Three U.S professors, analyzing import and export transactions between Russia and the U.S., have found that phony prices led to as much as $8.92 billion in capital flight from Russia to the U.S. in 1995-1999.

Even with calculations providing the most conservative estimate, at least $1.86 billion illegally left Russia during that period. Assuming a 25 percent average tax rate, the lower figure would mean nearly half a billion dollars in illegal tax evasion, and the higher one more than $2 billion in taxes lost, just in trade involving the U.S.

The authors of the study are [Dr.] Maria E. de Boyrie, New Mexico State University; [Dr.] Simon J. Pak, Penn State University and [Dr.] John S. Zdanowicz, Florida International University.

Their report, "Estimating the Magnitude of Capital Flight due to Abnormal Pricing in International Trade: The Russia-USA Case," is a working paper of the Center for International Business and Education Research at Florida International University and is currently under review for publication by an academic journal.

Professor Pak said the findings have not been presented either to academics or to officials in Russia.

The three professors analyzed millions of import and export transactions between the U.S. and Russia...
in 1995-1999. They sought to estimate the economic impact of over-invoiced and under-invoiced Russian imports and exports to and from the U.S. and to determine if capital movement or capital flight through trade was due to money laundering, tax evasion or portfolio manipulation.

They concluded that capital movement through trade in this case was caused by either money laundering and/or tax evasion. They noted that unreported money is commonly stashed in foreign bank accounts or transferred to Russia in undocumented cash. And they pointed out, capital flight erodes the country's tax base, increases public deficit, reduces domestic investment and destabilizes financial markets.

Methodology

Their research was based on the data contained in the U.S. Merchandise Trade Data Base, which is produced by the U.S. Department of Commerce and Bureau of Census. The 1995-1999 annual data base contains transactions data for over 15,000 import commodity codes and over 8,000 export commodity codes, and details over 18 million import transactions and 13 million export transactions per year.

The database shows information for some 235 countries and the 44 U.S. custom districts, and differentiates between air and sea transportation. It does not include the names of the individuals or firms involved in the transactions.

The authors developed a matrix with over 5.5 million cells, each with price data based on the transactions related to U.S. import or export of a particular commodity from and to a specific country, as well as to and from the world. Then, they compared the prices of Russia's imports and exports to and from the U.S. to the upper and lower quartile prices of similar products imported and exported from the U.S. by all countries in the world. The dollar value of price deviations was estimated and aggregated. The analysis resulted in estimates of capital flight from Russia to the U.S. ranging from $1.01 billion to $4.85 billion during 1995-1999.

The figures are per year. That is, $1.01 billion and $4.85 billion are the total amount imported and exported in 1998 and 1999, respectively (e.g., $1.01 = 679,003,202 (exports) + 331,256,005 (imports) for 1998). One is the lowest amount; the other is the highest amount. The figures for the remaining years fall in between these two values. It is based on price data based on all the trade United States did, not just Russia.

Based on the upper/lower quartile prices of U.S. trade with all countries, capital flight from Russia to the U.S. during the five-year period covered by the study was about $8.92 billion. This resulted from $7.24 billion under-invoiced exports from Russia to the U.S. and $1.68 billion over-invoiced imports into Russia also from the U.S. Then, they compared Russia's individual import and export transaction prices with the U.S. and determined the dollar value of price deviations based on Russia/U.S. import and export prices. This resulted in estimated capital flight from Russia to the U.S. ranging from $244 million to $550 million annually during the same period. Results are based on U.S./Russia upper/lower quartile prices. However, if they used average U.S./Russia trade prices, the total capital shifted from Russia to U.S. during 1995-1999 was $1.86 billion. So, Pak says the true figure is somewhere between the $1.86 billion and $8.92 billion.

How it had all begun

Pak explained how he and his colleagues got involved in the study. "In 1990, I was at Florida International University. The Miami banking community asked for some trade data published by the U.S. Census Bureau. They put out 2 CDs a month
— one on exports and the other on imports," he said. "Normally, you do not expect a wide variation of prices. We [Prof. Zdanowicz and I] found discrepancies in prices. We thought it was an error. It turned out there are situations where importers and exporters manipulate trade and prices," he added. "In 1998, we found over 600,000 units of single lens reflex cameras imported to U.S. at an average price of $239, which was reasonable. Then the same year, the U.S. re-exported nearly 200,000 units of single lens reflex cameras to Japan at less than $3.25. "We do not have access to company names."

In another case, he said, "We were importing razor blades from the Cayman Islands at $18 each, from Panama at $29 each and from Colombia at $35 each! The Cayman Islands does not produce anything!" Washington Customs in 1991 sent 16 people to talk with us. One inspector in Miami Customs jumped up said, "That is why so many razor blades are rusting in a warehouse on the river." So they could declare a loss and reduce taxable income by the 'price' of each blade," Pak explained.

Pak said he and Zdanowicz had been trying to get U.S. Customs to institute systematic investigations. In 2002, U.S. Senator Byron Dorgan sponsored a bill that appropriated $2 million to support their research in the U.S. Currently, they are analyzing the entire U.S. export/import data for several years and they will report next year. He said, "We hope there will be changes in how the U.S. government inspects import and export prices. Customs is aware of what we have been doing for 13 years."

Greater scrutiny by the U.S. customs could affect prices that Russian importers and exporters claim.

The report notes that since the massive out-

It blamed the failures of Russian policy on the absence of necessary laws and institutions. "Russia needed to adopt effective inspection at customs," Pak said.

Report reflects Tikhomirov's view

Noting that the export of capital through foreign trade by mispricing goods and double invoicing has been described before, the authors credit Vladimir Tikhomirov, a Russian academician, for publishing a journal article in 1997, which asserted that the level of capital flight through trade and trade can be estimated by calculating the difference between Russian export/import prices and the existing world prices for the same commodities.

Using the Russian average contract and average world prices for listed commodities published in the quarterly bulletin of the Russian Government Center of Economic Analysis, or Tsentr Ekonomicheskoi

The five export product categories least susceptible to capital flight were:
First: ships, boats and floating structures;
Second: cotton, including yarns and woven fabrics;
Third: plastics and plastics articles;
Fourth: ores, slag and ash;
Fifth: vegetable textile fibers, yarns and fabrics woven of vegetable textile fibers, paper.


The five export product categories most susceptible to capital flight were:
First: inorganic chemicals; organic or inorganic compounds of precious metals, of rare-earth metals, of radioactive elements or of isotopes;
Second: natural or cultured pearls, precious or semiprecious stones, precious metals; precious metal clad metals and articles; imitation jewelry; coins;
Third: iron and steel;
Fourth: aluminum and aluminum articles;
Fifth: printed books, newspapers, pictures and other printed products; manuscripts, typescripts and plans.

The five import product categories least susceptible to capital flight were:
First: Cotton, including yarns and woven fabrics;
Second: Sugars and sugar confectionery;
Third: Footwear, gaiters and parts;
Fourth: Photographic or cinematographic goods;
Fifth: Coffee, tea, mate and spices.


The five import product categories most susceptible to capital flight were:
First: ships, boats and floating structures;
Second: cotton, including yarns and woven fabrics;
Third: plastics and plastics articles;
Fourth: ores, slag and ash;
Fifth: vegetable textile fibers, yarns and fabrics woven of vegetable textile fibers, and paper.


The five imports products most susceptible to capital flight were:
First: nuclear reactors, boilers, machinery and mechanical appliances; parts;
Second: electrical machinery and equipment and parts; sound recorders and reproducers, television recorders and reproducers, parts and accessories;
Third: meat and edible meat;
Fourth: aircraft, spacecraft, and parts;
Fifth: vehicles, other than railway or tramway rolling stock, and parts and accessories.