The Economist

Trade and money laundering

Uncontained

Trade is the weakest link in the fight against dirty money

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CUDDLY toys don't have to be stuffed with cocaine or cash to be useful to traffickers. A few years ago American customs investigators uncovered a scheme in which a Colombian cartel used proceeds from drug sales to buy stuffed animals in Los Angeles. By exporting them to Colombia, it was able to bring its ill-gotten gains home, convert them to pesos and get them into the banking system.

This is an example of "trade-based money laundering", the misuse of commerce to get money across borders. Sometimes the aim is to evade taxes, duties or capital controls; often it is to get dirty money into the banking system. International efforts to stamp out 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," says John Cassara, who used to work for America's Treasury department.

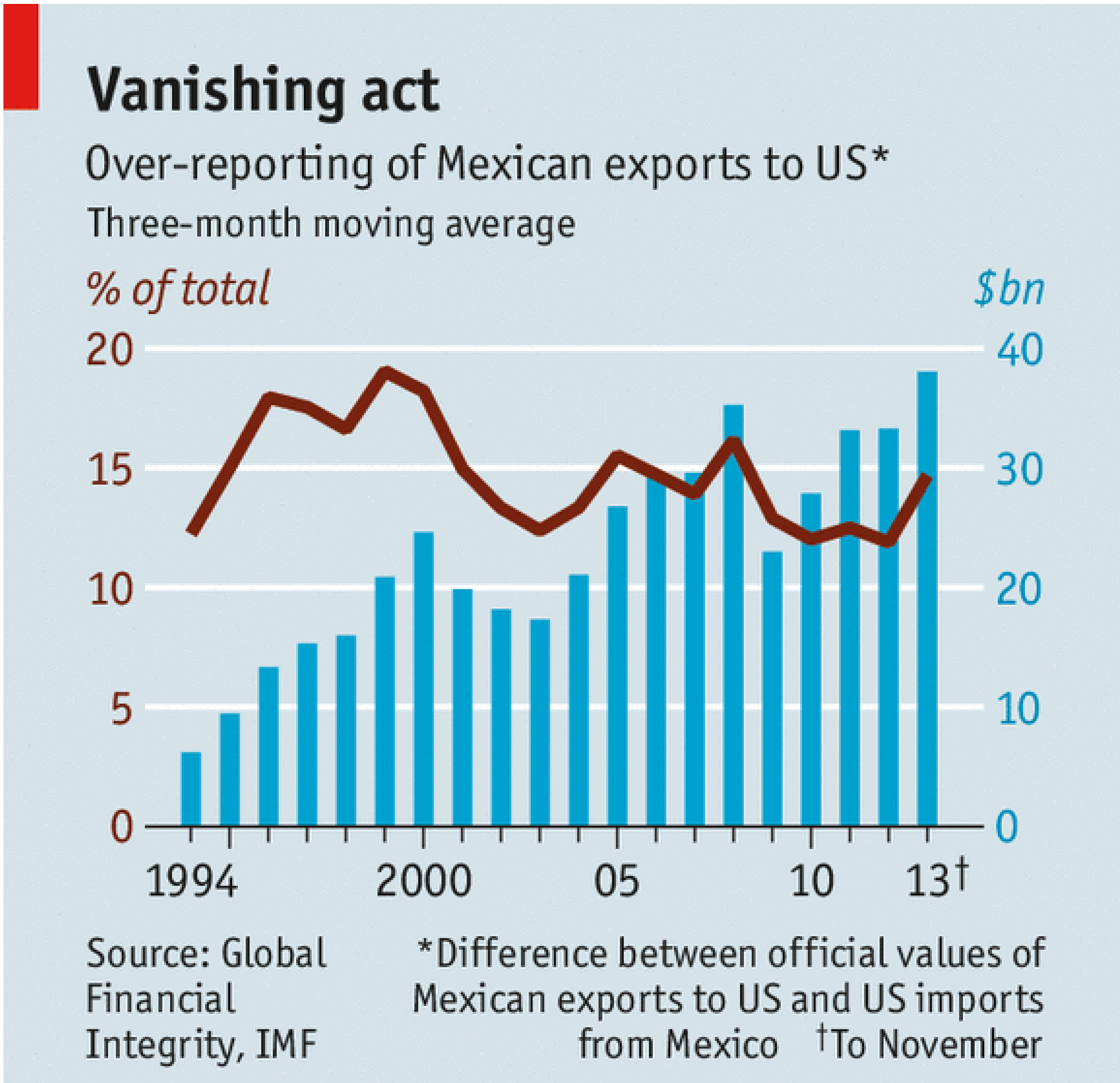
Adepts include traffickers, terrorists and the tax-evading rich. Some "transfer pricing" —multinationals' shuffling of revenues to cut their tax bills—probably counts, too. Firms insist that tax arbitrage is legal, and that the fault, if any, lies with disjointed international tax rules. Campaigners counter that many ruses would be banned if governments were less afraid of scaring off mobile capital.

Trade is "a ready-made vehicle" for dirty money, says Balesh Kumar of the Enforcement Directorate, an Indian agency that fights economic crime. A 2012 report he helped write for the Asia/Pacific Group on Money Laundering, a regional crime-fighting body, is packed with examples of criminals combining the mispricing of goods with the misuse of trade-finance techniques. Using trade data, Global Financial Integrity (GFI), an NGO, estimates that $950 billion flowed illicitly out of poor countries in 2011, excluding trade in services and fraudulent transfer pricing. Four-fifths was trade-based laundering linked to arms smuggling, drug trafficking, terrorism or public corruption.

The basic technique is misinvoicing. To slip money into a country, undervalue imports or overvalue exports; do the reverse to get it out. A front company for a Mexican cartel might sell $1m-worth of oranges to an American importer while creating paperwork for $3m-worth, giving it cover to send a dirty $2m back home. One group of launderers was reportedly caught exporting plastic buckets that cost $970 each from the Czech Republic to America.

To lessen the risk of discovery the deal may be sent via a shell company in a tax haven with strict secrecy rules. This may mean using a specialist "re-invoicing" firm to "buy" the oranges at an inflated price with an invoice to match and charge the importer the true price. The point is to get paperwork to justify an inflated transfer to the seller. Re-invoicers are used by multinationals to shift profits around, which gives them a veneer of respectability, says Brian LeBlanc of GFI—but they also "feed a giant black market in the offshore manipulation of paperwork".

According to American customs



investigators, Mexican drug gangs copied trade-based money-laundering techniques from Colombian ones. They have since become experts. Before going on the run in 2007, Blanca Cazares (aka "The Empress") repatriated profits for the Sinaloa cartel by trading toys, food and, in a touch of class, silk. Official figures for the past 20 years put Mexican exports to America well above American imports from Mexico (see chart). The discrepancy is more than accounting or data errors can plausibly account for. One reason to over-report exports would be fraudulently to collect export subsidies but these have been cut in Mexico. The logical explanation, says Mr LeBlanc, is that Mexican groups are using trade-based laundering to bring dollars into Mexico.

American authorities have ratcheted up penalties for banks that assist money-launderers, knowingly or not. In 2012 they reached a $1.9 billion settlement with HSBC after concluding that Latin American drug gangs had taken advantage of lax controls at its Mexican subsidiary. And last year they imposed a $102m forfeiture order on a Lebanese bank implicated in a complex scheme involving the export of used cars to West Africa with the proceeds funnelled to Hizbullah, an Islamist group.

Alternative remittance systems and currency exchanges, such as the trust-based *hawala* networks in Asia and the Middle East, and Latin America's Black Market Peso Exchange (BMPE), offer another route to launder money through trade. Organised crime funnels billions a year through the BMPE, much of it to legitimate importers who cannot get enough dollars through official channels because of currency restrictions, for instance in Argentina and Venezuela. Some schemes combine formal and informal finance. A recently leaked Turkish prosecutor's report describes an alleged conspiracy involving Turkish front companies and banks, an Iranian bank and money-exchangers in Dubai. By marking up invoices for food and medicine allowed into Iran—to as much as $240 for a pound of sugar—the scheme gave Iranian banks access to hard currency from Iran's oil sales that was locked in escrow accounts overseas, to be transferred only for approved transactions.

Trade-based techniques are also used to evade taxes and capital controls. Underinvoicing of imports, particularly of construction materials, by Philippine firms dodging customs duties and value-added tax means an estimated quarter of the country's imports do not show up in national statistics. India's official exports to the Bahamas shot up one-thousand-fold between 2008 and 2011, probably because of a surge in over-invoicing by Indians taking home money held in undeclared accounts, before a tax-transparency agreement between the two countries came into force. Because Chinese firms and individuals sought to evade capital controls and repatriate money parked in Hong Kong, exports from the Chinese mainland to Hong Kong were over-reported by $101m in 2012—nearly as much as total foreign direct investment into China that year.

Anything but transparent

Urged on by the Financial Action Task Force, an inter-governmental body that sets global anti-money-laundering standards, governments have begun to focus on the relation between trade and black-market money. American customs officials are arguing for the creation of a global network of "trade transparency units" which would share trade paperwork and set international standards for trade data. (So far they are mostly active in the Americas.) A more radical approach would be to set banklike compliance requirements for firms that trade across borders. But the extra red tape would be costly—and hard to justify in the face of a problem that, though clearly big, is unquantifiable.

In the meantime, launderers who curb their greed and invoice goods worth $10 for $9, or $11, will probably continue to get away with it. A dodgy deal is almost impossible to spot if the pricing is only slightly out and you see just one end, says one American investigator. “You can study the slips all day long, and all you see is stuff being imported and exported.”

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