

# The Global Illicit Trade Environment Index

A Briefing by the Transnational Alliance to Combat Illicit Trade



**ISRAEL**

# Global Illicit Trade Environment Index

## Israel Country Report

### Executive Summary

A densely-populated country on the south-eastern shore of the Mediterranean Sea, Israel has faced relentless security challenges since its creation in 1948. Its recurrent wars with neighboring countries and the protracted conflict with Palestinians have profoundly marked and continue to dominate the country's political dynamics and socio-economic environment.

Despite finding itself in a volatile geopolitical situation, Israel is a vibrant market economy capable of attracting sizeable foreign investment inflows. It plays a leading role in the export of cut diamonds, pharmaceutical products and technological equipment, all of which are vulnerable to illicit trade. In fact, Israel has grappled with illicit trade in arms, human organs and tobacco for years.

Over the past two decades, in particular, its high-tech industry has been on the cutting edge on the world scene. According to a survey conducted by the OECD in 2018, Israel finds itself in its 15<sup>th</sup> consecutive year of economic expansion characterized by low and falling unemployment and sound public finances.<sup>1</sup> The economic performance is sustained by an independent judicial system.

To inform the policy response to illicit trade, the Transnational Alliance to Combat Illicit Trade (TRACIT) commissioned the Economist Intelligence Unit (EIU) to produce the Global Illicit Trade Environment Index. It evaluates 84 countries on their structural capability to effectively protect against illicit trade, highlighting specific strengths and weaknesses across 25 policy, legal, regulatory, economic, trade, institutional and cultural indicators.

The findings are intended to help policy makers: (i) better understand the regulatory environment and economic circumstances that enable illicit trade; (ii) identify areas that merit greater attention; and (iii) formulate strategies to address the serious threats posed by illicit trade.

Against this background, it is critical that Israel's trade growth and economic expansion are accompanied by concurrent efforts to guard against the debilitating effects of illicit trade. One indication of Israel's structural capability to effectively address illicit trade is evidenced by its performance in the 2018 Global Illicit Trade Environment Index, where it ranks 21<sup>st</sup> out of 84 countries under evaluation. With an overall score of 73 (out of 100), Israel matches the strong performance exhibited by most Western European countries. In addition, it stands out as the best performing country in the Middle East region, which scores an average of only 50.

Amongst the four categories examined by the Index, Israel registers its strongest performance in absolute terms in the customs environment area, where it ranks 32<sup>nd</sup> and receives a score of 83.3. The presence of a functioning Authorized Economic Operator (AEO) program and an effective customs recordal system have contributed decisively to this outcome.

Israel's score in the supply and demand area (71.5 points) is also significantly higher than the global average (50.5 points).

The gap with the global average is less pronounced in the government policy area (73.6 points against an average of 62). In this category, Israel's good performance stems from the presence of solid institutions, the professionalism of its law enforcement officials, including their ability to employ special investigative techniques, and the quality of interagency collaboration. However, like a number of other countries in the Middle East, Israel's score could be improved if it committed itself to ratify and implement the full spectrum of international illicit trade-related treaties.

be adequate, Israel lags behind in terms of publication of data on trade-related IP infringements and drug seizures. Israel's score is also weighed down by its non-accession to Annex D of the Kyoto Convention.

It is worth highlighting that the Index is a measure of a country's structural capability to effectively protect against illicit trade, and not its actual performance—past or future.

In the coming years, Israel will thus need to leverage its potential in various directions. For example, it will be important to ensure that persistent economic disparities and lack of social cohesion, two factors emphasized by the OECD in its 2018 report,<sup>2</sup> do not combine to contribute to increases in illicit trade.

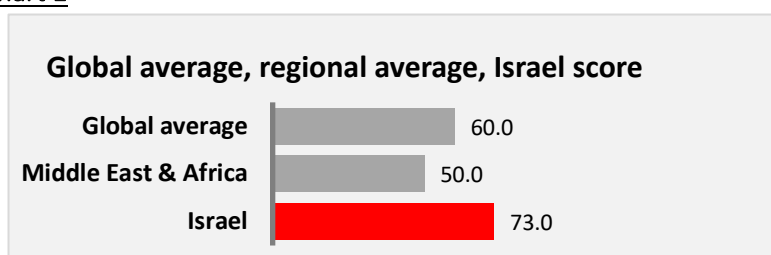
The country must also consider ways to ensure that its regulations and tax policies are not counterproductive and do not end up incentivizing illicit trade. For example, illicit tobacco trade has steeply increased due to high excise taxes (accounting for about 27% of the market<sup>3</sup>) and new regulations that standardize tobacco packaging can further increase the

demand for counterfeit and illicit products.

Industry and consumers also have a role to play in fighting illicit trade. Therefore, regulatory policies and tax policies in relation to consumer goods (legal and illicit)

should enable consumers to more readily identify illicit, illegal and fake products; and to make informed choices about legal products in accordance with their individual wishes and needs. Informed

**Chart 1**



Although Israel's score of 58.8 in the area of transparency and trade is still above the global average (52.6), this is the area where Israel's performance is the lowest. While its handling of FTZs is considered to

decisions enhance the individual health and well-being of consumers.

Additionally, it is of paramount importance for Israel to continually rely on the full strength of its institutions, regulatory frameworks and operational capabilities to prevent the entrenchment of organized crime in society. Some estimates indicate that organized crime in Israel generates as much as NIS 50 billion (USD14 billion) each year, with Israel's crime groups having branches in Europe, America, Africa, Australia, and Asia.<sup>4</sup>

In its 2018 evaluation of Israel, the Financial Action Task Force (FATF) estimated that “the overall threat deriving from serious organized crime and related-money-laundering is considerable [...]” The FATF also emphasized the major threat posed by methods used for terrorist financing in Israel. Sources and channels identified for this purpose include “smuggling of goods, valuables and funds through border crossings, including through trade [...]”<sup>5</sup>

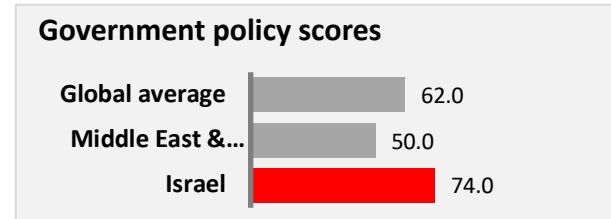
## Category 1: Government policy

This category of the Index measures the availability of policy and legal approaches to monitoring and preventing illicit trade. It measures the extent to which an economy has entered into 14 conventions related to illicit trade; its compliance with FATF recommendations on money laundering; its stance on IP protection; its approach towards corruption; law enforcement techniques in an economy; the extent of interagency collaboration; and its level of cyber-security preparedness.

Israel's rank of 25 out of 84 places it in the higher half of the Index (see Chart 2). The country receives top scores on both law enforcement techniques and interagency collaboration.

Israeli authorities are empowered to use a wide range of investigative techniques. The Customs Authority, for example, is specifically authorized to conduct “controlled deliveries” and resorts to this technique on an ongoing basis. The Police employ undercover agents in investigations dealing with, among others, drugs, weapons, human trafficking and other illicit trade.

Chart 2



Israeli law enforcement and customs authorities formally and regularly collaborate on countering illicit trade.

The country's compliance with FATF standards has also been positively assessed (85.6 points). In 2018, Israel officially joined the FATF following the publication of a mutual evaluation report which concluded that “Israel has implemented an Anti-Money Laundering and Countering Financing of Terrorism (AML/CFT) system that is effective in many areas. Particularly good results are being achieved in the areas of ML/TF risk assessment and risk understanding, investigation and

prosecution of ML and TF, including the use of financial intelligence, targeted financial sanctions related to terrorism

financing, preventing misuse of legal structures, and co-operating domestically and internationally.”<sup>6</sup>

The Government has given high priority to the recovery of criminal assets, which is evidenced by the fact that EUR 24.6 worth of proceeds and instrumentalities of crime were confiscated between 2013-2017.

At the same time, the FATF emphasized the need for Israel to strengthen the supervision and implementation of preventive measures. The FATF equally recognized public sector corruption as an ongoing issue, referring in particular to the identification of repeated corruption practices affecting municipal authorities.

On corruption, however, the Index gives Israel a very respectable score (62.5, rank 27 out of 84) in view of the solid judicial system in place to tackle this problem and the pro-active stance of its authorities in the investigation of potential corruption cases.

Israel’s ranking is aligned with the evaluation provided by Transparency International (TI), which in 2018 gave Israel the 34<sup>th</sup> position out of 180 countries. TI measures the perception of levels of public sector corruption according to experts and business people. Nonetheless, it should be noted that the perception of corruption in Israel has been on the increase since 2016.<sup>7</sup>

Israel receives a score of 75 (15<sup>th</sup> out of 84 countries) in terms of IP enforcement. Over the past few years, the country has carried out significant reforms in this area on the institutional, regulatory and law enforcement fronts. These enhancements were necessary to sustain the country’s increasing role as one of the world’s hubs

for global innovation.<sup>8</sup> In this context, the Customs Administration is authorized to seize goods used or suspected of use in the perpetration of a crime, including crimes relating to intellectual property.

While existing administrative and criminal sanctions should be systematically enforced to deter illicit activity, in addition to court-imposed penalties and fines, consideration should be given to rescinding business licenses from retailers, manufacturers and distributors involved in illegal trade.

Where Israel lags behind is in its commitment to international treaties. On this indicator, its score is in lowest half of the surveyed countries. Acceding to the full range of international instruments dealing with illicit trade is important for multiple reasons, including to ensure the availability of legal bases for international cooperation and the ability to smoothly assist other countries in cross-border investigations and information exchange.

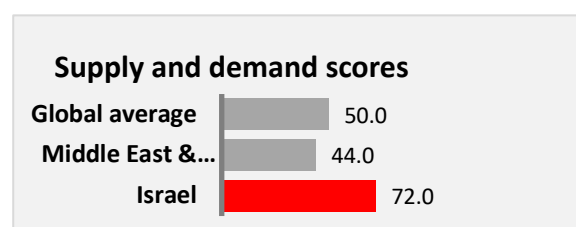
## Category 2: Supply and demand

This category measures the domestic environment that encourages or discourages the supply of, and demand for, illicit goods, including the level of corporate taxation and social security burdens, the quality of state institutions, labor market regulations, and perceptions of the extent to which organized crime imposes costs on business.

In terms of tax and security burdens, Israel receives a positive score of 87.5, placing it among the Index’s 10 best performing economies.

Illicit trade is notoriously linked to organized crime. It results in a considerable loss of tax and duty revenue for governments, which is effectively transferred to help fund organized crime

Chart 3



as well as terrorist groups. As far as the perception of organized crime is concerned, Israel received a score of 65; and it is ranked 51<sup>st</sup> position out of 137 countries on the World Economic Forum Global Competitiveness Report (2017-2018).

## Category 3: Transparency and trade

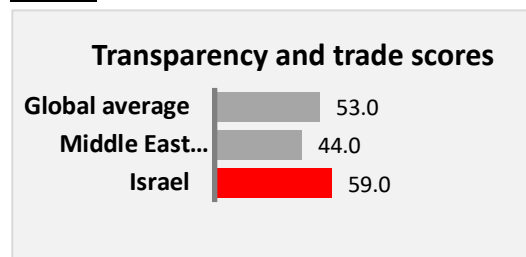
This category measures an economy's transparency regarding illicit trade and the degree to which it exercises governance over its FTZs and transshipments. Indicators include quality of consignment tracking and tracing services; the adoption of Annex D of the Revised Kyoto Convention (RKC), which seeks to ensure standardized customs procedures in customs warehouses and FTZs; the extent of monitoring and oversight at FTZs; and the extent to which governments report their efforts and share information to fight illicit trade.

Israel's average score in this category is slightly above the global average. The country receives the top score on its

management of its only FTZ located in the southern port of Eilat. Under the 1985 Eilat Free Trade Zone Law, authorized enterprises are entitled to a series of benefits that are primarily tax-related and seek to encourage tourism. Trade conducted via Eilat port is subject to the same procedures as imports generally. In addition to customs inspection points within Eilat port, as in other Israeli ports, inspection posts are maintained on the main roads out of Eilat, enabling customs officials to inspect vehicles travelling from the FTZ to the center of the country, to oversee and monitor goods purchased in Eilat or imported.

The overall score in this category is weighed down by Israel's lack of accession to Annex D of the revised Kyoto Convention as well as inadequate levels of information sharing and reporting. For example, the Central Bureau of Statistics does not appear to publish statistics on trade-related IPR infringements. The

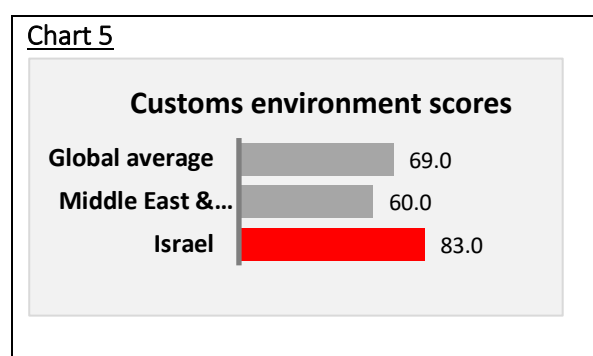
Chart 4



Justice Ministry does not provide such data or statistics either. Similarly, there is no systematic or regular publication of data or statistics on drug-related seizures. On the other hand, reporting on efforts to combat human trafficking receives high marks.

## Category 4: Customs environment

This category measures how effectively an economy's customs service manages its dual mandate to facilitate legal trade while also preventing illicit trade. It consists of five indicators: percentage of shipments physically inspected; the time taken for customs clearance and inspection; the extent of automation of border procedures; the presence of Authorized Economic Operator (AEO) programs; and the presence of customs recordal systems.



Israel's average score (83.3) is significantly higher than the global average. The country receives top scores in relation to its AEO program and IP customs recordal system.

Launched in 2011, the AEO program works on the basis of a formal customs procedure operated through voluntary adherence. Participating operators are validated by the customs authority when they meet a set of compliance and security requirements. Crucially, customs are in a position to extend or revoke AEO status after conducting follow-up inspections.<sup>9</sup>

Israel also operates an effective customs recordal system whereby brand owners can register their IP rights with the customs authorities. This ensures the possibility to interdict shipments

containing suspected infringing goods without the need for customs to receive a specific request by concerned brand owners.

A higher degree of automation in border procedures (Israel ranks 34<sup>th</sup> out of 84 countries) may be usefully implemented to further reduce opportunities to engage in corrupt practices and thus volumes of incoming illicit goods.

In Israel, the percentage of shipments physically inspected is lower than in most countries. This may facilitate illicit trade flows, especially in countries that do not run effective risk-management processes.

## Conclusions

In a timespan of 60 years, Israel has undergone an impressive transformation from an agrarian country into a sparking high-tech economy outperforming all other countries in the region.

When assessed on its structural capabilities to guard against illicit trade, it receives scores in the top half for all four policy categories under examination. On almost all accounts, results from the Index reflect good levels of preparedness to face the threats stemming from illicit trade. The country relies on solid institutions, modern regulatory frameworks and competent law enforcement personnel. Its vigorous economy continues to register steady growth. However, Israel's strong performance and the sophistication of its economy have created new vulnerabilities.

One set of challenges is posed by organized crime and an accrued risk of money laundering via the exploitation of complex financial schemes for money laundering. In 2017, a senior financial

fraud investigator argued before a Parliamentary panel that organized crime was widespread in the country and that its wealth and strength were the result of under-estimation by law enforcement of the magnitude of the problem.<sup>10</sup>

Another set of challenges is linked to Israel's peculiar geopolitical context and the hostility it continues to face from several countries in the region and beyond. Cross-border smuggling has been pointed out as one of the sources of terrorist financing.

Israel has all the credentials to play a leading role in the region and act as an

incubator for cutting-edge policies to tackle illicit trade. Its undeniable achievements should now be leveraged to ensure they do not offer a breeding ground for illicit trade. This requires action on different fronts, starting with the implementation of sound crime-prevention strategies via continued adherence to, *inter alia*, FATF policies and the ratification of the full spectrum of illicit-trade related treaties. Likewise, it will be important for Israel to sustain its economic growth by avoiding excessive levels of taxation that can inadvertently stimulate illicit trade and cause, in turn, the erosion of key State revenues.

## NOTES

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<sup>1</sup> [www.oecd.org/eco/surveys/Israel-2018-OECD-economic-survey-overview.pdf](http://www.oecd.org/eco/surveys/Israel-2018-OECD-economic-survey-overview.pdf)

<sup>2</sup> [www.oecd.org/eco/surveys/Israel-2018-OECD-economic-survey-overview.pdf](http://www.oecd.org/eco/surveys/Israel-2018-OECD-economic-survey-overview.pdf)

<sup>3</sup> <https://m.knesset.gov.il/EN/activity/mmm/me04049.pdf>; Also: [www.europeanbusinessreview.eu/page.asp?pid=2449](http://www.europeanbusinessreview.eu/page.asp?pid=2449)

<sup>4</sup> [www.tabletmag.com/jewish-news-and-politics/279808/a-field-guide-to-israeli-organized-crime](http://www.tabletmag.com/jewish-news-and-politics/279808/a-field-guide-to-israeli-organized-crime)

<sup>5</sup> [www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-Israel-2018-Executive-Summary.pdf](http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-Israel-2018-Executive-Summary.pdf)

<sup>6</sup> [www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-Israel-2018-Executive-Summary.pdf](http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-Israel-2018-Executive-Summary.pdf)

<sup>7</sup> [www.transparency.org/news/feature/corruption\\_perceptions\\_index\\_2017?gclid=Cj0KCQiAzKnjBRDPARIsAKxfTRDcftlii59E8UGOetQVCUz nkK8IzEDn4N\\_iqqKQrRvbfGdPyW1fU-8aAl\\_eEALw\\_wcB](http://www.transparency.org/news/feature/corruption_perceptions_index_2017?gclid=Cj0KCQiAzKnjBRDPARIsAKxfTRDcftlii59E8UGOetQVCUz nkK8IzEDn4N_iqqKQrRvbfGdPyW1fU-8aAl_eEALw_wcB)

<sup>8</sup> [www.luzzatto.co.il/en/about/ip-in-israel](http://www.luzzatto.co.il/en/about/ip-in-israel)

<sup>9</sup> [www.wcoomd.org/-/media/wco/public/global/pdf/topics/facilitation/instruments-and-tools/tools/safe-package/aeo-compendium-2017.pdf?db=web](http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/facilitation/instruments-and-tools/tools/safe-package/aeo-compendium-2017.pdf?db=web)

<sup>10</sup> [www.timesofisrael.com/police-binary-options-is-run-by-crime-bosses-has-grown-monstrous-in-size/](http://www.timesofisrael.com/police-binary-options-is-run-by-crime-bosses-has-grown-monstrous-in-size/)