EVERYTHING
EVERWHERE
ALL AT ONCE

Understanding the Implications of the Belt and Road Initiative on Trade-Based Money Laundering (TBML) and Illicit Supply Chains

Dr. Alexander Kupatadze & Lakshmi Kumar
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# ABBREVIATIONS

<table>
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<th>Abbreviation</th>
<th>Description</th>
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<tr>
<td>BRI</td>
<td>Belt and Road Initiative</td>
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<tr>
<td>OLAF</td>
<td>European Anti-Fraud Office</td>
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<td>EU</td>
<td>European Union</td>
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<td>CCAWEC</td>
<td>China-Central Asia-West Asia Economic Corridor</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>IFFs</td>
<td>Illicit Financial Flows</td>
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<tr>
<td>UN</td>
<td>United Nations</td>
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<tr>
<td>U.K.</td>
<td>United Kingdom</td>
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<td>NATO</td>
<td>The North Atlantic Treaty Organization</td>
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<td>ESG</td>
<td>Environmental Social &amp; Governance</td>
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<td>UAE</td>
<td>United Arab Emirates</td>
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<tr>
<td>TBML</td>
<td>Trade Based Money Laundering</td>
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<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
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<tr>
<td>GFI</td>
<td>Global Financial Integrity</td>
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<tr>
<td>INSTC</td>
<td>International North-South Transport Corridor</td>
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<tr>
<td>FIZ</td>
<td>Free Industrial Zone</td>
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<tr>
<td>BO</td>
<td>Beneficial Ownership</td>
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<td>FATF</td>
<td>Financial Action Taskforce</td>
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Abstract

Dubbed the ‘factory of the world,’ China is today a major supplier of counterfeit and diverted consumer products (e.g. tobacco and pharmaceuticals) as well as illicit commodities, and its importance in global illicit trade has been steadily growing. This paper looks at the impact of China’s Belt and Road Initiative (BRI) on illicit trade. Building on the findings of an OLAF-funded workshop convened at King’s College London in spring 2022, the two co-authors examine BRI-related global supply chain risks for individual partner countries in connectivity projects, various commodities, free-trade zones and general trends of corruption and crime. The paper outlines policy recommendations for addressing and managing some of these risks.

About the Authors

Dr. Alexander Kupatadze is an Associate Professor (Senior Lecturer) at King’s College London, UK.

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KEY FINDINGS

- BRI projects render supply chains more stretched and complicated, thereby increasing opportunities for illicit activity and criminal exploitation.

- BRI expansion creates more rent-seeking opportunities among political elites in BRI partner countries and makes the environment more vulnerable to corrupt practices in customs and border agencies.

- The BRI increases legal trade that may contribute to the proliferation of counterfeit and diverted commodities.

- The impact of the BRI on increasing illicit trade flows at present is negligible. However, improved road and railway transportation may deliver illegal commodities faster and with more regularity.

- New BRI infrastructure projects may attract the migration of illicit actors, who intend to profit from the economic growth as a result.

- The absence and purposeful manipulation of trade data in countries that are part of the BRI increases the challenge of detecting trade-based money laundering and illicit activity across supply chains.

- Improved trade facilitation only exacerbates pre-existing limitations in supervision, oversight and enforcement in free-trade zones, while new transhipment schemes may make it easier to mask the origin of products.

- An increase in trade means consequent growth in trade-based money laundering (TBML) activities including opportunities for newer and more innovative black market peso exchange schemes to launder proceeds from drug trafficking in the EU.
KEY RECOMMENDATIONS

Ensure easy and transparent access to both aggregated and disaggregated data.

Increase the law enforcement presence and disclosure of trade data going through free-trade zones.

Implement beneficial ownership registries across the financial, transport and trade systems.

Improve cross-border sharing of trade data.

Implement TBML assessment and price assessment tools at the country.

Require commercial entities including consumer industry actors and shipping and transport companies to conduct better and more detailed due diligence processes.
China’s Belt and Road Initiative (BRI), sometimes referred to as ‘Globalisation 2.0,’ is a global infrastructure development strategy that aims to fundamentally reshape global trade. The BRI is a key element of the Chinese President Xi Jinping’s ‘Major Country Diplomacy,’ which intends to expand China’s leadership role in global affairs. The BRI covers 149 countries and promises increased connectivity between China and the rest of the world through infrastructure projects, policy coordination, unimpeded trade, financial integration, and people-to-people bonds. Since its inception in 2013, China has already spent an estimated US$200 billion on renewing and modernising infrastructure along the sea and overland trade routes that make up the BRI. However, it is not clear whether the BRI will actually deliver on its promise of achieving deeply transformative economic growth.

**“China has already spent an estimated US$200 billion on renewing and modernising infrastructure along sea and overland trade routes that make up the BRI.”**

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**INTRODUCTION**

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**INTRODUCTION**

China’s Belt and Road Initiative (BRI), sometimes referred to as ‘Globalisation 2.0,’ is a global infrastructure development strategy that aims to fundamentally reshape global trade. The BRI is a key element of the Chinese President Xi Jinping’s ‘Major Country Diplomacy,’ which intends to expand China’s leadership role in global affairs. The BRI covers 149 countries and promises increased connectivity between China and the rest of the world through infrastructure projects, policy coordination, unimpeded trade, financial integration, and people-to-people bonds. Since its inception in 2013, China has already spent an estimated US$200 billion on renewing and modernising infrastructure along the sea and overland trade routes that make up the BRI. However, it is not clear whether the BRI will actually deliver on its promise of achieving deeply transformative economic growth.
Much like the impact of the internet when global online connectivity transformed criminality (global cybercrime now generates over US$1.5 trillion per year\(^2\)), the rapid development of infrastructural linkages and logistical corridors has the potential to radically alter the illegal trade landscape.\(^3\) As with the inception of the internet, the BRI has not been designed and implemented with the aversion of crime in mind, which may lead to negative developments including the expansion of illicit supply chains.\(^4\)

**Fig 2: Countries of the BRI**

<table>
<thead>
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<th>Sub-Saharan Africa</th>
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<td>Europe &amp; Central Asia</td>
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<td>East Asia &amp; Pacific</td>
<td>25</td>
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<tr>
<td>Latin America &amp; Caribbean</td>
<td>20</td>
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<tr>
<td>Middle East &amp; North Africa</td>
<td>18</td>
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<tr>
<td>South Asia</td>
<td>6</td>
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Income Group

| High income | 34 |
| Upper middle income | 42 |
| Lower middle income | 41 |
| Low income | 30 |

(c) Copyright 2022 Green Finance & Development Center, Fudan University, Shanghai

Source: Fudan University, Shanghai\(^5\)

To understand the consequences of BRI connectivity, we convened a two-day-long workshop at King’s College London with the financial support of the European Anti-Fraud Office (OLAF), attended by leading experts on illicit trade as well as representatives of both consumer industries (namely tobacco, pharmaceuticals, and fertilisers) and international organisations. This paper is an outcome of the discussion(s) that took place at that same workshop as well as the research of the two co-authors on the BRI and its implications for illicit trade.
China has recently become the largest trade partner for the EU, with 22 percent of the latter’s imports coming from China in 2021. BRI-related projects have indeed contributed to the expansion of EU-China trade, even though it is difficult to quantify to what extent. Some infrastructure projects predate the BRI, for example the regular rail shipping route between Łódź (Poland) and Chengdu, which has been operational since 2013. Maritime trade between China and the EU also received a major boost after the BRI’s investment in the Greek seaport of Piraeus, even though BRI projects have mostly promoted a shift away from transportation by sea and air toward rail. Recent transport infrastructure projects to the EU under the BRI have mostly focused on developing the China-EU economic corridor via Russia (i.e., the Eurasian Land Bridge and the China-Mongolia-Russia Economic Corridor) and the China-Central Asia-West Asia Economic Corridor (CCAWEC) via Central Asian countries. These transport corridors not only provide additional means of connectivity between the EU and China, but also have major implications for participants including Russia, Mongolia, and Central Asian and South Caucasian countries. These countries gain from transit trade and improved access to goods and capital but may also lose out due to the additional opportunities surfacing for rent-seeking, smuggling and criminality.

Fig 3: Six Economic Corridors of the BRI

Source: OECD
The war in Ukraine and the sanctions subsequently imposed on Russia has delayed China’s Silk Road Rail Corridor via Russia and forced Beijing to rethink its regional trade, development and security strategies. In the first half of 2022, no new deals were struck under the BRI, and BRI investments in Russia fell to zero. Over the shorter term, to maintain China-EU connectivity, projects will have to rely more on old maritime routes, which have proved more resilient than road or rail networks. Over the medium and longer term, China may look increasingly towards the CCCAWEC as an alternative to the Eurasian Land Bridge.

Under the BRI projects, countries in Central Asia and Eastern Europe have experienced the largest increases in trade flows due to the overall reduction in trade costs. Furthermore, the World Bank estimates reductions in travel times by up to 12 percent and an increase in trade between 2.7 percent and 9.7 percent as a result of all implemented BRI projects. Indeed, the average shipment times between China and Central Asia will reduce from 15 to 13 days once all BRI projects are implemented. The route from the Khorgos free-trade zone in Kazakhstan, one of the major BRI links in this corridor, has witnessed an intense increase in activity subsequent to the opening of the Khorgos Gateway dry port. Since it started operations, container flows between Asia and Europe have increasingly been shipped by train through Kazakhstan, the impact of which may vary across countries.

For Kyrgyzstan, despite the development of road connectivity, the volumes and values of export and import with China did not increase between 2013 and 2017. The China-Kyrgyzstan-Uzbekistan International Highway, which is yet to be completed, may cut transport times between eastern China and Iran by half compared to the current route, which sends goods to Shanghai for onward shipping to Iran. The easier and faster movement of goods is supposed to entice companies to export their production via land routes. However, road cargo transportation has been suffering from an increase in time delays due to rent-seeking behaviour already rampant along border crossings in Uzbekistan, Kazakhstan and Turkmenistan. Complicated logistics and complex geography are other impediments for cargos transiting via this route stretching from China via Central Asia, the Caucasus and Turkey onto Europe, also known as the Middle Corridor. The route received a relatively small share of shipments in the past, but has grown in popularity since Russia’s invasion of Ukraine.
China and its role in global trade

In 1990, China accounted for only 2 percent of global GDP. By 2021, it accounted for a little over 18 percent of global GDP. Much of this can be attributed to the growth in Chinese industrial and manufacturing policies. Between 1979 and 2009, Chinese exports year on year rose on average by 16 percent. In 2020, the U.S. and China together accounted for “43 percent of the global economy valued at around $85 trillion.” In 2013, China became the world’s largest trading nation and in 2017, the world’s largest exporter of goods. A recent study of 186 countries found that China was the “largest export destination for 33 (countries) and the largest source of imports for 65 (countries).”

As part of this export-led economic growth model, a key pillar of Chinese economic expansion has been the broadening of the country’s footprint across global maritime. This makes particular sense given the Chinese economic model and that roughly 80 percent of global trade moves by sea. Prioritising the development of and investment into maritime networks has been a focus for the country both domestically and overseas. China’s expansion overseas has garnered particular attention with regard to the security threats it may pose to Western democracies.

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3 | CHINA AND THE IMPACT OF THE BRI ON TBML AND SUPPLY CHAINS RISKS

Fig 2: Growth of Chinese Exports (1978 - 2020)

Source: UNCTAD 2021
Furthermore, China today has more shipping ports on its territory than any other country, while other assessments demonstrate Chinese ownership or investment in at least 100 ports across 63 countries. According to Craig Singleton, a China expert at the Foundation for Defense of Democracies: “These port linkages allow Beijing to exert political influence not only in the country hosting the port, but in many cases the surrounding countries as well.” The same report found that Beijing “either controls or has major investments in all 15 of the world’s top 15 ports ranked by container volume.” Today, Chinese companies are now owners of major ports all along routes from China to Southeast Asia, Africa and even Europe that make up the Maritime Silk Road, a key component of the BRI.

Fig 3: Countries with significant Chinese port investments

Source: VOA news

China’s economic expansion and impact on global IFF risks

A question that frequently comes up in relation to Chinese economic expansion is the risk that this poses to the movement and migration of illicit financial flows (IFFs) all along these trade routes. A discussion of those risks in the Chinese context needs to be situated in the larger discussion on global trends in IFFs. The UN estimates that money laundering makes up roughly 2-5 percent of global GDP. By logical extension, and all things being equal, it would be fair to say that the larger the economy, the greater the estimated amount of money being laundered through it. This, of course, discounts countries or jurisdictions where the state apparatus is an active participant, and where there is weak rule of law, systemic corruption, and insufficient technical resources to enforce laws, all of which raise the risk of money being laundered. With China’s GDP valued at US$14.72 trillion, it is estimated that on average US$294 billion to US$736 billion is laundered annually through the Chinese economy.”
second only to the US economy with a GDP of US$20.94 trillion, where it is estimated that on average somewhere between US$418 billion and US$1 trillion is laundered every year. At the same time, what is key to understanding the IFF risks in the Chinese context is that criminal actors looking to move illicit money are attracted to the same locations that very often attract legitimate businesses. This is why the US, the EU, and the UK are all critical global financial centres but also magnets to parties seeking to hide illicit money. In the case of the BRI, an analysis of these risk factors in addition to the infrastructure benefits that will exacerbate IFF risks is therefore required.

**Economic growth from new transport corridors may also mean an increase in gang activity, cargo theft, corruption and other types of crime**

Transport and infrastructure corridors boost connectivity between people, businesses and marketplaces, but they also have the potential to connect criminals and illicit networks, to enhance the exchange of illicit commodities and to make formerly isolated regions vulnerable to criminal exploitation. It is widely established that transnational mobility allows criminal organisations to expand their business on a larger scale. Pertinently, an increased flow of people and services also means an increased risk of various types of smuggling and trafficking that is often embedded within legal trade flows. The BRI has aimed to transform the Greek seaport of Piraeus into an entry point for Chinese goods to Europe, which has also made the seaport attractive for smuggling. This is an example of the unintended consequences of such development, namely increased criminal activity along the transit routes. Recent research in Latin America has shown that new transport routes had a positive impact on economic growth in some municipalities, but also that better economic performance attracted gangs to these areas to tap into newly-created opportunities.

In the areas and localities where illicit trade is institutionalised, new transnational connectivity may bring other unintended consequences. Under certain conditions, new infrastructure corridors may provide opportunities to more professional and organised smuggling networks that can claim bigger market shares at the expense of petty shuttle traders. Cargo theft is yet another problem whereby intermodal and multimodal containers pass through areas associated with high levels of crime that makes them vulnerable to theft. The cargo redirected via land routes as a consequence of improvements brought about by the BRI could be at greater risk than before because organised theft is more common in road haulage. Indicative of the potential problem here is the petty theft of construction materials and equipment on the BRI-funded railway construction project connecting northern and southern Kyrgyzstan.
New transport infrastructure may also exacerbate the problem of corruption in partner/transit countries. In particular, public procurement and construction processes linked to the implementation of large infrastructure projects give ample opportunities for bribery and collusion.37 The Central Asian region already has several well-documented cases of BRI-linked bribes being paid to influential politicians and bureaucrats going as high as the prime ministerial office in Kyrgyzstan. Transparency International’s 2011 Bribe Payers Index38 ranked Chinese companies second out of a list of 28 economically-developed countries in terms of their willingness to pay bribes. Crucially, China lacks legislation equivalent to the US Foreign Corrupt Practices Act or the UK Bribery Act and, so far, no charges have ever been brought in China against a company for corrupt practices committed overseas.

Transport corridors may also increase the costs of corruption for other trading partners because state actors become more likely to demand higher bribes or facilitation fees. For example, as a result of the NATO-run logistics supply chain - the Northern Distribution Network39 - informal fees levied by the police in Uzbekistan doubled.40 One monitoring project revealed that in this region, roughly “30% of the transport costs were due to unofficial payments.”41

Improved transport corridors may boost the counterfeit industry

This research in the context of the BRI raises some definite areas of risk. China, dubbed the ‘factory of the world,’ is already a major supplier of counterfeit and diverted consumer products (e.g., tobacco, pharmaceuticals, and alcohol) as well as illicit commodities like fentanyl, and its importance in global illicit trade has been steadily growing.42 China’s role in these illicit markets predates the development of the BRI as illicit trade has long existed along the transport corridors that have since received BRI investment. However, the potential impact on illicit trade of the improvement of these transport corridors is an increase in both the volume and regularity of shipments of illicit goods. Research has demonstrated that the BRI’s transport projects are estimated to increase trade by between 2.8 and 9.7 percent for corridor economies and between 1.7 and 6.2 percent for the rest of the world.43 Since illicit commodities often travel with licit goods, this increase is equally applicable to illicit trade. A particular transport corridor that may be at a particularly high risk is the CCAWEC, while copyright holders continue to raise concerns about the adequacy of enforcement in the Eurasian Customs Union.44 The limited enforcement seen at the borders of Kazakhstan and Kyrgyzstan offers an attractive transit route for China-based counterfeiters. In many countries across Central Asia, the ruling elites have treated the flows of international trade as a source of personal income.45 The ability of criminals to pay their way through Central Asia coupled with changing dynamics after Russia’s invasion of Ukraine makes this corridor particularly valuable for both China to ship goods to the Russian market and for smugglers to provide Russia access to goods that would otherwise be restricted due to economic sanctions.”
market and for smugglers to provide Russia access to goods that would otherwise be restricted due to economic sanctions. In March 2022, the Russian government announced the notion of ‘parallel imports’ in response to many global brands halting their exports to Russia. Parallel imports legalised the importation of banned goods via third countries, but at the same time it led to the multiplication of unvetted suppliers and vulnerable supply chains. By the admission of Russia’s customs service, the scheme has become a conduit for counterfeit goods sent to Russia mostly from Asian countries including equipment, garments and toys that have now flooded shops throughout Russia.\(^{46}\)

The war in Ukraine has altered the movement of counterfeits in many other ways including new routes and shifting production. For example, there is evidence that some of the substances used in counterfeit pesticides that are usually shipped from China to Ukraine for processing were diverted to Kazakhstan after March 2022.\(^{47}\)

In the context of the BRI and counterfeits, transport corridors particularly heighten the risk of ‘deceptive’ counterfeits (i.e., counterfeits that sneak into legal supply chains whereby fake products are sold as authentic ones at similar prices).\(^{48}\) For example, counterfeit medications sold at prices similar to the authentic originals or illicit cigarettes sold alongside brand-name cigarettes/ones. In the context of the BRI, improved connectivity may have a substantial impact on the proliferation of deceptive counterfeits given the increase in the legal trade flows of these goods.

**Illicit goods may become more easily and rapidly accessible**

At present, commodities are mostly transported by container ships as sea cargo.\(^{49}\) Maritime transport is cheaper than land transport as well as more reliable, but rail is better when it comes to transporting perishable goods while usually being quicker and costing less. Indeed, rail transport delivers cargo faster and more regularly. This is particularly important for legal trade because time-sensitive goods account for more than three quarters of the value of China’s exports to the EU, and more than 60 percent of the EU’s exports to China.\(^{50}\) There may be notable benefits for illegal trade as well. For example, fruits became the favoured cargo for smuggling drugs from Latin America to Europe because they need to be moved quickly to avoid spoiling.\(^{51}\) The logic of expediting trade often undermines security concerns and without adequate counter measures, the BRI-enhanced legal trade may also increase the availability of illicit commodities.

Theoretically, infrastructure development and improved accessibility reduces the effort required to commit a crime, as rational choice theory of criminology would predict.\(^{52}\) According to the routine activities theory, one might expect that the ‘suitability of the target’ improves due to easier accessibility. Likewise, the motivation of offenders is also enhanced due to the enhanced ease of moving goods over long distances.\(^{53}\) However, most of the workshop participants agreed that, so far, the impact of the BRI on increasing illicit trade flows was not noticeable.
Is the BRI increasing or decreasing illegal trade?

Infrastructural development under the auspices of the BRI could be a double edged sword for illicit trade. On the one hand, transport corridors exacerbate the problem of illicit supply chains because they increase connectivity, reduce transaction costs of illegal trade, increase risks of corruption and provide more developed infrastructure for cross-border and international smuggling. A report from the UN Office on Drugs and Crime found that connectivity and integration have allowed transnational crime to evolve and, in turn, have facilitated new types of crime, including smuggling in drugs and precursors, human trafficking and environmental crime to emerge in China’s neighbourhood. Past research has shown that new road infrastructure may increase illegal logging and animal poaching. Recent studies have expressed significant concern that the BRI will exacerbate the negative impacts of the illegal wildlife trade from traditional markets such as Africa and will also create new supply sources such as in Central Asia. There is a significant overlap between BRI transportation routes and illicit trafficking routes and transit hubs. Notably, transport corridors are increasing connectivity between the sources of illicit commodities (e.g. drug producers in Afghanistan or counterfeit cigarette producers in India and China) and the consumption markets. They are also enhancing the infrastructure along the major smuggling routes and decreasing transport times and costs accordingly. For example, the BRI has enhanced the road infrastructure along the routes traditionally used for illegal trade in jade in Myanmar and for the smuggling of wildlife trophies, stolen cars, and minerals in Kenya.

On the other hand, transport corridors may also alleviate the problem of illicit supply chains. Such corridors may bring about trade liberalisation programmes to different countries and studies have demonstrated that, under certain conditions, trade liberalisation programmes may significantly reduce incentives to smuggle due to reduced profitability. There is some evidence that China, in pursuit of defending its own economic and national security interests, has made efforts to counter smuggling and trafficking. For example, the Chinese government together with its Central Asian neighbours have held a number of training exercises to bolster joint defences against arms smuggling in the region. Similarly, together with its Southeast Asian neighbours, China has also run patrols along the Mekong River to detect smuggling and other types of criminal activity. Chinese stakeholders of the BRI have repeatedly reassured the wider international community that the initiative has good governance at its heart. In 2019, the Chinese government announced that it was embedding anti-corruption inspectors in all BRI projects. Indeed, it is possible for ‘islands of integrity’ to exist in a mostly corrupt environment. For example, the Asian Infrastructure Investment Bank (AIIB), the development bank founded by China that has funded many BRI projects, abides by international corporate governance standards, and has a transparent procurement policy and a merit-based process for appointing staff. Though the Chinese government has displayed significant tolerance towards the counterfeit industry, there has nevertheless been a gradual improvement.
in the protection and enforcement of intellectual property rights in the country.⁶⁴

“**The number of parties, transfers, and transhipments make it difficult to fully secure these supply chains against the potential penetration of skilled criminal groups.**”

It is also important to bear in mind that supply chains in legal commodities are very complex. One study counted up to 25 different entities including the manufacturers, shippers and distributors that participate in an average supply chain.⁶⁵ The number of parties, transfers and transhipments make it difficult to fully secure these supply chains against the potential penetration of skilled criminal groups. Moreover, these supply chains may become even more complex and hence vulnerable to criminal exploitation as the BRI extends these supply chains over larger geographic distances and through several countries.⁶⁶ The BRI will also increase the pool of companies responsible for these supply chains. These companies, located in different jurisdictions with inevitably varying standards of transparency and social responsibility, run the risk of lagging behind international best practices on transparency, good governance, ESG and sustainability.⁶⁷
What trade data tell us about IFF risks in the BRI

A key way to target the risks of IFFs passing through a trade system is to have transparent access to aggregated and disaggregated trade records. Such records can provide for a mapping of the sectors most vulnerable to IFFs and inform the deployment of resources to focus on particular trade corridors, commodities and channels of transport. Based on the quantity and quality of data available, these can be incredibly valuable resources that researchers, governments, international organisations and the private sector use to mitigate IFF risks in trade. Trade records can be both aggregated (e.g., showing how much wheat is exported between two countries) and disaggregated (e.g., showing the companies that trade in wheat between two countries). Aggregated trade records recollected and published by the UN and are accessible to the public Meanwhile, disaggregated trade records materialise from a mixture of government bodies and companies specialising in producing and selling data of this nature. Both types of data are incredibly valuable to expose IFF risks in trade and there are abundant examples of their use in tracking IFF risks in the gold sector (see the diagram below), the timber sector, as well as trade in illicit whites and other counterfeit goods during the COVID-19 pandemic.

At the same time, an analysis using trade data to better understand and mitigate IFF risks in the BRI is only as strong as the available data. In recent years, there have been several examples showing how trade data disclosure amongst BRI partner countries can be and has been obfuscated and manipulated to make it challenging to identify IFF trade red flags. For instance, UAE, a key transport corridor that is part of the BRI and a key trading hub connecting Africa, Europe and Asia is a noteworthy example of how trade data can obscure IFF risks. UAE in its official records submitted to the UN lists its largest exporting partners under the category ‘unspecified.’ Unsurprisingly, 51.85 percent of all UAE exports fall under this category.

The revival of the International North-South Transportation Corridor (INSTC) as a “sanctions-proof” trade corridor in the wake of Russia’s invasion of Ukraine has allowed India, Russia, and Iran to skirt around Western sanctions and continue to trade with each other.
Similarly, one of the top five partners for UAE imports is also ‘unspecified,’ accounting for 13.65 percent of all UAE imports. The lack of transparency and clarity in how this information is reported can make it extremely challenging to detect criminal activity. Meanwhile, another BRI partner country, Sudan, has retrospectively altered its trade records. For instance, a 2020 research project found that that in “2014 gold accounted for 2.6 percent of all exports” though reports released by reputable non-profit organisations around 2014 “cite wildly different numbers of 70 percent and 29 percent using Central Bank data.” This suggests that records were modified after the fact, thus skewing the final result and hindering accurate identification of red flags for TBML or illicit trade. This conclusion is supported by the fact that, in 2015, in a presentation before the United Nations Conference on Trade and Development (UNCTAD), one Sudanese government official presented numbers on Sudan’s 2011-2014 gold production that were markedly different from those presented by another Sudanese government official for the same period in 2017. This highlights that a lack of honesty and consistency on the part of some governments has obstructed the collection of accurate export and import data, which are necessary to detect any IFF red flags.

The trade records for gold between 13 BRI-partner African countries and UAE is a useful depiction of this problem as displayed in Figure 5. GFI, a think tank based in Washington D.C., also identified 14 developing countries, some of whom are also BRI member countries, that do not regularly submit trade data to the UN, which would make future assessments of vulnerabilities across certain trade corridors or commodities challenging for government officials in those countries and in China.
When it comes to granular trade records that identify companies, shipment dates and methods of shipment, among other information, these records can be expensive to purchase and are not universally available for all countries. Apart from creating barriers to transparency as seen above, illicit actors including the Turkish state bank, Halkbank, deliberately manipulated invoices and created fraudulent trade records. The resultant scheme was the largest sanctions evasion scheme in US history and netted the Government of Iran approximately US$100 billion.  

While not a focus of this paper, the development of the BRI raises the risks of separate transport corridors that can evade US and EU sanctions and limit the impact of economic sanctions on the whole. The revival of the International North-South Transportation Corridor (INSTC) as a ‘sanctions-proof’ trade corridor in the wake of Russia’s invasion of Ukraine has allowed India, Russia and Iran to skirt around Western sanctions and continue to trade with each other. All three countries are members of the BRI with some commentators arguing that although the INSTC is an “opponent to China’s BRI, the reality is that both systems are extremely synergistic on multiple levels” have also demonstrated other ways in which new economic corridors can be exploited, thereby reducing the effectiveness of international counter measures against IFFs or corrupt, kleptocratic or authoritarian countries or regimes. Evidence has shown that sanctions-evading trade corridors are also exploited by transnationally-organised criminal groups seeking to engage in illicit activity.
The BRI covers 149 countries.\textsuperscript{81} Currently, there are over 5,000 free zones in the world.\textsuperscript{82} As indicated in the map below, the vast majority of these zones fall within countries covered by the BRI. Yet, free zones are subject to limited law enforcement oversight and are recognised as high risk for IFFs, while there is little information on the nature of commodities moving in and out of these zones.

Many of the free zones that are part and parcel of the BRI have been implicated in schemes covering an array of activities including sanctions evasion, proliferation financing, human trafficking, illicit trafficking of precious metals, environmental crimes, corruption, armed conflict, drug trafficking, terrorist financing and TBML.\textsuperscript{84} Yet, there currently
exist no formal requirements globally to ensure that free zones’ risks are adequately captured in a country’s IFF risk management practices. The interconnectivity that the BRI brings therefore only serves to exacerbate the pre-existing risks within such zones.

**Fig x: Examples of free zones along the BRI utilised in sanctions evasion tied to the proliferation of financing and dual-use technologies**

<table>
<thead>
<tr>
<th>Examples</th>
<th>Nature of use</th>
<th>Location of Free Zone</th>
</tr>
</thead>
<tbody>
<tr>
<td>German uranium enrichment components shipped illegally to Pakistan.³²</td>
<td>Transshipment</td>
<td>UAE</td>
</tr>
<tr>
<td>Mustard gas and nerve agent precursors shipped from India to Iran.³³</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Attempted export of a high-speed oscilloscope from the Netherlands to Pakistan.³⁴</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Export of maraging steel from Belgium to Iraq.³⁵</td>
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<tr>
<td>U.S. State Department reported that TBML schemes – facilitated by the extensive number of FTZs in the UAE “might support sanctions-evasion networks and terrorist groups in Afghanistan, Pakistan, Iran, Iraq, Syria, Yemen, and Somalia.”³⁶</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Export of heavy water from Germany to India.³⁷</td>
<td></td>
<td></td>
</tr>
<tr>
<td>In the case of the H.Q. Khan network, FTZs in Dubai were critical in allowing nuclear technology to reach Iran, DPRK, Libya, and other states.³⁸</td>
<td></td>
<td></td>
</tr>
<tr>
<td>In July 2020, the U.S. Department of the Treasury published a settlement agreement with Essentra FZE, a Jebel Ali Free Zone incorporated company, which traded with and accepted payment from North Korea for the illegal export of cigarette filters using deliberately deceptive practices.³⁹</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Controlled vacuum pumps exported to Iran via a UAE-based FTZ were given a fake final destination and re-labeled and undervalued as “spare parts.”⁴⁰</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Illegal export of hundreds of controlled pressure transducers from China to Iran.⁴¹</td>
<td>Falsification of documentation to hide cargo</td>
<td>Shanghai</td>
</tr>
<tr>
<td>An FTZ in North-Korea, the Rason Special Economic Zone, enables Russia and China to get away with sanctions evasion due to a loophole in the sanctions that allows for the entry of goods into North Korea that are ostensibly only transiting through the country and are re-exported to third country destinations.⁴²</td>
<td>Transshipment on paper as a sanction evasion technique</td>
<td>North Korea</td>
</tr>
<tr>
<td>The Poti Free Industrial Zone (FIZ), located near to the Black Sea port city of Poti, the largest seaport in Georgia, has been used by companies seeking to evade sanctions on Iran.⁴³</td>
<td>Transshipment</td>
<td>Georgia</td>
</tr>
</tbody>
</table>

*Source: Global Financial Integrity⁸*
While many countries in the last decade have made commitments towards implementing beneficial ownership, access to reliable and verified information on individuals that own companies trading through the BRI infrastructure project is still very lacking. The map below indicates how many countries as of 2020 had implemented beneficial ownership laws (Fig 7). Meanwhile, the number of countries with active beneficial ownership registries are far fewer (Fig 8). International organisations like the UN and think tanks such as GFI have recognised beneficial ownership as essential to addressing the IFF risks in illicit trade. The danger is that if concurrent measures to limit risk do not keep pace, and trade facilitation under the BRI continues to grow, IFFs leaving vulnerable developing will remain unchecked. A 2020 report from the UN draws attention to this very issue and found that the continent of Africa lost US$88.6 billion annually in IFFs. Even though 43 sub-Saharan countries are part of the BRI, remarkably few have implemented beneficial ownership registries (Fig 8). A similar analysis of 35 East Asia and Pacific countries and 20 Latin American and Caribbean countries showed poor rates of implementation.

**Fig 7: Countries that have committed to beneficial ownership**

**Source: Open Ownership**

Key: Purple indicates central BO registry; green indicates public BO registry; pink indicates open ownership engagement
Trade-Based Money Laundering (TBML) in the BRI

Like the other risks outlined in this paper, TBML risks are not unique to the BRI. TBML is a method through which IFF risks move in the trade system. The risks from TBML, like other risks outlined here, are exacerbated by increased trade facilitation without the requisite developments in supervision and oversight. TBML is an ongoing risk for which there is currently not an international framework that could help countries to set standards. This in turn has meant that standard-setting is piece meal and that TBML policies are often shoehorned into legacy AML systems that are better designed to capture money laundering risks in the financial system. A continued reliance on a paper-based system for trade transactions has meant that falsifying documents for the same transaction at different points is easy.
forms part of the BRI network. This, in turn, has meant that it is easy to change countries of origin, and even the types and value of goods without detection. Given that many of the countries in the BRI are already at heightened risk of TBML, especially countries reliant on the exports of primary commodities, adopting ways to dovetail TBML supervision and oversight from financial institutions to customs officers is paramount in order to limit IFF risks.
### Table 1. The expected impact of the BRI

<table>
<thead>
<tr>
<th>Factor</th>
<th>Expected Impact</th>
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</table>
| Supply chains      | - Supply chains are more stretched and complicated, thereby increasing opportunities for illicit activity.  
                    |  - The introduction of newer firms in jurisdictions with a less-established track record and less experience on good governance raises risks of criminal exploitation.  
                    |  - Easier to create ‘sanctions-proof’ corridors that may weaken key US and EU foreign policy countermeasures like economic sanctions. |
| Country risks      | - Support for a pre-existing corrupt/authoritarian government engenders instability in the given country and the wider region.  
                    |  - More rent-seeking among political elites in BRI partner countries.  
                    |  - The BRI project deepens systemic institutional corruption.  
                    |  - Conducive environment for exacerbation of corrupt practices in customs and border agencies.                                           |
| Product-specific risks | - Expansion of legal trade may contribute to the proliferation of ‘deceptive’ counterfeits.  
                         |  - Expansion of existing product-level IFF risks to newer markets.                                                                        |
| Transportation     | - As some cargoes may shift from maritime to railway transport, illegal commodities may be delivered faster and with more regularity.  
                    |  - Challenging to secure robust trade record data as commodities choose transportation methods with lower data visibility.  
                    |  - Movement away from maritime trade can allow certain parties to take advantage of porous borders thereby increasing opportunities for smuggling. |
| Criminality        | - New infrastructure may attract migration from licit actors. This, in turn, also provides increased incentives to illicit actors who may migrate/expand operations into the same area.  
<pre><code>                |  - Cargo theft from railway and road transport, especially in high-crime areas.                                                          |
</code></pre>
<table>
<thead>
<tr>
<th>Factor</th>
<th>Expected Impact</th>
</tr>
</thead>
</table>
| Free zones’ risks | - Pre-existing limitations in supervision, oversight, and law enforcement presence in free zones only increased with improved trade facilitation.  
- Transhipment schemes make it easier to mask origin of products.  
- Free zone authorities in BRI partner countries continue to lack incentives to tackle illicit trade risks because they are also responsible for revenue generation and economic growth. |
| TBML             | - Growth in trade means consequent growth in TBML activities.  
- Opportunities for newer and more innovative black market peso exchange schemes to launder proceeds from drug trafficking in the EU.  
- Increased challenges for developing countries to meet domestic resource mobilisation goals and detect loss in revenue. |
RECOMMENDATIONS

Ensure easy and transparent access to both aggregated and disaggregated data

Currently, countries publish aggregated trade data to UN Comtrade. But, as detailed above, these are not always complete, subject to obfuscation and manipulation, and in certain cases, countries simply fail to submit them at all. To really understand the risks arising from the BRI, it is important that aggregated and disaggregated trade records be made available information or at nominal cost.

Increase law enforcement presence and disclosure of trade data going through free zones

Ensure that free zones form part of an AML/TBML regime within a country and that adequate IFF risk assessments are conducted of free zones, including separate reporting of goods/commodities moving in and out of them.

Implementing beneficial ownership registries across the financial, transport and trade system

Ensure that beneficial ownership registries are implemented and provide useful information for authorities. This information in the context of the BRI should cover all companies that import and export through trade corridors along the BRI, while it should also be ensured that this information is recorded for ships too.

Improve cross-border sharing of trade data

Among the BRI countries, information sharing of cross-border data and information continues to be a challenge due to differences in technologies adopted, technological constraints and a lack of international cooperation. Prioritising improved pathways for the cross-border sharing of trade information on a real-time basis is critical to red-flagging IFF risks from the BRI.
Implement TBML assessment and price assessment tools at the country level

Countries should include TBML assessments as part of their national risk assessments conducted to identify IFF risks. Uniform international standards akin to those for money laundering in the financial system should be developed and be made mandatory through the Financial Action Task Force (FATF) mechanism.

Encourage commercial entities including consumer industry actors and shipping and transport companies to do better and to practice more detailed due diligence processes

It is crucial that businesses undertake better and more specific, actor-oriented due diligence in order to understand the issues related with corruption, ethics and transparency among partners in the supply chain. In jurisdictions with a less-established track record of good governance, it is crucial to have a more fine-grained picture of local patronage systems especially in relation to customs and law enforcement structures, institutional and individual complicity and complacency in smuggling and counterfeiting and the local decision-making structure. Business executives in the consumer products industry in U.S., the U.K. and the EU often need to go through local law enforcement in these jurisdictions in order to solve issues with counterfeiting-related crimes. Often this does not yield any results because of the complicity of law enforcement officers and related leakages of information.
Endnotes


3. Illicit supply chains in legal and illegal commodities, defined as manufacturing, transportation, cross-border smuggling, and distribution of prohibited commodities as well as counterfeit and diverted products.

4. The impact would have been no less if not more with the invention of automobile, telephone and radio in early twentieth century (Naylor 2004) but back then we lacked data and methodology to measure the effect.


11. Financial Times, China’s Belt and Road spending in Russia drops to zero, 24 July 2022


23 UNCTAD 27 April 2021


25 UNCTAD 27 April 2021

26 CSIS, China power, https://chinapower.csis.org/china-ports-connectivity/


28 Ibid

29 https://www.voanews.com/a/6224958.html


35 TAPA, Cargo theft trends in Russia 2020


Manufacturing experienced temporary disruptions as a consequence of covid-19 related lock downs e.g. in case of fentanyl precursor materials and counterfeit goods production in China but this has been restored soon.


economic integration in the former Soviet region consisting of five members: Russia, Belarus, Kazakhstan, Kyrgyzstan, and Armenia. Its formal objectives are to create a common market much like the European Union (EU).


The Moscow Times, 13 September 2022. «S jetim my boremsja»: tamozhnja priznala zavoz poddelok v Rossiju pod vidom parallel'nogo importa, available at https://www.moscowtimes.ru/2022/09/13/rossiyan-o-
dobivat-redkie-metalli-v-vechnoi-merzlo-
te-a24227

Information supplied by a company from pesticide industry, personal communication with the authors, July 2022.

Deceptive counterfeits are hard to detect while non-deceptive counterfeits can be distinguished from the brand products and their supply chains function independently of legal supply chains (Johns and Hayes, 2003).

OECD Global Trade in Fakes 2021

ING 2018 Trade impacts of the Belt and Road Initiative


57 Comolli, V. (2021), China's New Silk Road: Navigating the organized crime risk
https://globalinitiative.net/analysis/bri-crime/


59 Interpol 2018. Overview of Serious and Organized Crime in East Africa


61 State Council of The Peoples Republic of China, 28 May 2022,

62 Financial Times18 July 2019, https://www.ft.com/content/a5815e66-a91b-11e9-984c-fa c8325aaa04


73 ibid


https://thecradle.co/Article/Investigations/13240

It should be noted that prior to the Russian invasion of Ukraine, Chinese spending in Russia towards BRI had dropped to zero. Prior to this, between 2000 – 2017, BRI spending totaled $125.4 billion. This may change post-invasion and should be monitored. See Financial Times July 24 2022 [https://www.ft.com/content/470e2518-410b-4e78-9106-cf881dd43028](https://www.ft.com/content/470e2518-410b-4e78-9106-cf881dd43028)

https://thecradle.co/Article/Investigations/13240


[https://www.openzonemap.com/map](https://www.openzonemap.com/map)


[https://www.openownership.org/en/map/](https://www.openownership.org/en/map/) Key: Purple indicates Central BO Registry; Green indicates Public BO Registry
EVERYTHING EVERWHERE ALL AT ONCE:
Understanding the Implications of the Belt and Road Initiative on Trade-Based Money Laundering (TBML) and Illicit Supply Chains

Dr. Alexander Kupatadze
& Lakshmi Kumar
November, 2022

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