, cement, asbestos, mica or similar materials | 2,577 | 7.8 |
| 69 | Ceramic products | 3,984 | 9.9 |
| 70 | Glass and glassware | 2,765 | 9.5 |
| 71 | Natural or cultured pearls, precious or semi-precious stones, precious metals, metals cladwith precious metal, and articles thereof; imitation jewellery; coin | 22,802 | 4.7 |
| 72 | Iron and steel | 11,391 | 5.8 |
| 73 | Articles of iron or steel | 17,525 | 9.1 |
| 74 | Copper and articles thereof | 6,655 | 12.2 |
| 75 | Nickel and articles thereof | 205 | 5.6 |
| 76 | Aluminum and articles thereof | 9,766 | 10.4 |
| 78 | Lead and articles thereof | 197 | 9.0 |
| 79 | Zinc and articles thereof | 305 | 9.2 |
| 80 | Tin and articles thereof | 29 | 6.2 |
| 81 | Other base metals; cermets; articles thereof | 90 | 6.6 |
| 82 | Tools, implements, cutlery, spoons and forks, of base metal; parts thereof of base metal | 1,557 | 8.5 |
| 83 | Miscellaneous articles of base metal | 2,004 | 9.2 |
| 84 | Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof | 58,086 | 7.9 |
| 85 | Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, and parts and accessories of such articles | 52,903 | 8.8 |
| 86 | Railway or tramway locomotives, rolling-stock and parts thereof; railway or tramway track fixtures and fittings and parts thereof; mechanical (including electro-mechanical) traffic signalling equipment of all kinds | 504 | 5.5 |
| 87 | Vehicles other than railway or tramway rolling-stock, and parts and accessories thereof | 49,440 | 8.5 |
| 88 | Aircraft, spacecraft, and parts thereof | 5,937 | 4.9 |
| 89 | Ships, boats and floating structures | 1,277 | 2.7 |
| 90 | Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instruments and apparatus; parts and accessories thereof | 8,311 | 8.3 |
| 91 | Clocks and watches and parts thereof | 1,198 | 5.4 |
| 92 | Musical instruments; parts and accessories of such articles | 53 | 7.0 |
| 93 | Arms and ammunition; parts and accessories thereof | 77 | 0.7 |
| 94 | Furniture; bedding, mattresses, mattress supports, cushions and similar stuffed furnishings; lamps and lighting fittings, not elsewhere specified or included; illuminated signs, illuminated name-plates and the like; prefabricated buildings | 8,061 | 9.4 |
| 95 | Toys, games and sports requisites; parts and accessories thereof | 1,276 | 8.1 |
| 96 | Miscellaneous manufactured articles | 1,171 | 8.9 |
| 97 | Works of art, collectors' pieces and antiques | 478 | 12.9 |
| 99 | Commodities not specified according to kind | . | . |

*Note 1: A "." indicates missing data. This may be the case even if trade statistics are filed by the country with the UN Comtrade database.*

**Appendix Table 3. Annual total misinvoicing in the Arab region by HS 2-digit code, as a share of total trade 2008-2015 (Percentage)**

| HS 2-digit code | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | Average |
|---|---|---|---|---|---|---|---|---|---|
| 1 | 4.1 | 5.9 | 6.4 | 5.5 | 4.9 | 5.1 | 7.5 | 4.4 | 5.5 |
| 2 | 2.2 | 3.1 | 3.1 | 2.7 | 2.8 | 4.0 | 5.0 | 4.0 | 3.5 |
| 3 | 14.0 | 10.5 | 9.5 | 11.0 | 11.1 | 12.0 | 13.5 | 10.9 | 11.6 |
| 4 | 5.6 | 4.6 | 5.1 | 5.3 | 5.2 | 6.0 | 6.7 | 5.9 | 5.7 |
| 5 | 17.9 | 12.4 | 15.4 | 23.1 | 18.9 | 19.7 | 18.9 | 12.0 | 17.2 |
| 6 | 3.7 | 3.0 | 4.3 | 3.2 | 3.8 | 6.5 | 9.1 | 15.6 | 7.0 |
| 7 | 7.5 | 4.4 | 5.9 | 6.8 | 6.1 | 7.1 | 8.1 | 7.7 | 6.8 |
| 8 | 6.5 | 5.3 | 6.2 | 5.5 | 6.6 | 8.7 | 10.0 | 10.6 | 7.8 |
| 9 | 6.7 | 4.4 | 5.8 | 6.1 | 6.3 | 6.1 | 9.1 | 8.1 | 6.8 |
| 10 | 3.7 | 3.6 | 5.4 | 2.7 | 2.6 | 3.0 | 2.4 | 3.1 | 3.2 |
| 11 | 1.4 | 1.6 | 2.9 | 2.0 | 2.1 | 1.7 | 2.4 | 2.4 | 2.1 |
| 12 | 6.0 | 3.6 | 4.1 | 3.3 | 5.5 | 4.2 | 6.9 | 13.2 | 6.1 |
| 13 | 3.4 | 1.4 | 2.7 | 4.0 | 8.7 | 9.4 | 12.7 | 6.7 | 6.1 |
| 14 | 3.6 | 4.0 | 6.1 | 17.0 | 4.1 | 4.4 | 8.1 | 15.4 | 6.8 |
| 15 | 3.8 | 4.5 | 8.1 | 6.6 | 6.1 | 6.0 | 8.4 | 6.2 | 6.4 |
| 16 | 4.8 | 5.2 | 6.7 | 8.0 | 4.6 | 5.5 | 7.5 | 7.2 | 6.3 |
| 17 | 3.1 | 3.3 | 2.9 | 2.7 | 2.7 | 3.5 | 3.7 | 4.9 | 3.3 |
| 18 | 6.4 | 5.1 | 6.8 | 6.1 | 7.5 | 9.4 | 12.6 | 8.3 | 8.5 |
| 19 | 7.0 | 5.6 | 6.9 | 6.2 | 7.2 | 8.3 | 9.5 | 7.5 | 7.6 |
| 20 | 5.4 | 4.3 | 5.8 | 5.8 | 7.3 | 8.0 | 8.2 | 6.7 | 6.7 |
| 21 | 9.8 | 5.8 | 7.4 | 11.0 | 11.3 | 12.2 | 12.7 | 9.2 | 10.4 |
| 22 | 4.7 | 4.9 | 5.4 | 5.1 | 5.7 | 8.6 | 10.5 | 5.8 | 6.6 |
| 23 | 2.5 | 1.9 | 2.4 | 2.7 | 5.3 | 3.5 | 3.6 | 8.9 | 4.2 |
| 24 | 7.9 | 9.1 | 10.2 | 9.0 | 5.6 | 7.3 | 7.4 | 5.2 | 7.4 |
| 25 | 4.8 | 5.3 | 9.3 | 6.4 | 7.8 | 9.1 | 10.6 | 11.1 | 8.3 |
| 26 | 2.4 | 2.2 | 8.1 | 5.6 | 7.5 | 5.1 | 4.5 | 5.6 | 5.7 |
| 27 | 6.0 | 11.3 | 8.5 | 17.4 | 6.9 | 15.2 | 14.4 | 10.0 | 12.3 |
| 28 | 7.0 | 7.0 | 6.5 | 7.4 | 9.6 | 8.7 | 10.3 | 9.2 | 8.6 |
| 29 | 29.7 | 19.3 | 26.9 | 21.6 | 17.4 | 14.4 | 9.7 | 8.9 | 16.6 |
| 30 | 8.8 | 8.4 | 10.2 | 12.0 | 11.0 | 11.5 | 13.8 | 11.7 | 11.3 |
| 31 | 9.3 | 9.4 | 9.4 | 9.8 | 7.5 | 9.5 | 8.1 | 6.5 | 8.6 |
| 32 | 7.0 | 5.2 | 6.3 | 6.3 | 7.6 | 7.5 | 9.9 | 8.8 | 7.6 |
| 33 | 8.8 | 4.2 | 7.1 | 5.8 | 8.5 | 11.1 | 16.0 | 10.0 | 9.9 |
| 34 | 7.5 | 5.3 | 7.8 | 7.0 | 8.7 | 8.8 | 11.2 | 8.8 | 8.6 |
| 35 | 8.1 | 5.6 | 9.7 | 7.3 | 7.7 | 8.0 | 10.7 | 9.8 | 8.5 |
| 36 | 3.9 | 5.2 | 5.1 | 5.0 | 4.5 | 4.5 | 3.8 | 3.2 | 4.3 |
| 37 | 10.8 | 5.3 | 7.2 | 6.8 | 7.1 | 8.7 | 9.1 | 10.4 | 8.4 |
| 38 | 5.8 | 5.9 | 8.1 | 8.6 | 8.8 | 9.8 | 12.9 | 10.6 | 9.2 |
| 39 | 9.7 | 9.5 | 13.2 | 13.4 | 13.3 | 13.7 | 12.5 | 11.5 | 12.4 |
| 40 | 8.8 | 5.0 | 6.7 | 6.0 | 7.2 | 8.6 | 10.0 | 10.3 | 8.0 |
| 41 | 18.0 | 16.0 | 17.3 | 16.6 | 13.6 | 14.6 | 17.5 | 19.9 | 16.6 |
| 42 | 10.5 | 5.8 | 8.9 | 9.9 | 9.9 | 9.8 | 16.6 | 12.3 | 11.2 |
| 43 | 30.5 | 1.0 | 1.4 | 0.4 | 1.5 | 2.2 | 43.4 | 11.3 | 11.0 |
| 44 | 7.7 | 4.9 | 6.8 | 6.3 | 6.0 | 7.0 | 9.8 | 8.8 | 7.3 |
| 45 | 9.8 | 6.9 | 9.6 | 8.8 | 9.5 | 9.0 | 5.2 | 8.8 | 8.1 |
| 46 | 14.8 | 2.6 | 6.4 | 11.1 | 11.0 | 6.6 | 13.8 | 7.4 | 9.8 |
| 47 | 6.9 | 6.3 | 7.4 | 6.6 | 9.0 | 7.9 | 11.6 | 12.3 | 8.8 |
| 48 | 7.3 | 6.0 | 7.4 | 6.5 | 7.4 | 7.7 | 10.3 | 9.3 | 8.0 |
| 49 | 8.3 | 7.2 | 8.8 | 7.5 | 10.7 | 12.1 | 17.2 | 12.8 | 11.5 |
| 50 | 5.0 | 2.5 | 5.7 | 6.0 | 4.2 | 5.0 | 20.8 | 11.1 | 7.2 |
| 51 | 6.2 | 7.0 | 8.0 | 7.1 | 8.0 | 6.5 | 8.4 | 21.9 | 9.2 |
| 52 | 12.3 | 9.9 | 11.4 | 10.2 | 9.5 | 10.7 | 13.4 | 17.9 | 11.9 |
| 53 | 11.5 | 7.7 | 12.5 | 8.0 | 7.0 | 7.1 | 8.8 | 16.7 | 9.8 |
| 54 | 8.6 | 7.1 | 10.5 | 10.1 | 11.2 | 11.3 | 17.2 | 15.7 | 11.7 |
| 55 | 11.4 | 7.9 | 9.2 | 9.1 | 9.1 | 9.4 | 13.9 | 15.4 | 10.8 |
| 56 | 6.8 | 7.1 | 7.4 | 8.2 | 8.2 | 8.1 | 11.0 | 13.7 | 9.1 |
| 57 | 5.0 | 4.2 | 4.7 | 6.8 | 9.4 | 8.6 | 19.2 | 18.0 | 10.8 |
| 58 | 17.4 | 5.0 | 6.3 | 6.2 | 6.4 | 6.2 | 19.2 | 13.2 | 10.0 |
| 59 | 14.2 | 10.3 | 11.6 | 11.8 | 13.0 | 13.8 | 13.8 | 23.3 | 14.3 |
| 60 | 13.9 | 7.7 | 8.7 | 9.4 | 9.8 | 10.0 | 16.3 | 20.7 | 12.6 |
| 61 | 14.6 | 7.5 | 11.6 | 11.8 | 10.1 | 8.9 | 16.1 | 7.9 | 10.9 |
| 62 | 13.6 | 10.1 | 12.8 | 12.8 | 13.1 | 12.2 | 19.7 | 12.4 | 13.6 |
| 63 | 12.6 | 7.6 | 9.9 | 9.7 | 10.7 | 10.2 | 15.3 | 10.1 | 11.0 |
| 64 | 8.1 | 6.9 | 8.1 | 7.2 | 9.9 | 9.6 | 18.5 | 11.9 | 11.0 |
| 65 | 5.4 | 5.6 | 9.3 | 6.9 | 7.9 | 11.3 | 12.8 | 10.0 | 9.3 |
| 66 | 6.4 | 1.7 | 3.5 | 4.7 | 7.6 | 10.2 | 14.1 | 11.6 | 6.6 |
| 67 | 11.7 | 6.3 | 8.8 | 10.3 | 13.1 | 8.9 | 47.4 | 4.8 | 16.8 |
| 68 | 2.5 | 3.9 | 5.8 | 6.3 | 8.3 | 9.5 | 11.5 | 12.5 | 7.8 |
| 69 | 8.3 | 6.1 | 7.6 | 7.7 | 9.1 | 9.2 | 15.4 | 10.8 | 9.9 |
| 70 | 11.7 | 5.5 | 7.0 | 6.9 | 9.7 | 8.8 | 11.3 | 12.2 | 9.5 |
| 71 | 6.5 | 1.2 | 1.5 | 1.2 | 3.6 | 2.8 | 11.8 | 4.2 | 4.7 |
| 72 | 6.1 | 4.2 | 5.1 | 3.9 | 5.3 | 6.3 | 7.4 | 7.1 | 5.8 |
| 73 | 8.3 | 7.0 | 8.4 | 7.0 | 8.0 | 9.1 | 12.2 | 11.4 | 9.1 |
| 74 | 10.7 | 7.2 | 9.9 | 12.0 | 15.7 | 13.6 | 13.4 | 11.9 | 12.2 |
| 75 | 3.0 | 1.9 | 1.1 | 2.2 | 5.3 | 4.8 | 12.6 | 6.4 | 5.6 |
| 76 | 8.2 | 5.8 | 7.7 | 8.9 | 10.8 | 10.5 | 12.9 | 12.1 | 10.4 |
| 78 | 7.8 | 4.9 | 9.4 | 8.6 | 9.1 | 10.2 | 11.9 | 6.5 | 9.0 |
| 79 | 13.3 | 4.9 | 10.4 | 6.8 | 9.7 | 7.7 | 11.3 | 8.8 | 9.2 |

| HS 2-digit code | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | Average |
|---|---|---|---|---|---|---|---|---|---|
| 80 | 6.7 | 8.8 | 9.9 | 5.8 | 5.6 | 4.8 | 6.0 | 4.7 | 6.2 |
| 81 | 7.0 | 2.3 | 8.4 | 4.5 | 6.9 | 4.4 | 7.2 | 10.7 | 6.6 |
| 82 | 9.9 | 5.1 | 6.1 | 6.0 | 7.6 | 7.8 | 12.5 | 9.9 | 8.5 |
| 83 | 9.3 | 6.0 | 6.9 | 7.6 | 8.1 | 8.5 | 12.8 | 11.0 | 9.2 |
| 84 | 8.4 | 4.7 | 6.4 | 6.1 | 6.0 | 7.7 | 12.0 | 9.5 | 7.9 |
| 85 | 10.3 | 5.6 | 6.9 | 7.8 | 6.7 | 7.5 | 11.5 | 10.8 | 8.8 |
| 86 | 4.7 | 2.2 | 7.9 | 9.4 | 2.4 | 4.8 | 6.4 | 7.1 | 5.5 |
| 87 | 7.5 | 7.3 | 7.6 | 6.9 | 6.1 | 8.4 | 11.5 | 10.6 | 8.5 |
| 88 | 8.7 | 2.2 | 1.2 | 2.2 | 2.4 | 4.2 | 8.0 | 5.8 | 4.9 |
| 89 | 2.6 | 1.5 | 1.1 | 1.9 | 3.0 | 3.3 | 4.6 | 1.6 | 2.7 |
| 90 | 8.5 | 4.3 | 6.8 | 6.4 | 7.3 | 9.0 | 11.0 | 10.5 | 8.3 |
| 91 | 6.0 | 2.0 | 2.0 | 2.0 | 5.1 | 5.8 | 10.5 | 5.4 | 5.4 |
| 92 | 8.1 | 4.0 | 3.0 | 3.6 | 4.3 | 6.1 | 14.1 | 5.4 | 7.0 |
| 93 | 1.4 | 1.3 | 0.5 | 0.6 | 0.4 | 0.6 | 1.1 | 0.4 | 0.7 |
| 94 | 8.2 | 4.5 | 6.6 | 6.9 | 8.1 | 8.3 | 15.1 | 11.4 | 9.4 |
| 95 | 7.9 | 2.9 | 7.3 | 7.1 | 7.4 | 9.6 | 10.8 | 8.4 | 8.1 |
| 96 | 9.9 | 6.3 | 8.6 | 7.9 | 6.7 | 8.6 | 10.3 | 11.1 | 8.9 |
| 97 | 12.5 | 1.3 | 3.1 | 7.2 | 11.2 | 23.3 | 22.3 | 13.3 | 12.9 |
| 99 | . | . | . | . | . | . | . | . | . |

*Note: A single dot "." indicates missing data. This may be the case even if trade statistics are filed by the country with the UN Comtrade database.*

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# ENDNOTES

1 Including differences in valuations and attribution of trade partners; quarantines, seizures of counterfeit and pirated commodities; recording of re-exports (entrepôt-trade), unallocated trade, currency conversions, time lags, and classification differences. See: Javorsek, 2016.
2 Nitsch, 2017.
3 Carrère and Grigoriou, 2015
4 Based on The State of Financing Development in the Arab Region (ESCWA, 2018). Direct FfD inflows include: remittances; official development assistance; net foreign direct investments; international trade tax; humanitarian aid; net foreign portfolio equity inflows; change in claims of the Bank for International Settlements, variance in external debt; innovative and Islamic financing services; debt and interest forgiveness; and private philanthropic grants.
5 Kar and Spanjers, 2015.
6 Alemayehu, 2016, p. 124.
7 World Economic Forum, 2015.
8 The leak of 11.5 million files from the database of the world's fourth biggest offshore law firm, Mossack Fonsec.
9 1.3 million leaked files on offshore companies originating from the tax haven's corporate records.
10 Reuters, 2017.
11 Within the related literature on capital flight, some studies exist, such as Abdullah Almounsor, 2008.
12 Addis Ababa Action Agenda, 2015, p. 8.
13 Including the report of the High-Level Panel on Illicit Financial Flows from Africa, the 2017 report of the United Nations Inter-Agency Task Force on FfD, Global Financial Integrity, and Tax Justice Network.
14 Kar and Freitas, 2012, pp. 21–26.
15 IMF, 2008.
16 Traditional system of transferring money used in Arab countries and South Asia, whereby the money is paid to an agent who then instructs an associate in the relevant country or area to pay the final recipient.
17 Cassara, 2016, pp. 49–72.
18 Volker, 2017.
19 World Economic Forum, 2015.
20 The Rotterdam-Antwerp effect provides a case in point wherein European Union trade figures are artificially inflated as large shares of the its imports arrive through the ports of Rotterdam and Antwerp. These imports are subsequently recorded as intra-European Union exports when moved to their final destination within the European Economic Area (EEA) and the European Union single market.
21 Nitsch, 2017.
22 The magnitude (intensity and direction) by which each category of incentives influences the misinvoicing of trade naturally differs from one country to another. Accordingly, region-wide aggregations and cross-sectional analysis should be probed with scrutiny as they may not necessarily provide an accurate assessment across regions.
23 Jacobson, 2009.
24 Ayadi and others, 2015.
25 Cambridge University Press, 2013, p. 276.
26 Mishra and others (2007) show that the elasticity of tax evasion for tariffs is a decreasing function of the quality of tariff enforcement.
27 Fisman and Wei, 2009, pp. 82–96.
28 Hardy, 2016.
29 Shepherd, 2009.
30 World Trade Organization, 2015, p. 98.
31 Center for Complex Operations, 2016.
32 OECD, 2016a.
33 Carrère and Grigoriou, 2015, p. 17.
34 World Health Organization, 2013.
35 Rijkers and others, 2015.
36 Asongu and Nwachukwu, 2016, pp. 221–246.
37 United States Department of the Treasury. See https://www.treasury.gov/press-center/press-releases/Pages/tg1057.aspx.
38 International Monetary Fund, 2017.
39 OECD, 2016b, p. 152.
40 Qureshi and Mahmood, 2016.
41 The Economist, 2014.
42 The estimation method used in sections III and IV cannot attribute misinvoicing to any one or several motivations in particular.
43 Campos and Sanjay, 2007.
44 Bhagwati and others, 1974, pp. 148–154; Gulati, 1987, pp. 68–78.
45 Weinland, 2016.
46 Patnaik and others, 2012. pp. 891–910.
47 Yalta and Demir, 2010, pp. 41–66.
48 Zafar and Azhar, 2001, pp. 173–185.
49 Mishra and others, 2007; Fisman and Wei, 2004, pp. 471–496.
50 For a case study on informal trade, see, for example Bensassi and others, 2015.
51 Bhagwati, 1964, pp. 389–397.
52 ECLAC, 2016.
53 ECA, 2015, p. 33.
54 ECA, 2015, pp. 94–95.
55 Kar and Freitas, 2012, p. 1.
56 Country specifics play some role in driving the overall trend. For example, Morocco's trade misinvoicing was quite low for all years except for 2015, indicating that data revisions may reduce the 2015 finding when newer data vintages are released. The exclusion of the United Arab Emirates from the sample, for example, creates a consistent upward trend in dollar volumes from 2009 to 2015, as it experienced a large spike in measured trade misinvoicing in 2014.
57 Classifications as resource-based or non-resource-based are sourced from Almounsor (2008). To supplement, Palestine is considered non-resource-based.
58 This finding is robust to the inclusion of HS 27 in both misinvoicing calculations in the numerator and total trade in the denominator. With its inclusion, the figures are, instead, 10.8 per cent of total trade for non-resource-based economies and 8.2 per cent for resource-based economies.
59 Cassara, 2016, pp. 89–110.
60 Douglas, 2017
61 Due to the nature of trade in mineral fuels, differences in valuations, attribution of trade partners and the recording of re-exports (entrepôt trade) are suspected as the primary reasons for mirror trade gaps in HS 27.
62 It should be noted that some lower figures for Comoros, Djibouti, Iraq, Libya and Somalia were excluded due to limited or non-existent data, rather than lack of misinvoicing. Beyond statistical considerations, due to the security situation in each of these countries, it is likely that much of the IFF problem is taking place through channels that would be unrecorded regardless of data availability (such as bulk cash smuggling).
63 ESCWA, 2014, pp. 31–38.
64 Hamwey, 2015.
65 Freund and Portugal-Perez, 2012, p. 5.
66 Hamwey, 2015.
67 For further details on the scenarios and intricacies involved in the establishment of the Arab Customs Union refer to the Arab Development Outlook: Vision 2030 (chapter 6).
68 ESCWA, 2015.
69 Frankel and Romer, 1999, pp. 379–399; Krueger, 1998, pp. 1513–1522; Carrère, 2006, pp. 223–247.
70 Rodrik, 2015; Rodriguez and Rodrik, 2001.
71 Younes, 2010.
72 Kpodar and Imam, 2015.
73 ACCESS recognizes that the Arab Customs Union, along with the proposed Arab common customs code being negotiated with the League of Arab States, needs to be tailored to the issue of IFFs and trade misinvoicing. The ongoing negotiations on tariff structure among members of the union, the trade misinvoicing implications arising from non-unification of the harmonized commodity description system, the use of the Arabian Dinar as a basis for customs valuation, customs declarations, fines and other related customs offences, as well as on the revenue collection mechanism to be enforced within the union, are all influenced by the findings of this report and solutions are provided through ACCESS, in line with SDG 16. ESCWA, 2014.
74 Javorcik and Narciso, 2017, pp. 59–69.
75 Lovatt and Toaldo, 2015.
76 Weiss, 2013.
77 Wippel, 2013, p. 196.
78 Trade reporting gaps for intraregional trade are halved to avoid double counting of flows between two parties for a given commodity category in the two directions.
79 Oman, for example, and until recently the United Arab Emirates, was the sole window to the other GCC markets, and many goods were imported to Oman via Emirates ports. The United Arab Emirates maintains 45 free zones that account for a substantial share of the country's non-oil trade and engages heavily in both inbound and outbound re-export activities. According to the OECD Financial Action Task Force, several money-laundering vulnerabilities have been found in connection to free zones. The European Anti-Fraud Office reported that free zones have been used as a conduit for illegal trade, exploiting the European Union's Generalised Scheme of Preferences.
80 Kellenberg and Levinson, 2016b.
81 These Councils alongside multi-agency units may include officials from various ministries or departments who specialize inter alia in: financial intelligence; banking supervision; trade; import and export administration; transfer pricing; income tax; national criminal investigations; national criminal prosecutions; and anti-corruption.
82. Bahrain, Kuwait, Lebanon, Qatar, Saudi Arabia and the United Arab Emirates. See: OECD, 2017, accessed on 12 April 2017.
83 Financial Action Task Force, 2012.
84 WTO and MDG. Available at https://www.wto.org/english/thewto_e/coher_e/mdg_e/summing_up_e.htm.
85 Francesco Sindico. Unraveling the Trade and Environment Debate through Sustainable Development Law Principles. Available at http://www.esil-sedi.eu/sites/default/files/Sindico_0.PDF)
86 Bhagwati, 1964, pp. 389–397.
87 ECLAC, 2016, p. 124.
88 ECA, 2015, p. 33.
89 ECA, 2015, pp. 94–95.
90 Kar, Dev and Sarah Freitas, 2012, p. 1.
91 United Nations Comtrade database, accessed 3 March 2017.
92 Gaulier and Zignago, 2010. BACI is a French acronym of Base pour l'Analyse du Commerce International.
93 One limitation to this comparability is data coverage; comprehensive annual data coverage is not available for some countries in the sample.
94 The effects of weighting to eliminate outliers and/or data points are particularly evident in estimating trade gaps for the region (including for HS 27). A comparison between weighted and unweighted trade gaps in the region demonstrates that the weighted version provides a significantly less volatile image of misinvoicing than unweighted estimates.
95 Kar and Spanjers, 2015.
96 Kar and LeBlanc, 2013.
97 Nitsch, 2017.

Illicit financial flows (IFFs) are constantly evolving outpacing detection at every corner. IFFs undermine the rule of law, distort macro-economic stability, and raise severe security complications for the Arab region. These flows constitute substantial leakages to domestic public revenues that could have otherwise been harnessed to finance national and regional efforts devoted to achieving the 2030 Agenda for Sustainable Development.

Illicit flows are increasing nearly twice as fast as global output. They are driven by a myriad of socio-economic and governance infractions, including public embezzlement, bribery, tax evasion, profit shifting by multinational corporations, money laundering, drug trafficking, and financing terrorism to name a few.

Trade misinvoicing is a predominant form and channel used to move money undetected across borders. This report provides insight into the scope, conduits and scale of commodity trade misinvoicing in the Arab region. It finds that the elimination of IFFs by 2030 could save the region billions of dollars annually. Curbing illicit financial flows remains a critical ingredient to ensure the effective mobilization of domestic resources, galvanize international private finance, foster enhanced forms of international development cooperation, and to safeguard that trade continues to be a source and engine for growth as well as secure sustained paths to debt management.