

Smugglers' Paradises in the Global Economy: Growing Threats of Hubs of Illicit Trade to Security & Sustainable Development

HUBS OF ILLICIT TRADE (HIT) PROJECT

Final Report

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- Singh, R., & Lasmar, J. (2023). *The Tri-Border Area: A Hub of Illicit Trade with a Global Impact*. TraCCC.
- Krylova, Y., & Rico, D. (2023). *Regional Hubs for Illicit Trade in Central America: Panama, Belize, and Guatemala*. TraCCC.
- Krylova, Y. (2023). *Dubai: A Global Hub for Illicit Trade and Sanctions Evasion*. TraCCC.
- Shostko, O. (2023). *Ukraine's Illicit Trade Internal Report*. TraCCC.
- Kupatadze, A. (2023). *Regional Hub of Illicit Trade: Ukraine*. TraCCC.

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CONTENTS

EXECUTIVE SUMMARY	3
1. INTRODUCTION: CONCEPTUALIZING HUBS OF ILLICIT TRADE	6
1.1. Defining hubs of illicit trade	6
1.2. Why it is important to study hubs of illicit trade	9
1.3. A note on the research methodology	10
1.4. The scope and the structure of the report	10
2. POLY-CRIMINALITY AND CRIME CONVERGENCE IN HUBS OF ILLICIT TRADE	12
KEY TAKEAWAYS	12
2.1. The convergence of different types of smuggling, routes, & illicit actors	13
2.2. Crimes supporting the circulation of goods, services, and money through hubs	14
2.3. An increasing role of hubs in sanctions evasion	15
2.4. Connecting hubs with criminal violence and terrorism	16
3. THE ENABLING ENVIRONMENT FOR SMUGGLERS' PARADISES	18
KEY TAKEAWAYS	18
3.1. Free trade zones.....	18
3.2. Transport and logistics infrastructure	20
3.3. Financial, money-laundering, and offshore business infrastructure	22
3.4. Corruption, weak law enforcement, and poorly guarded borders.....	23
3.5. Mobility, diasporic cross-border smuggling networks, and transient populations.....	25
4. DISRUPTING HUBS OF ILLICIT TRADE	27
KEY TAKEAWAYS	27
4.1. International cooperation & coordination at the policymaking & enforcement levels	29
4.2. Supply chain management policies	30
4.3. Capacity building, assistance, & training	31
4.4. Anti-money laundering policies	32
4.5. Free trade zone regulations	32
4.6. Cross-border public-private partnerships & multi-stakeholder cooperation	33
4.7. Awareness-raising & education	34
4.8. Trade analytics, technology, and innovation	34
5. CONCLUSION: A WAY FORWARD	35
REFERENCES	36



Colón Free Zone, Panama

EXECUTIVE SUMMARY

This report presents a summary of major findings within the *Hubs of Illicit Trade* project, a strategic evidence-based research initiative that was launched by the Terrorism, Transnational Crime and Corruption Center (TraCCC) and the Anti-Illicit Trade Institute (AITI) at George Mason University in 2022. Its key objective is to inform policymakers and communities about the interconnected harms and multiple compounding threats associated with hubs of illicit trade and to provide recommendations for their disruption by tackling their interconnected nature. This project covers different types of illicit trades, including natural resources, counterfeits, excise goods, drugs, arms, and human trafficking and smuggling. It focuses on well-known hubs located in the four regions:

- ❖ the Argentina-Brazil-Paraguay Tri-Border Area in South America;
- ❖ Dubai (the United Arab Emirates – UAE) in the Middle East;
- ❖ Panama, Belize, and Guatemala in Central America; and
- ❖ Ukraine in Eastern Europe.

Illicit trade has devastating impacts on sustainable development and security worldwide, endangering the well-being of communities, undermining public health, destroying the environment, depriving governments of revenues, and causing irreversible damage to legitimate businesses across all industries and sectors. Among the direct harms of illicit trade are the exploitation of vulnerable populations, particularly in fragile and conflict-ridden states, the destruction of the rule of law and good governance, and the spread of violence, corruption, and criminality along illicit supply chains. The diversion of financial flows from legitimate industries destabilizes national economies and local communities. Billions of dollars of profits from illicit trade are reinvested into other criminal activities and are mixed with licit financial flows, which makes their detection more challenging.

In today's global economy, key accelerators of licit trade also facilitate the rapidly growing scope of illicit activities. The enhanced connectivity due to contemporary transport infrastructure, the high-tech financial system, and the expansion of free trade zones and e-commerce have also driven the growth of hubs of illicit trade in various regions of the world. Such hubs are often located at cross points of global or regional trade routes. However, their position is also determined by the most appealing characteristics for smuggling networks, including political and administrative corruption, lax business and financial regulations, socio-economic vulnerabilities, and ineffective law enforcement. For illicit traders, such characteristics constitute an ideal criminal ecosystem offering both profitable business opportunities and low risks of detection and prosecution. Below are other research findings of the *Hubs of Illicit Trade* project.

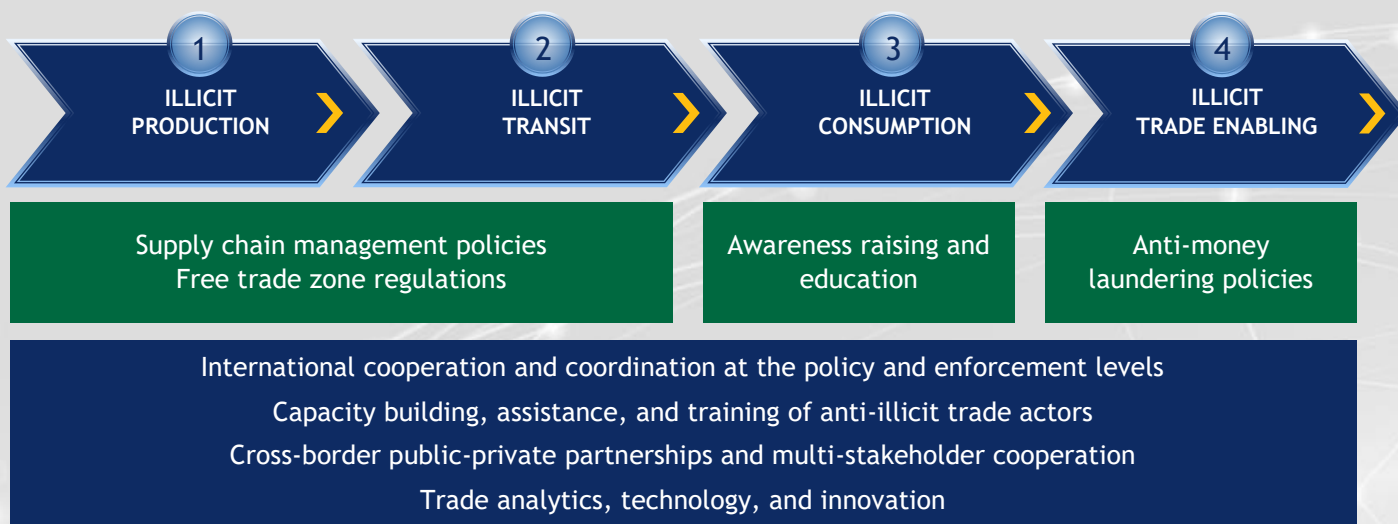
KEY FINDINGS: HUBS OF ILLICIT TRADE

- ❖ **Hubs for illicit trade are characterized by a high level of poly-criminality and crime convergence**, with the same actors often involved in different types of trafficking and smuggling. Illicit trade networks often share the same routes, transportation modes, resources, convergence points, and enabling networks. Illicit trade is supported by document and accounting fraud, asset manipulation, abuses of shell corporations, cybercrime, corruption, and money laundering, among other crimes.
- ❖ **Criminal networks operating in hubs of illicit trade rely on a wide range of legally registered companies**, including suppliers of raw materials and key inputs, producers of illicit or counterfeit commodities, distributors, shipping, postal, and logistics operators, and financial enablers. These enablers can be located within hubs and in other parts of the world, including developed countries.
- ❖ **The role of hubs in sanctions evasion is becoming more prominent** under a recent increase in the number of international and national sanctions imposed on various countries. Sanctions evasion schemes often rely on the use of complex business structures, multiple front companies, often registered in offshore havens, and various levels of ownership and management that are constantly changing to avoid detection.
- ❖ **Hubs of illicit trade have negative spillover effects on trading partners and neighboring countries.** Countries along supply chains face many consequences of illicit trade, often witnessing a drastic increase in criminal violence, illicit consumption, corruption, poverty, socioeconomic inequality, reduced public health, environmental degradation, and other negative implications. Illicit trade actors often exploit vulnerable segments of society and geopolitically unstable states.
- ❖ **Hubs of illicit trade are dynamic in nature**, with criminal networks demonstrating high levels of creativity and flexibility in modifying their business portfolios and modi operandi in response to new conditions and law enforcement threats. As evidenced by the Covid-19 pandemic and the Russia-Ukraine war, hubs of illicit trade have a high level of resilience to external shocks.
- ❖ **Free trade zones are hotbeds of all types of smuggling and counterfeiting.** Their major vulnerabilities include limited transparency, due diligence, and background checks of companies, as well as a lack of proper technology to identify and detect illegal merchandise. Many businesses in free zones accept large volumes of cash for wholesale trade, while banks and money transfer services in these zones facilitate money laundering activities.
- ❖ **Hubs characterized by a high level of financial secrecy and deficiencies in financial regulations are particularly attractive to smuggling networks** engaged in money laundering, including trade-based money laundering and money laundering through gold trade and real estate. The presence of developed crypto infrastructure, coupled with regulatory deficiencies, creates additional vulnerabilities exploited by smuggling networks operating in hubs of illicit trade.
- ❖ **A common characteristic among all hubs of illicit trade is a high level of corruption.** Well-established illicit trade patterns rely on a system of bribes to administrative officials, customs officers, and border guards in free trade zones, ports, national crossings, and checkpoints, while corrupt political and judicial systems provide them immunity from prosecution.
- ❖ **Hubs of illicit trade are characterized by ethnic diversity and high population mobility**, with intensive movements of local residents, tourists, and migrants, both legal and illegal. Population heterogeneity and mobility, particularly in border regions, facilitate the development of ethnic cross-border networks important to all forms of smuggling.
- ❖ **There are strong connections between illicit trade operations in hubs, violence, and terrorism.** Many hubs are characterized by high levels of violence committed by drug traffickers, gangs, corrupt police, and security officials. Hubs also fuel violence in other countries along the supply chains, especially in conflict-ridden and fragile states. The illicit trade-terror convergence poses growing threats to global security.

Source: Author.

An important implication of illicit trade operations concentrated in particular geographic locations is that they create *hub-and-spoke systems* responsible for the spillover of negative effects along the entire supply chain, including growing illicit consumption, increasing criminality, systemic corruption, and widespread violence. Depending on their specialization, hubs participate in the production, transshipments, and consumption of various illicit goods and services. They can also perform enabling and supporting functions by providing offshore financial and money laundering services for smuggling networks located within these hubs and in other parts of the world. The disruption of hubs of illicit trade, therefore, requires a holistic strategy based on a set of policies that simultaneously address all their major functions, including the production, transit, and consumption of illicit goods and services, as well as their enabling and facilitating functions, as shown in the figure below.

Figure: Policies to counteract illicit activities in hubs of illicit trade



Source: Author.

The dynamic nature of hubs, their interconnectivity, and the complexity of illicit trade operations present additional challenges for law enforcement. Effective actions aimed at disrupting cross-border supply chains, which often go through several jurisdictions, require close international cooperation and coordination across various anti-illicit trade policy domains. Among the most critical steps are the ratification of international conventions and treaties regulating specific types of illicit trade, joint law enforcement initiatives, and enhanced data sharing and trade analytics. Since illicit trade networks operating in hubs benefit from differences in national legislation, the harmonization of customs regulations, taxation, and penalties for smuggling between integrated trading countries is another critical policy domain.

Detecting and investigating complex illicit trade transactions require sophisticated expertise in all relevant policy domains and advanced data analytics. Capacity building, assistance, and training of anti-illicit trade actors is, therefore, another cornerstone defining the effectiveness of law enforcement. These activities require cross-agency cooperation within national governments (a whole-of-government approach) and their cooperation with the private sector and civil society (a whole-of-society approach). To curb illicit trade through supply chain management policies, for example, national governments need to strengthen their partnerships with legitimate companies in affected industries. In turn, the effective adoption and implementation of enhanced free trade zone regulations and anti-money laundering policies are impossible without cooperation with financial organizations and free zone operators. Finally, partnerships with private-sector companies, academia, and civil society are necessary for launching effective awareness-raising campaigns and education initiatives targeting consumers of illicit goods and services.



Jebel Ali Port, Dubai

1. INTRODUCTION: CONCEPTUALIZING HUBS OF ILLICIT TRADE

Global trends in population growth and mobility, urbanization, and the use of new information technology have led to further growth of international trade and the increasingly interconnected global economy (OECD 2016). The dark side of these trends, however, is rapidly growing illicit trade, which is currently responsible for annual losses of over US\$2 trillion to the world's economy (UNCTAD 2022). In 2021, these losses surpassed the global domestic product of such countries as Canada and Brazil and even exceeded the economy of the entire regions of Sub-Saharan Africa and the Central European and Baltic states (World Bank n.d.). Another important trend is a growing concentration of illicit trade flows in specific geographic areas that play the role of smugglers' paradises by providing a criminal ecosystem supporting the convergence of various types of crimes. In 2022, the Terrorism, Transnational Crime and Corruption Center (TraCCC) and the Anti-Illicit Trade Institute (AITI) launched the *Hubs of Illicit Trade* research project – to study these areas that present multiple harms and threats to the global community and economy. This project covers various types of illicit trade, including the smuggling and trafficking of narcotics, weapons, humans, counterfeit and pirated goods, illegal tobacco and alcohol products, and gold and precious minerals. Its geographical focus lies on well-known hubs of illicit trade located in the four regions: the Argentina-Brazil-Paraguay Tri-Border Area in South America, Dubai in the Middle East; Panama, Belize, and Guatemala in Central America; and Ukraine in Eastern Europe. This report presents the key findings of this research and provides actionable recommendations for disrupting hubs of illicit trade based on a holistic all-inclusive approach.

1.1. Defining hubs of illicit trade

For the purpose of this research, hubs of illicit trade are defined as geographic areas with a high concentration of illicit flows of commodities and services and with a strong presence of criminal actors and a wide range of enablers, often from the legitimate economy, who provide supportive activities for illicit transactions. These transactions involve different categories of commodities and services, including prohibited goods or services (e.g., drugs, forced labor, or commercial sex); regulated commodities (e.g., firearms, antiquities, flora, fauna, or sanctioned goods and services); counterfeit or untaxed commodities (e.g., cigarettes, alcohol, clothing, sportswear, or pharmaceuticals); and stolen goods (e.g., vehicles or their parts). Although hubs of illicit trade are generally classified as a source, destination, or transit point, most of them do not fit just one classification category (OECD 2016: 31). Given a variety of illicit goods and services traded in particular hubs, their growing production facilities, and local demand for illicit products, they simultaneously fit multiple categories. Like licit traders, however, criminal networks take advantage of hubs' specialization, focusing their resources on illicit markets with comparative advantages.

While there are no exact estimates of criminality levels in trading hubs, the use of multi-dimensional indexes allows for their comparative analysis. The Global Organized Crime Index, for example, provides multi-dimensional metrics to compare criminal markets and actors in 193 countries around the world (GI-TOC n.d.). Criminality scores for each country are calculated based on assessments of the scope, scale, and impact of their specific criminal markets and evaluations of the structure and influence of various criminal actors they host (GI-TOC 2022: 27). The coverage of this index in 2021 was limited to the drug trade, human trafficking and smuggling, flora and fauna crimes, non-renewable resource trade, and arms trafficking. At the same time, it provides a general perspective on the scope of illicit trades carried out at the country level (Figure 1), which allows for cross-hub comparisons.

Figure 1: Major illicit trades identified in hubs of illicit trade

HUB OF ILICIT TRADE	COUNTRY	ARMS From 1 (best) to 10 (worst)	PEOPLE (average) From 1 (best) to 10 (worst)	DRUGS (average) From 1 (best) to 10 (worst)	NATURAL RESOURCES From 1 (best) to 10 (worst)	FLORA & FAUNA (average) From 1 (best) to 10 (worst)	CIGARETTES Billion sticks
DUBAI	UAE	6.5	7.5	6.8	6.0	6.5	100
CENTRAL AMERICA	Guatemala	7.0	6.8	7.1	2.5	4.0	20
	Panama	6.5	6.8	5.9	6.0	7.0	
	Belize	4.5	5.0	4.1	3.0	5.0	
TRI-BORDER AREA	Paraguay	8.5	6.5	5.4	3.5	6.3	65
	Argentina	3.0	3.5	4.5	3.0	3.3	
	Brazil	8.0	4.5	5.8	8.0	8.5	
EASTERN EUROPE	Ukraine	8.0	6.8	4.3	7.0	5.3	20
Illicit trade scale & reach in 2021		<div>Little</div> <div>Moderate</div> <div>Significant</div> <div>Severe</div>					

Source: Author based on data from GI-TOC (2022) and industry estimates.

In terms of actors responsible for the growth of illicit markets at the country level, it is worth noting that the Global Organized Crime Index focuses on organized crime and state actors, and, therefore, does not place much emphasis on legitimate companies engaged in illicit trade. The assessment of illicit trade risk levels in hubs, therefore, requires a multi-dimensional approach that combines indicators related to other aspects of illicit trade, such as corruption in the private and public sectors, money laundering, and financial secrecy, among other dimensions (Figure 2).

Figure 2: Illicit trade risk levels based on related global indicators

HUB OF ILICIT TRADE	COUNTRY	Global Organised Crime Index From 1 (best) to 10 (worst)	Illicit Trade Environment Index From 0 (worst) to 100 (best)	Corruption Perception Index From 0 (worst) to 100 (best)	Human Trafficking Tier Tiers 1-3, & special cases	Financial Secrecy Index From 5 (best) to 1,951 (worst)	ILICIT TRADE RISK LEVEL
DUBAI	UAE	5.8	68	67	2	648	VERY HIGH
CENTRAL AMERICA	Guatemala	6.5	46	24	2	265	VERY HIGH
	Panama	6.7	55	36	2	474	VERY HIGH
	Belize	4.6	35	NA	2	76	MEDIUM
TRI-BORDER AREA	Paraguay	6.7	43	28	2	72	HIGH
	Argentina	4.4	64	38	1	82	MEDIUM
	Brazil	6.5	51	38	2	135	HIGH
EASTERN EUROPE	Ukraine	6.2	38	33	2	125	HIGH
Country scores in 2022 or latest year available		<div>Best</div> <div>Intermediate</div> <div>Critical</div> <div>Worst</div>					

Source: Author based on data from GI-TOC (2022); Economist Intelligence Unit (2018); Transparency International (2022); U.S. Department of State (2022); Tax Justice Network (2022).

Trade hubs emerge in certain locations for a number of reasons, including their geostrategic positions (e.g., cross points of trade routes; proximity to key consumer markets and intermediary hubs; or high connectivity with other

regions) and available infrastructure (e.g., transport, shipping, business incubators, and free trade zones, finance, information technology, and e-commerce). In addition, hubs that specialize in illicit trade take advantage of lax business and trading regulations, political and administrative corruption, weak law enforcement, and poorly guarded borders in certain countries. By exploiting various types of infrastructure and taking advantage of political, administrative, and socioeconomic vulnerabilities, hubs of illicit trade provide a criminal ecosystem aimed at accelerating illicit trade operations. Criminal actors and enablers operating in hubs of illicit trade also prey upon vulnerabilities in other countries, exploiting the poor, persons fleeing from wars and conflicts, and unprotected economic migrants, among other groups. Figure 3 shows key drivers of illicit trade. The growth of particular hubs of illicit trade can be characterized as a combination, to varying degrees, of these variables.

Figure 3: Drivers of illicit trade



Source: Author.

This research focuses on both coastal and landlocked hubs of illicit trade. Coastal hubs with large seaports, such as Dubai and Panama, for example, are characterized by a high level of trade connectivity. Their significant role in international trade is explained by the fact that about 80% of global trade is transported in cargo containers, and this number is even higher in most developing countries (UNCTAD n.d.). Free trade zones located within or near large seaports, for example, the Jebel Ali Free Zone (Jafza) in Dubai or the Colón Free Zone in Panama (Figure 4), serve as hotspots of both licit and illicit trade activities, which will be discussed in detail in the next sections.

Figure 4: Locations of the Colón Free Zone and Jafza



Source: Google Maps.

Compared to coastal hubs, landlocked countries, such as Paraguay, have difficulties in accessing international markets and, therefore, are more dependent on the stability and openness of neighboring countries to ensure wider trade connectivity. For example, Paraguay has an agreement with Brazil to use free warehouses in the ports of Paranaguá located in the Brazilian state of Paraná and Santos in the Brazilian state of São Paulo (Singh & Lasmar 2023). To move goods from Paraguay to Brazil, smuggling networks mostly utilize trucks across the Iguazu National Park to access the network of Brazilian municipal rural roads and highways, which are used to transport these goods







to the city of São Paulo, a major distribution center, Brazilian ports (mainly Santos and Paranaguá), and other locations across the country (ibid.). In addition, smugglers use rivers and clandestine small airports located in more remote regions to move commodities out of Paraguay (ibid.).

Another important characteristic of hubs of illicit trade is their dynamic nature. Smuggling networks demonstrate high levels of creativity and flexibility in modifying their trade routes, transport modes, connection points, and moduli in response to new conditions and law enforcement threats. During the Covid-19 pandemic, for example, due to restrictions on air travel, criminal groups located in the UAE increasingly used containerized sea cargo and trucks for cigarette smuggling to India. In 2021, India witnessed an increase in the market share of illicit cigarettes (estimated at one-third of the entire cigarette market), with 65% of them coming from Dubai (DRI 2021). A similar effect was observed in the Tri-Border Area where the black market of smuggled goods exploded both in its volume and assortment due to official restrictions on legitimate supply chains and logistical challenges caused by the Covid-19 pandemic (Singh & Lasmar 2023). In another example, the impacts of the Russia-Ukraine war included a higher intensity of drug smuggling through European ports due to the blockade and closure of Ukraine's major seaport infrastructure, as well as the diversification of smuggling routes and the use of new transportation modes (Frontex 2022). These examples show that smuggling networks are eager to take advantage of new business opportunities and are resilient to external shocks.

1.2. Why it is important to study hubs of illicit trade

Hubs of illicit trade represent an important unit of analysis due to their role as critical nodes of illicit supply chains. With their high connectivity provided by their geostrategic positions and developed infrastructure, hubs facilitate the proliferation of criminal activities at all levels, serving as connection points for local, regional, and international smuggling networks that coordinate illicit flows between source, destination, and transit points. The negative impacts of illicit trade on governments, communities, and legitimate businesses are well documented (Table 1).

Table 1: Impacts of illicit trade

CATEGORY		IMPACTS	EXAMPLES
	Financial losses	Criminal organizations and legally registered companies involved in illicit trade deprive national governments of revenues, undermining their socioeconomic development.	<ul style="list-style-type: none"> > \$2 trillion annual loss caused by illicit trade > \$40.5 billion tax revenue loss linked to illicit cigarette trade
	Undermining legitimate industries	Illicit trade deprives legitimate companies of significant financial revenues, limiting the ability of businesses to invest in research and development and create new jobs.	<ul style="list-style-type: none"> > 90 thousand jobs lost in the EU linked to illicit counterfeit medicines > 7-16% depression of global prices linked to the illicit trade in timber
	Health impacts	Cheaply produced illicit goods are not subject to quality control, posing additional health risks to consumers. Illicit alcohol can contain methanol, which leads to seizures, organ failure, and death. The diffusion of counterfeit pharmaceuticals and personal protective equipment leads to deaths and microbial resistance.	<ul style="list-style-type: none"> > 2.5-3 million death toll from harmful use of illicit alcohol each year
	Environmental impacts	Illegal wildlife trade undermines biodiversity and ecosystem-based climate change adaptation. Other impacts include clear-cutting forests, river dredging, the use of toxic chemicals, and pollution. Illicit trade in sand leads to the destruction of coastlines and maritime life.	<ul style="list-style-type: none"> > Over 2 thousand tons of mercury released into the air, water, & land every year due to Illicit gold mining
	Forced and child labor	The lack of oversight and control over illegal production leads to the problem of labor exploitation of vulnerable groups, including children, women, the poor, minority groups, refugees, displaced persons, and migrants.	<ul style="list-style-type: none"> > 10-15 million workers (including 4-5 million women and children) subjected to harsh working conditions in artisanal & small-scale gold mines
	Corruption, crime, and violence	Illicit trade is linked to increased criminality, corruption, violence, and instability at the country, regional, and global levels.	<ul style="list-style-type: none"> > Rising violence from terrorist organizations in the Sahel region, including ISIL & Al-Qaida who benefit from illicit trades in that region

Source: OECD (2012); TRACIT (2021); UN Security Council Report (2022); UNCTAD (2020); UNEP (2019); WHO (2019; 2021).

There has been less focus, however, on the role that hubs of illicit trade play in fostering poly-criminality and enhanced connectivity between criminal networks, terrorist organizations, and a wide range of enablers. The anonymity offered by shell companies registered in secrecy jurisdictions allows illicit trade actors to disguise their operations and launder illicit proceeds. Panama's role as an offshore secrecy jurisdiction was exposed in the 2016 Panama Papers with leaked records of a myriad of shell companies. Although recently Panama has made some progress in this area, it remains among the Financial Action Task Force grey-list countries. In 2022, the Financial Action Task Force added Dubai to this list due to deficiencies in its regime to counter money laundering, terrorist financing, and proliferation financing. In 2021, for example, the U.S. Treasury designated the Islamic Revolutionary Guard Corps and Hizballah financial facilitators who headed a network of nearly 20 individuals and front companies located in Dubai and other jurisdictions used for "the movement and sale of tens of millions of dollars' worth of gold, electronics, and foreign currency" (U.S. Treasury 2021, September 27).

An important implication arising from the research on hubs of illicit trade is that they have multiple negative spillover effects on trading partners and neighboring countries. Countries along supply chains ultimately absorb major issues associated with illicit trade, often witnessing a drastic increase in criminal violence, illicit consumption, corruption, poverty, socioeconomic inequality, and other negative effects. Another important implication is that tax evasion by illicit trade actors gives them competitive advantages associated with lower prices. In turn, dumping due to cheap illicit commodities seriously hits legal manufacturers, many of whom respond by increasing their illicit production. As a result, countries with large inflows of illicit commodities from hubs of illicit trade might experience an increase in their own illicit production.

From a policy-making perspective, hubs represent a challenging issue due to a high concentration of illicit trade operations, a wide diversity of actors, and a wide range of commodities and services that are produced, transported, and consumed in these locations. At the same time, if governments succeed in disrupting hubs of illicit trade, it will result in substantially higher costs for illicit networks and their enablers than simple supply or demand-side policy measures focusing on either source or final destination countries. The dynamic nature of hubs implies that illicit trade networks are endlessly diversifying their portfolios to capitalize on new opportunities. They also adapt their *modi operandi* to new conditions and often change specific trading routes to avoid detection by law enforcement. These features dictate the necessity to study hubs of illicit trade in order to create early warning systems for fast and efficient information exchange among all stakeholders involved in anti-illicit trade operations.

1.3. A note on the research methodology

This research is based on a combination of qualitative and quantitative data collected in the course of a two-year project. Depending on specific hubs' characteristics, research teams applied various methods to study their common and distinct issues. These methods include a case study analysis and in-depth interviews with subject matter experts, industry representatives, government and law enforcement officials, and staff of academic and nongovernmental organizations. For comparative analysis, this research uses international rankings and evaluations of various states that host illicit trade hubs, such as the Global Organized Crime Index, the Corruption Perception Index, the Financial Action Task Force assessments, and the Financial Secrecy Index.

This research also entails a detailed review of available sources in English, Spanish, Portuguese, Ukrainian, and Russian related to illicit trade in the selected hubs and neighboring countries. Secondary sources of information include scholarly publications, investigative media publications, court documents and legislation, official statements, assessments, and evaluations, and reports by national law enforcement agencies, governments, and regional and international organizations. The data collection methodology also includes analyses of seizure data from law enforcement agencies and trade data from the United Nations (UN) Comtrade database. For money laundering analyses, the research uses data from the Sayari beneficial ownership database, the Financial Crimes Enforcement Network (FinCEN) files, and the International Consortium of Investigative Journalists (ICIJ) offshore leaks databases. The triangulation of various sources and methods facilitates data validation through their cross-verification.

1.4. The scope and the structure of the report

This final report is based on four individual reports written by four research teams working on the hubs of illicit trade located in Panama, Belize, and Guatemala in Central America, the Tri-Border Area in South America, Dubai in the Middle East, and Ukraine in Eastern Europe. This report provides examples of common and distinct features of these hubs, identifies current trends, and analyzes key enabling factors behind their expansion. The choice of these hubs is explained by their different specializations and various levels of illicit activities and policy and law enforcement responses. They also represent distinctive trade patterns that exist at the regional level in the globalized economy. Their comparisons help trace how illicit trade networks operate in different institutional environments. All of these hubs facilitate illicit flows of a myriad of commodities and services, but each individual report is limited to a detailed analysis of the most critical illicit trades.

This report consists of five sections. Following this introduction, the second section analyzes various types of criminal convergence and poly-criminality observed in all hubs of illicit trade. The third section explores the enabling environment for the proliferation and expansion of hubs of illicit trade, with a focus on free trade zones, financial and money-laundering infrastructure, corruption, and the role of diasporic and transient populations. The fourth section discusses major policy recommendations and solutions for disrupting hubs of illicit trade. The concluding section summarizes key findings and identifies directions for future research in this area.





2. POLY-CRIMINALITY AND CRIME CONVERGENCE IN HUBS OF ILLICIT TRADE

KEY TAKEAWAYS

- ❖ **Criminal convergence:** Hubs of illicit trade are characterized by a high level of poly-criminality, with the same actors often involved in various types of trafficking and smuggling and sharing the same routes, resources, and enabling networks with other actors.
- ❖ **Supportive crimes:** The circulation of goods, services, and money in illicit trade operations hosted by hubs is enabled by various supportive crimes, such as money laundering, document and accounting fraud, asset manipulation, corruption, and cybercrime, among many others.
- ❖ **Sanctions evasion:** Hubs of illicit trade play a critical role in sanctions evasion, helping designated persons, entities, and countries to undermine national and international sanctions regimes through the abuse of shell companies registered in safe havens and other methods.
- ❖ **Violence and terrorism connections:** Illicit trades are associated with widespread violence in countries along supply chains. The illicit trade-terror convergence, particularly in fragile and conflict-affected states, poses additional threats to global security.

In local communities, illicit trade is sometimes seen as a victimless crime, and, therefore, more socially acceptable than other criminal activities. This section debunks this myth by demonstrating that hubs of illicit trade are characterized by poly-criminality, resulting in interconnected harms, higher levels of violence, and threats to sustainable development and global security. It also shows that the deconstruction of criminal convergence is critical for effective law enforcement responses and awareness-raising campaigns targeting local communities.

Crime convergence takes various forms. Like legitimate companies, criminal networks often diversify their portfolios, capitalizing on new business and market opportunities. Examples include MS-13 and Barrio 18 criminal gangs traditionally involved in extortion and drug trade in the United States and Central America who increasingly turn to sex trafficking due to its profitability and lower risks compared to narcotics (Krylova & Shelley 2023). Criminal networks engaged in different illicit trades often share the same routes, transportation modes, resources, convergence points, and enabling networks. Another issue is the convergence of illicit trade with all types of supportive crimes, including document and accounting fraud, asset manipulation, abuses of shell and front corporations to disguise the illicit nature of operations, corruption, cybercrime, the misuse of new technologies (e.g., blockchains, digital assets, and the dark web), trade-based money laundering, and money-laundering through the financial sector and real estate (Figure 5). Criminal violence, intimidation, and terror represent another cause for concern. The illicit trade-terror convergence, particularly in fragile and conflict-affected states, poses additional threats to global security.

Figure 5: The convergence between illicit trade and supportive crimes

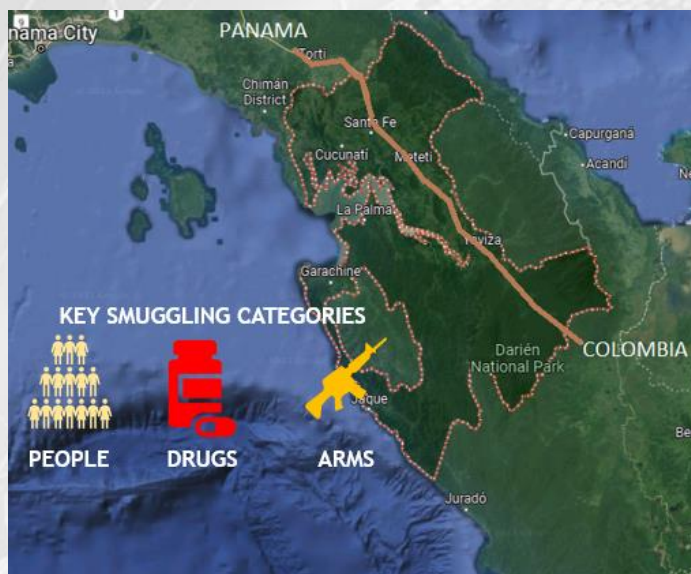


Source: Author.

2.1. The convergence of different types of smuggling, routes, & illicit actors

Criminal networks, terrorism organizations, and armed groups often share the same trade routes, transportation modes, and networks to move various commodities from, in, and through hubs of illicit trade. An example is the Darién Gap, a roadless swath of jungle that serves as a land connection corridor between Panama and South America. The Darién Gap is a main land route for illegal drugs and people transiting through Colombia and Panama on their way to the United States (Figure 6).

Figure 6: Smuggling via the Darién Gap



Source: Google Maps (adapted).

In 2022, reportedly 250,000 people from Latin America, South Asia, and other regions crossed the Darién Gap (Zamorano & Sherman 2023). The UN Refugee Agency and the International Organization for Migration estimated that in 2023, their number could reach 400,000 people (IOM 2023). Many migrants are forced to carry drugs and other illicit goods. Historically, the key actor controlling the trafficking of commodities and people through the Darién Gap was the 57th Front of the Revolutionary Armed Forces of Colombia (FARC), which is largely demobilized. Currently, the Darién Gap is primarily controlled by another paramilitary movement – the *Urabeños* (also known as the Gulf Clan or the Gaitanis Self-Defense Forces of Colombia), who originate from Colombia's region of Urabá (Loaiza 2021). The *Urabeños* are connected with major drug trafficking organizations, migrant smuggling networks, armed groups, and gangs operating in this region.

Various goods, including prohibited, regulated, counterfeit, and contraband commodities, are often shipped in the same shipments. To illustrate this point, Figure 7 shows goods transported together with illicit cigarettes and drugs based on a sample of 285 seizures by Ukraine's State Border Guard Services between 2020 and 2022 (n.d.). Specifically, cigarettes and drugs were seized together with arms, illicit alcohol, electronics, clothes, and other goods.

Figure 7: Goods seized with illicit cigarettes and drugs (% of seizures), 2020-2022



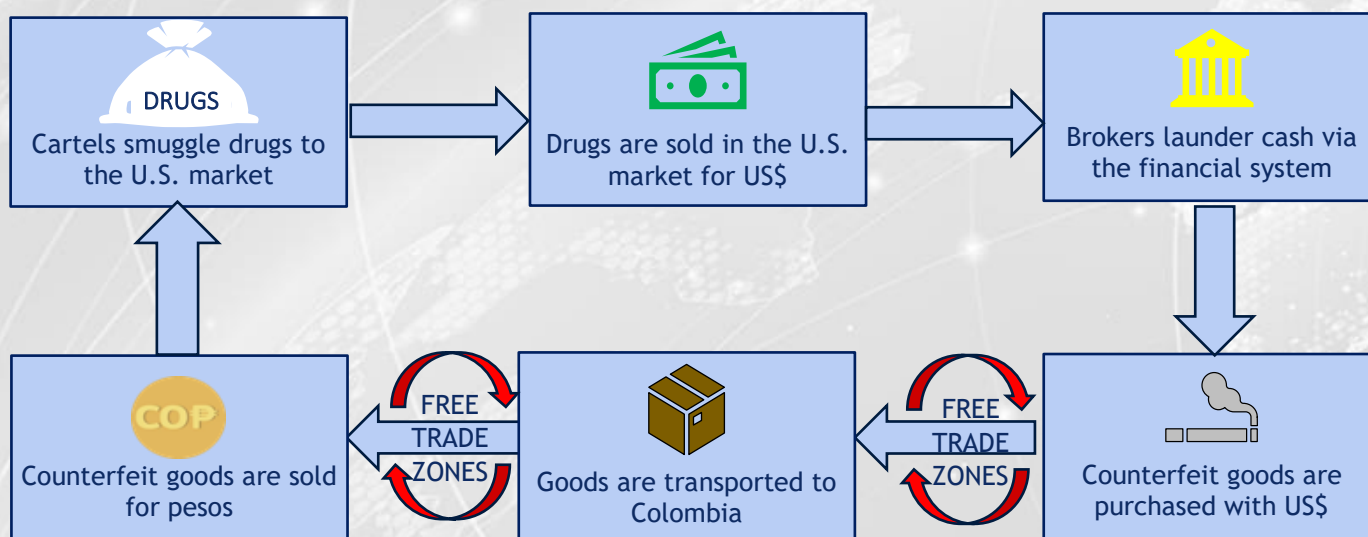
Source: Author based on a sample of cigarette & drug seizures (n=285) by Ukraine's State Border Guard Services (n.d.).

Like legitimate businesses, smugglers try to optimize their logistics, for example by avoiding freight transportation running empty. To increase their economic profit, they often run a complete cycle, transporting certain types of commodities in one direction and other commodities in the opposite direction. Illustrative of this is one case prosecuted by the Polish authorities who detained an organized crime group transporting drugs from Spain through Poland to Ukraine and smuggling illicit cigarettes in the opposite direction (TraCCC 2019). Furthermore, illicit goods are often mixed with licit goods to make their detection more challenging.

2.2. Crimes supporting the circulation of goods, services, and money through hubs

Illicit trade actors rely on a wide range of financial and non-financial enablers: banks, hawala and e-hawala, dealers in precious metals, lawyers, trust and company service providers, finance companies, foreign commercial operators, real estate agents, insurers, auditors, and accountants. Illicit trade actors use a wide variety of different schemes to support the illicit circulation of goods, services, and money. One illustration is a black-market peso exchange scheme, widely utilized by drug cartels to launder their proceeds received from selling drugs in the United States through purchasing counterfeit commodities, including in the Colón Free Zone in Panama and other free zones. Importantly, counterfeit commodities in this scheme can be resold several times and they can go through several free trade zones. This circulation of commodities helps smugglers to disguise their actual origin and change their value (Figure 8).

Figure 8: The circulation of money and goods in a black-market peso exchange scheme



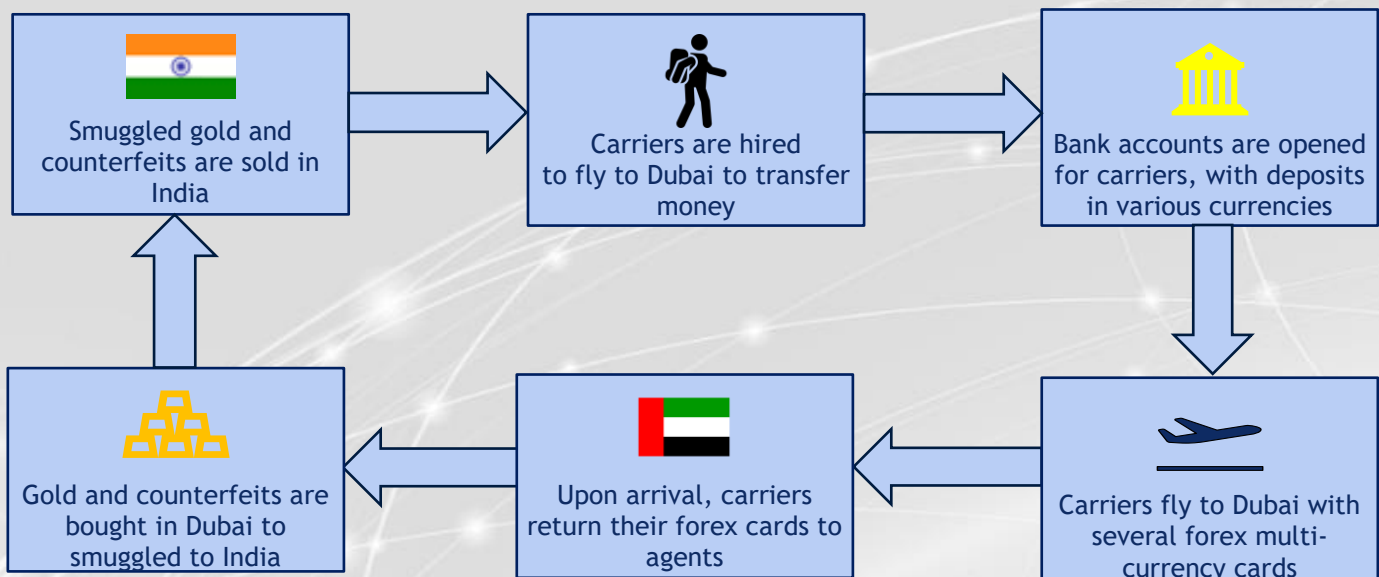
Source: Author.

To date, the black-market peso exchange remains one of the most popular trade-based money laundering schemes in the Western Hemisphere, with a wide variety of goods, including electronics, counterfeit cigarettes, alcohol, precious metals, and even e-gold, among many other commodities. For example, the first bilateral U.S.-Panama black-market peso exchange investigation resulted in the seizure of the Colón Free Zone company, Speed Joyeros S.A., with all its assets transferred to the United States, including approximately 468 boxes of gold, silver jewelry, gemstones, and watches weighing over ten tons (U.S. Department of Justice 2010). The use of e-gold in the black-market peso exchange is also popular due to the ease with which customers can purchase and transfer it anonymously.

and because it is widely used for transactions involving investment scams and credit card and identification fraud (U.S. Department of Justice 2012).

The research on Dubai provides evidence of other schemes used to launder money. For example, in an e-hawala scheme discovered by India's police in 2018, smugglers used illegal currency transfers to support the illicit circulation of goods and money between Dubai and Mumbai. In this case, investigators found that within one month, at least 54 passengers flying from Mumbai to Dubai carried cash and multi-currency cards on behalf of gold smugglers, helping them to transfer funds equivalent to US\$5.9 million (Namboodiri 2018). Smugglers provided these carriers with passports and travel visas, and opened bank accounts for them with deposits in various currencies. Upon arrival in Dubai, carriers handed their cards to agents to buy gold, electronics, and other counterfeit goods to smuggle them back to India (Figure 9).

Figure 9: The circulation of money and goods in an e-hawala scheme



Source: Author.

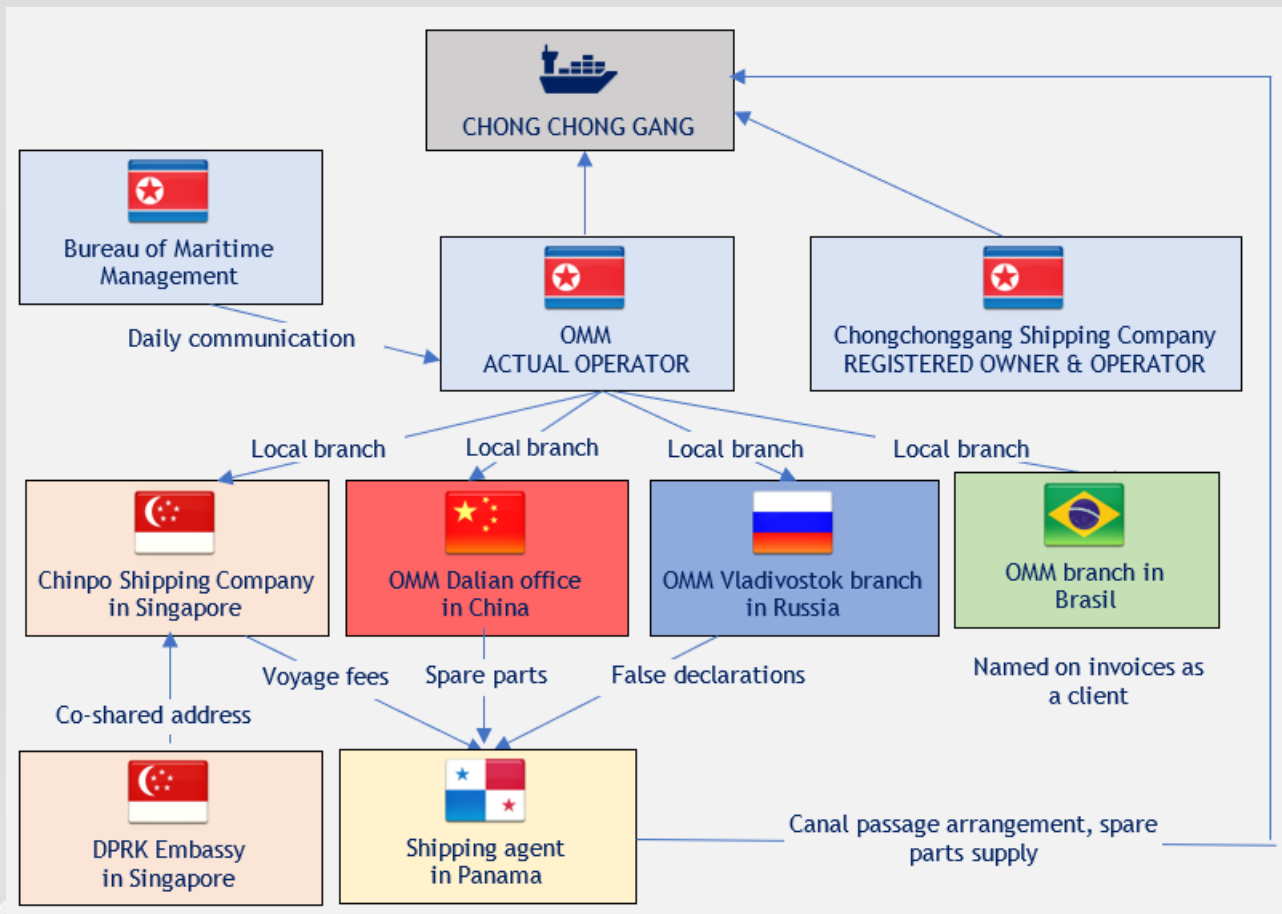
The difference between this scheme and traditional hawala schemes is that the money received from gold sales is sent through the banking system, instead of a network of money brokers operating in different locations and transferring money by matching financial records without any physical money flows. E-hawala schemes are also used for other types of illicit trades.

2.3. An increasing role of hubs in sanctions evasion

Iran, North Korea, and Venezuela are illustrative examples of how Panama, Dubai, and other hubs of illicit trade can be used to evade sanctions and support modern dictatorships. Under a recent increase in the number of international and national sanctions imposed on Russia, Belarus, and other countries, the role of hubs in sanctions evasion is becoming more and more prominent. Sanctions evasion schemes often rely on complex business structures, multiple front companies registered in offshore havens, and various levels of ownership and management, which are constantly changing to avoid detection.

The interconnectedness between different hubs is vividly illustrated by a sanctions evasion scheme involving the North Korean vessel Chong Chon Gang transporting sugar with hidden missile systems, aircraft engines, and ammunition to North Korea through the Panama Canal. The UN investigation found that the actual Chong Chon Gang operator was Ocean Maritime Management Company, Ltd (OMM), a front company linked to the North Korean Government and over 34 entities in more than 11 countries, including Panama, Russia, and Brazil (UN Security Council 2014a). These entities were used to obscure the connection of this transaction to North Korea. Thus, entities in Vladivostok in Russia were used to submit false declarations; Brazilian entities were named on invoices as clients and were used to pay transit fees through the Panama Canal; and a company in Singapore was used to pay voyage fees (Figure 10). Another Singaporean company also served as a front company in a more recent case involving illegal tobacco trade in North Korea in violation of U.S. and international sanctions (U.S. Treasury 2023, April 25).

Figure 10: The interconnectedness of hubs in sanctions evasion



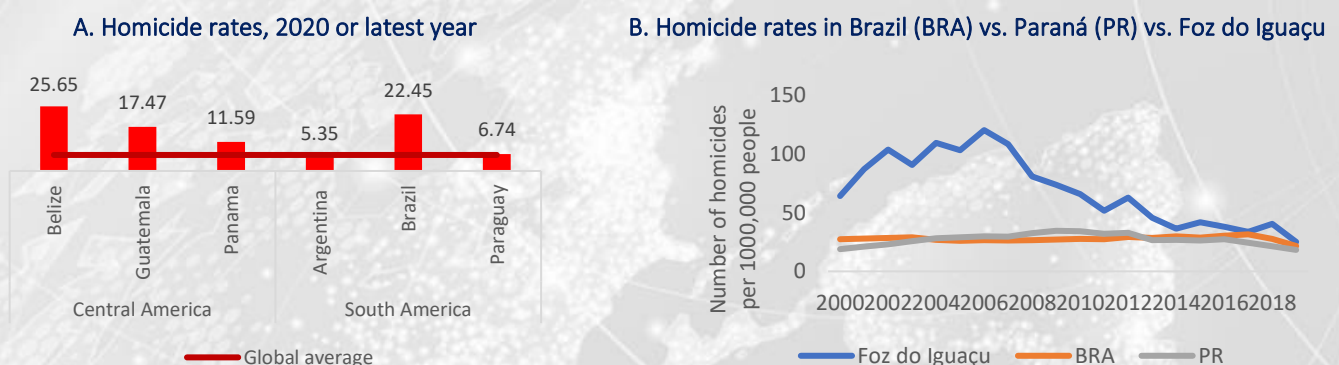
Source: Adapted from UN Security Council (2014a).

The Panama Canal is one of the world's most important marine trade routes connecting the Pacific and Atlantic oceans. Its strategic location allows Panama to serve as a transshipment hub for all types of sanctioned, prohibited, counterfeit, and contraband commodities. Furthermore, as one of the most popular ship registration locations, Panama remains attractive to smuggling networks because it offers less expensive services and has more flexible regulations compared to traditional national registries.

2.4. Connecting hubs with criminal violence and terrorism

Illicit trade carried out through hubs fuels conflicts and violence. Levels of violence committed by drug traffickers, gangs, and corrupt policemen are particularly high in Central America, contributing to rising fears among citizens and facilitating further criminality. Belize, with 25.65 homicides per 100,000 people in 2020, remains among the most violent countries in Latin America and the world (Figure 11A). In South America, Brazil has one of the highest homicide rates. Yet, the level of violence is even higher at illicit trade hotspots, such as the city of Foz do Iguaçu located in the Brazilian state of Paraná (Figure 11B) (Singh & Lasmar 2023).

Figure 11: Homicide rates per 100,000 people in Central America and South American hubs

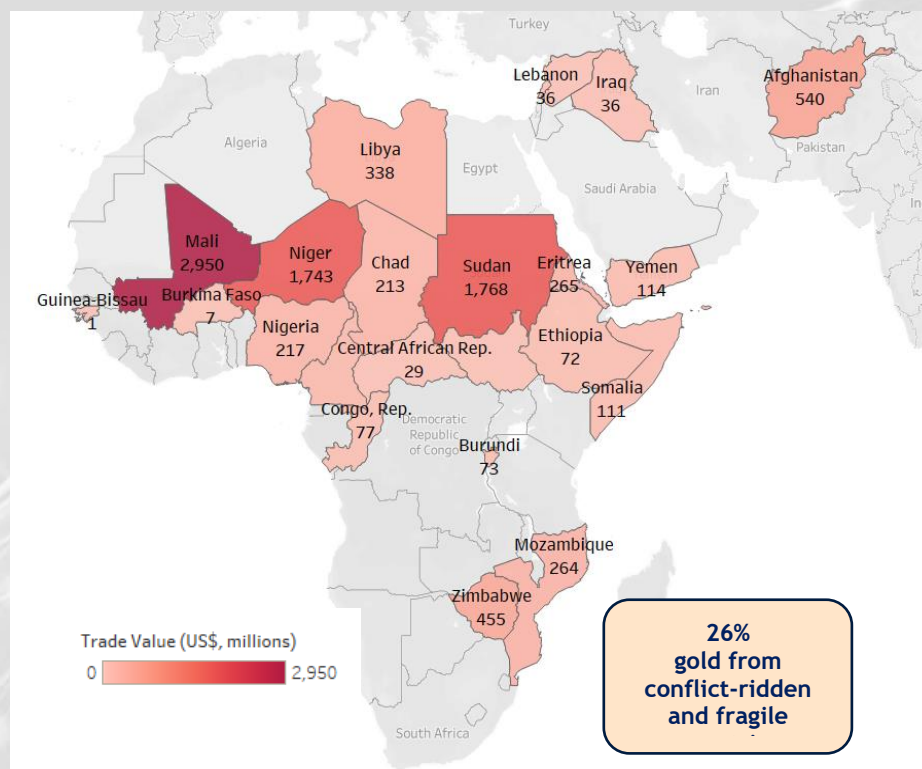


Source: Figure 11.A: Author based on UNODC (2020); Figure 11.B: Singh & Lasmar (2023).

Illicit trade is also linked to terrorist financing as it benefits a wide range of terrorist organizations, armed groups, and militias. Specifically, there is evidence that among beneficiaries of illicit trades carried out through the hubs featured in this report are the Islamic Revolutionary Guard Corps, the Islamic State of Iraq and the Levant (ISIL), Jama'a Nusrat ul-Islam wa al-Muslimin, Hizballah, Al Qaida, the Taliban, Colombian militant groups, and the largest Brazilian criminal organization Primeiro Comando da Capital (PCC), among others.

Armed groups and terrorists use illicit proceeds to finance their violent activities far beyond a particular hub location, often creating security threats for the entire regions along the supply chain. Within the Sub-Saharan region, for example, increased illicit gold mining, particularly in conflict-affected and fragile countries (e.g., Mali, South Sudan, the Central African Republic, Mozambique, Ethiopia, and Cameroon), is associated with growing terrorist threats (UN Security Council 2021). Gold is particularly attractive to both state and non-state actors involved in illicit trade and terrorist financing because its specific properties provide a high level of anonymity to transactions.

Figure 12: The UAE gold import from conflict-ridden and fragile countries (US\$, millions), 2020



Source: Author based on UN Comtrade. (n.d.).

Known as the City of Gold, Dubai is the largest global hub for the black-market gold trade, a significant share of which originates in conflict-affected and fragile states. Based on the UN Comtrade data, the share of gold coming to the UAE from such states of the total gold trade value was estimated at 26% in 2020 (Figure 12). Yet, it is important to note that the UN Comtrade database does not contain records from many conflict-affected countries, and it does not include gold that is laundered in third countries. The actual share of conflict gold coming to the UAE reaches up to 46% (Page & Vittori 2020). Conflict gold traded in Dubai can be traced back primarily to two regions: Sub-Saharan Africa and the Middle East and North Africa. Many countries in both regions have high security risks and continue to face the threat of violent extremism and terrorism.

In the Tri-Border Area, radical Islamist groups, the PCC, and other criminal groups abuse lax border controls to smuggle arms, drugs, and other commodities. In particular, free trade areas with large Middle Eastern populations facilitate a mutually beneficial symbiotic relationship between Hizbollah, other terrorist organizations, criminal groups, and corrupt officials (Singh & Lasmar 2023). Profits from illicit trade are often used to support terrorist activities in various parts of the world.



3. THE ENABLING ENVIRONMENT FOR SMUGGLERS' PARADISES

KEY TAKEAWAYS

- ❖ **Free trade zones:** Free trade zones serve as hotbeds of all types of illicit trade. Their major vulnerabilities include weak procedures to inspect goods, a lack of adequate cooperation between zone and customs authorities, limited transparency, due diligence, and background checks of companies, as well as a lack of proper technology to identify and detect illegal merchandise.
- ❖ **Transport and logistics infrastructure:** Transport infrastructure developments and the availability of key logistics services result in record levels of containerized cargo and air traffic in major trading hubs, which makes the detection of suspicious shipments extremely challenging. To transport illicit merchandise, smuggling networks rely on a wide range of legitimate transport, shipping, and logistics companies, including those located outside the hubs of illicit trade.
- ❖ **Financial, money laundering, and offshore business infrastructure:** Hubs characterized by a high level of financial secrecy and deficiencies in anti-money laundering regulations are particularly attractive to smuggling networks engaged in money laundering, including trade-based money laundering and money laundering through gold and real estate.
- ❖ **Corruption, weak enforcement, poorly guarded borders:** Well-established illicit trade networks rely on a system of bribes to administrative officials, customs officers, and border guards, while corrupt political and judicial systems provide them immunity from prosecution.
- ❖ **Mobility, diasporic cross-border smuggling networks, and transient populations:** Illicit trade hubs are characterized by ethnic diversity and intensive movements of local residents, tourists, and migrants, both legal and illegal. Population heterogeneity and mobility, especially in border regions, facilitate the growth of ethnic cross-border networks important to all forms of smuggling.

Smuggling networks operating in hubs of illicit trade exploit their transport, logistics, and financial infrastructure. They also take advantage of lax free trade zone regulations, political and administrative corruption, weak law enforcement, poorly guarded borders, and socioeconomic vulnerabilities. Together, these features create an ideal criminal ecosystem providing smuggling networks with multiple business opportunities and low risks of detection.

3.1. Free trade zones

Free trade zones serve as hotbeds of all types of illicit trade. Illicit trade actors exploit their vulnerabilities, including weak procedures to inspect goods and a lack of adequate cooperation between zone and customs authorities. Free trade zones also serve as key transshipment and distribution centers, with a high concentration of criminal logistics with illicit flows from numerous sources. Jafza and other free zones in Dubai, for example, serve as key provenance

and transit points for illicit cigarettes smuggled across the so-called “Maghreb route,” which connects countries in the Middle East and Northwestern Africa with the regional and European illicit markets. In 2016, 7.4 billion illicit cigarettes (57%) in the Maghreb region reportedly originated from trademark owners based in free zones located in the UAE (KPMG 2017). The Maghreb route is also popular among smugglers of hashish, humans, and arms. Along this route, illicit cigarettes flow in several directions. One of these directions goes to Algeria – a critical outflow market destined for European countries, including France, Italy, and Spain. There are over 100 different routes for trafficking illicit cigarettes from Dubai to Algeria (Aziani & Dugato 2019). Some of them can be quite complex, including the use of different modes of transportation and cross-border transfers (Figure 13).

Figure 13: Select paths of illicit cigarette smuggling from Dubai to Algeria



Source: Author based on UN Security Council (2021) & Aziani & Dugato (2019).

In Panama, the most important illicit trade hotspot is the Colón Free Zone, the largest free trade zone in the Western Hemisphere and the second largest in the world after Hong Kong (Panama FOB n.d.). It is located near the Panama Canal, which generates 6% of all global commerce (Parliamentary Intelligence-Security Forum 2021). This location is one of the main keys to the attractiveness of the Colón Free Zone to both licit and illicit traders. The zone also benefits from the fact that the United States dollar is one of the official currencies of Panama. Other critical free zones are located in Belize, e.g., the Corozal Free Zone, and in Guatemala, such as Santo Tomás de Castilla, a free zone and a port city, which represents an administrative part of Puerto Barrios, the country’s main Caribbean port. Interviews with subject matter experts in Central America indicate that port authorities and operators of free trade zones have strong connections with powerful officials (e.g., current and former politicians, high-level customs officers, and members of Congress). A high level of political influence, coupled with ample resources, allows them to systematically block attempts to change regulations and enhance control in free zones and ports (Krylova & Rico 2023).

The Colón Free Zone in Panama has a long reputation as a hub of illicit trade specializing in a wide variety of commodities and services. Colombia’s expert on criminal economies, Daniel Rico, characterized this free zone as “the Disneyland of smuggling” offering various illicit goods – “whisky, cigarettes, medicines – everything” (cited in Jaccard et al. 2021). Similarly, the Corozal Free Zone in Belize is infamous as one of the largest smuggling hubs in Central America. Importantly, on their way to the destination markets, illicit goods often go through several free zones in various countries. For example, illicit cigarettes from free trade zones in Panama often make a roundtrip to free trade zones in the United States and then return to Panama (Box 1). Such operations allow cigarette smugglers to alter the cargo value, as well as to change the certificate of origin, a practice known as “origin laundering.”

Box 1: Transshipments of illicit cigarettes through Central American and U.S. free zones

Panama's free trade zones are the main node of the illicit cigarette trade in Latin America. Cigarette shipments arrive there directly from Asian and other provenance economies, including Paraguay, with transit points located in Caribbean free zone ports. After arriving in Panama, the cargo is forwarded to intermediary free trade zones in other countries, including the United States (see Table 2), as well as Central American free zones. From intermediary free zones, containers with illicit cigarettes are shipped to other hubs located close to the main consumer markets (not necessarily coastal cities) from where the cargo goes further to urban wholesalers.

Table 2: U.S. free zones on the contraband route

FREE ZONE	LOCATION, GRANTEE, & COMPANIES IN PROXIMITY
FTZ # 25	Seaport: Fort Everglades Grantee: Fort Everglades - Department of Broward County Close companies: Miami Warehouse Logistics; Heritage Tobacco; RJ World Trading.
FTZ # 241	Seaport: Port Everglades Grantee: Fort Lauderdale - c/o Fort Lauderdale Executive Airport
FTZ # 281	Seaport: Port Miami Grantee: Miami - Dade County, Florida.
FTZ # 12	Location: 640 S. 33rd St., McAllen, TX 78501 Grantee: McAllen Economic Development Corp. Close company: Valley Bonded Warehouse

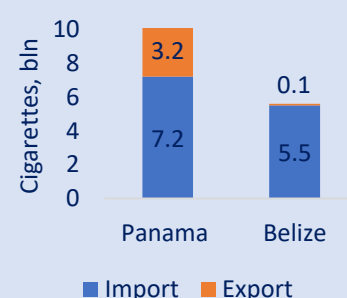
Source: Adapted from Rico (2022).

There are no exact estimates of illicit cigarette volumes. Yet, comparisons of Panjiva export and import data point to existing discrepancies. In 2021, for example, the gaps between exported and imported cigarettes in Panama and Belize were 4 billion cigarettes and 5.4 billion cigarettes, respectively (Figure 14). Domestic cigarette consumption in both countries is much lower than these gaps. Even after controlling for consumption, the actual volumes of illicit cigarettes are much higher than the related gaps since they represent only legally declared cigarettes. At the same time, significant numbers of cigarettes arriving in free zones in both countries are not declared at all. Criminal profits are also difficult to calculate. Yet, comparisons of value changes along the illicit cigarette supply chain provide a proxy estimate showing that smugglers can easily triple the original cigarette value through free zone transshipments. For example, after cross-referencing the cigarette consumption prevalence data by brand with the profit margin, a conservative estimate of annual proceeds of illicit cigarettes sold in Central America in 2021 was between US\$150 and US\$250 million.

Sources: Rico (2022); ICP (2018).

The movement of cigarette containers between different free zones has a common denominator: the cargo is always declared as "in transit." The authorities in transit ports do not exercise any control over this cargo as it is the responsibility of the authorities in the final destination port. In reality, most of this illicit cargo is rerouted somewhere else along the path to avoid customs control in the destination port. To achieve this, smugglers rely on two main mechanisms: (1) the use of customs logistics operators to avoid the required free zone control and (2) the creation of shell companies for an illicit operation, with the closure of these companies after one-time or limited use.

Figure 14: Panama and Belize's cigarette import and export, 2021

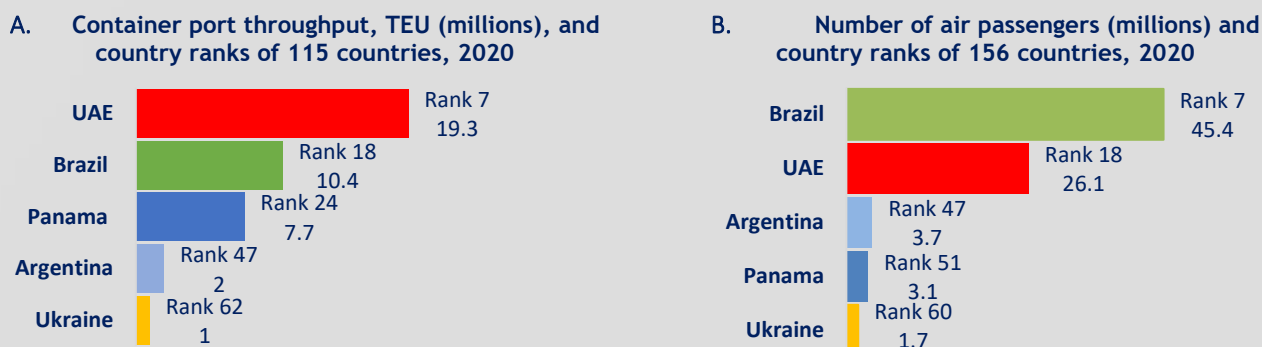


Source: Rico (2022) based on Panjiva

3.2. Transport and logistics infrastructure

Transport infrastructure developments in trading hubs improve their trade connectivity and their interconnectedness with origin and destination economies and intermediary hubs. Merchandise shipments and transshipments also depend on the quality and availability of key logistics services. Important indicators of improved trade connectivity are increasing cargo movements and air traffic in major trading hubs. Yet, large volumes of merchandise transported through hubs make it difficult to identify suspicious shipments. Globally, less than 2% of more than 500 million containers shipped each year are inspected by customs authorities (UNODC n.d.). As a result, those hubs that rank high on container port throughput and air traffic become important targets for illicit trade actors (Figure 15).

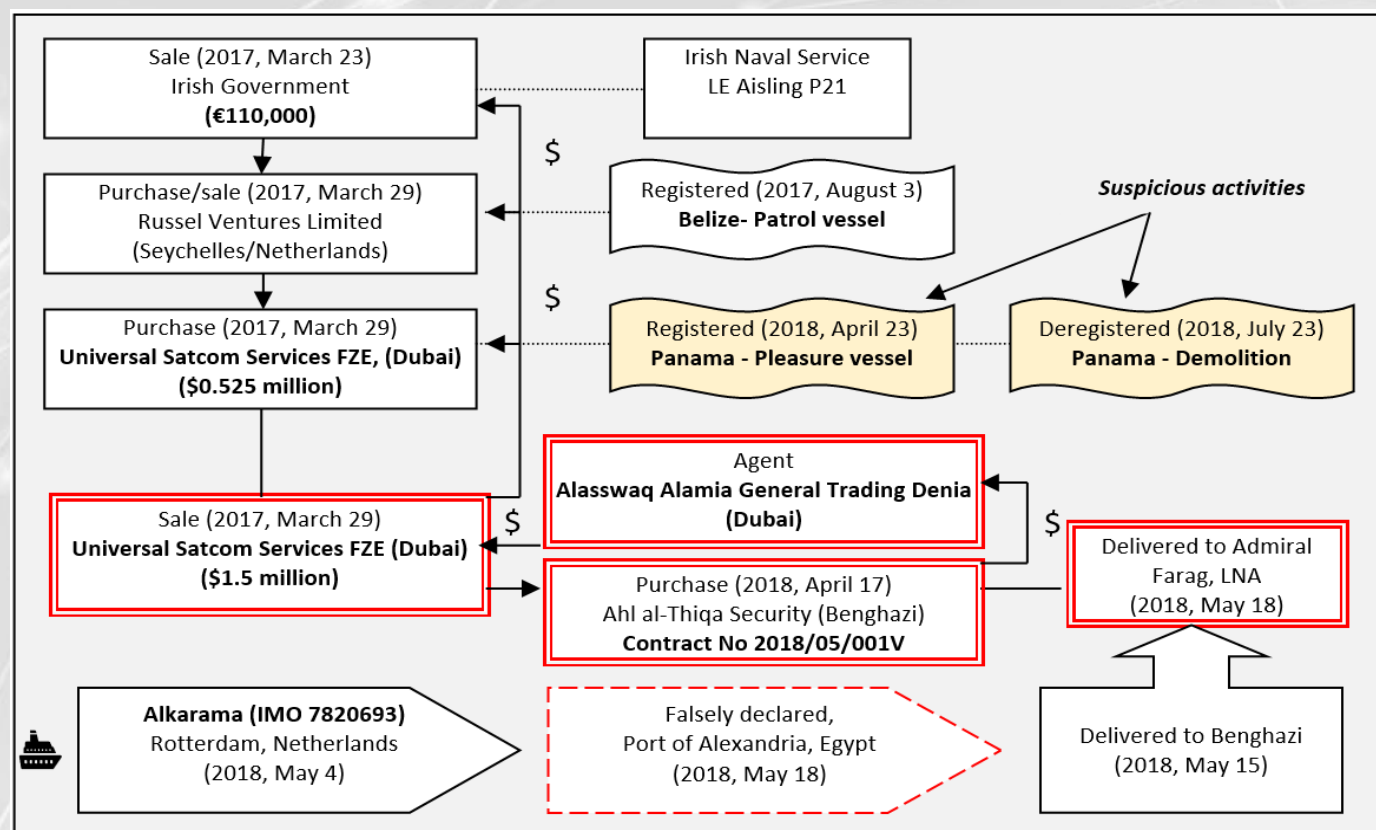
Figure 15: Air traffic and cargo movement through major hubs, 2020



Source: Author based on data from World Bank (n.d.).

Panama has the largest shipping fleet in the world, exceeding the fleets of the United States and China combined. As of 2021, 22% of the world's bulk carrier fleet was registered in Panama because it offers more flexible regulations (Panama Maritime Authority 2021). This explains why Panama-flagged vessels often appear in smuggling and trafficking cases. An illustrative example is the transfer of the naval vessel *Alkarama* (IMO 7820693) from Ireland to Libya in 2018 in violation of the UN arms embargo. The transfer involved several suspicious activities when the patrol vessel was first registered as a pleasure ship in Panama and then declared demolished before it was sold to shell companies (Figure 16).

Figure 16: The supply chain for the offshore patrol vessel *Alkarama*



Source: Adapted from UN Security Council (2019).

The use of shell companies in safe havens helped keep the *Alkarama* vessel supply chain nontransparent. Strategies to disguise this illicit transfer included: (i) changing the shipping register at each stage of the supply chain; (ii) modifying the use declaration to disguise the vessel's true purpose; (iii) making a false declaration of demolition to Panama, the final flag registry of the vessel; and (iv) diverting en route from the declared port of destination of Alexandria in Egypt to Benghazi in Libya.

Illicit trades rely on a wide range of shipping enablers and logistics companies from the legitimate economy, including those located outside the hubs. In a recent case, for example, criminal networks operating in the Western Hemisphere used aviation trust companies registered in the United States to facilitate drug trafficking and other illicit trades (Box 2).

Box 2: The use of U.S. aviation trust companies by criminals in Latin America

In 2021, the U.S. Government indicted Aircraft Guaranty Corporation, a Texas aviation trust company, and Wright Brothers Aircraft Title Inc., an Oklahoma corporation serving as an escrow agent in aircraft transactions. The owner of these companies and her employee registered thousands of aircraft in Onalaska Texas, an East Texas town that does not even have an airport. The defendants used their status as United States citizens to register aircraft on behalf of drug traffickers who wanted to get a coveted N tail number because foreign authorities are less likely to inspect or force down aircraft registered in the United States.

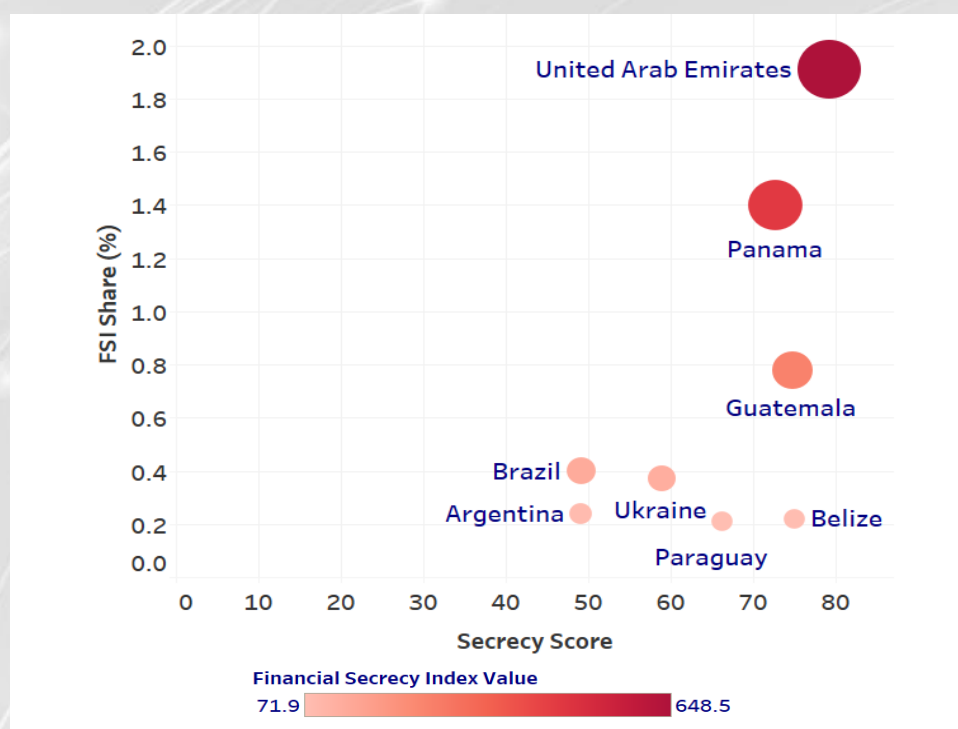
Several of the illegally registered aircraft were used by transnational criminal organizations in Panama, Guatemala, Belize, Colombia, Venezuela, Ecuador, Honduras, and Mexico to smuggle cocaine to the United States. In the case of seizures, the defendants deregistered or otherwise transferred ownership of the aircraft. Aircraft purchases were typically completed by wiring funds from *casa de cambios* or banks located in Mexico to shell corporations operating in the United States as aircraft sellers and brokers. To launder illegally obtained funds, these companies participated in a series of bogus aircraft sales transactions.

Source: Indictment, *United States v. Debra Lynn Mercer-Erwin* (2021).

3.3. Financial, money-laundering, and offshore business infrastructure

The financial infrastructure in hubs of illicit trade helps smuggling networks launder illicit proceeds through financial and non-financial enablers. Deficiencies in anti-money laundering regulations play a critical role in illicit trades, making hubs like Dubai and Panama extremely attractive to all types of illicit actors.

Figure 17: Hubs' financial secrecy and shares of non-resident financial services (millions), 2020



Although both the UAE and Panama have made certain progress in this area, they remain on the grey list of the Financial Action Task Force due to deficiencies in their anti-money laundering regimes. In 2022, the Financial Secrecy Index (FSI) developed by the Tax Justice Network ranked the UAE 8th in the world on financial secrecy, followed by Panama (18th) and Guatemala (45th) (Figure 17). This index is calculated by combining a country's secrecy score and its global scale weight. The first indicator measures the scope for financial secrecy within financial and legal systems (with zero meaning no scope and 100 meaning an unrestrained scope), while the second indicator measures a percentage of financial services provided by the jurisdiction to non-residents.

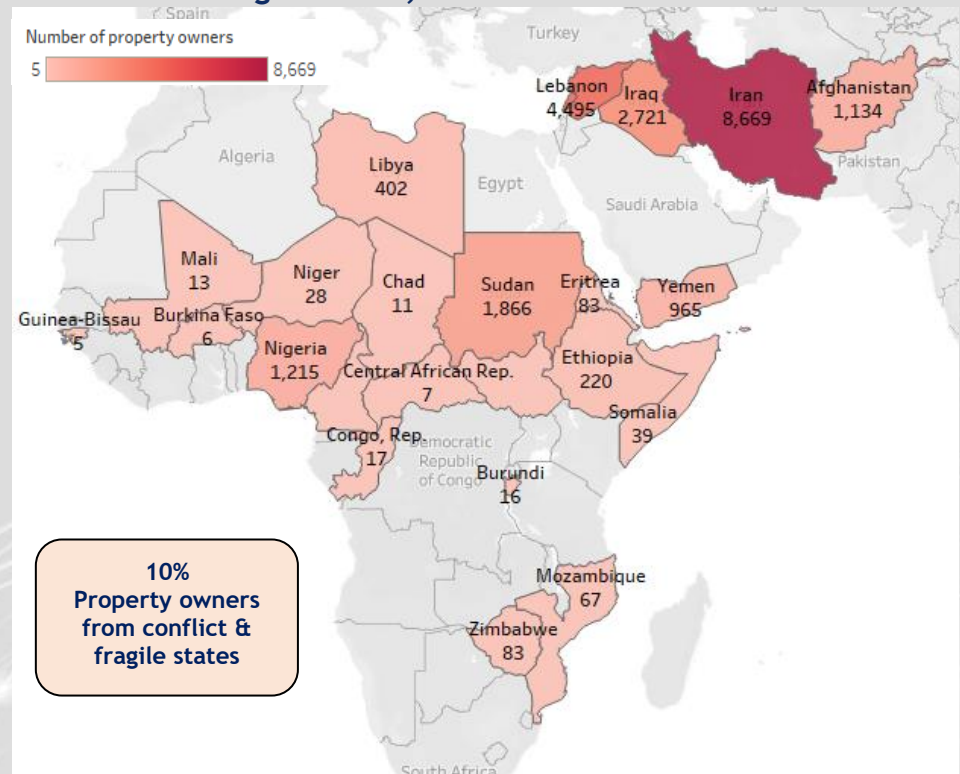
Source: Author based on Tax Justice Network (2022).

Factors that make hubs particularly vulnerable to money-laundering risks include large amounts and high frequency of cash transactions (particularly in trade operations using gold, other precious metals, and stones); the large size and openness of the financial sector; large volumes of remittances; significant shares of foreign residents; expanded free trade zones; and geographic proximity to conflict-ridden and fragile countries and states under international and national sanctions. Crypto exchanges play an increasing role in illicit trade and sanctions evasion. Without strict regulations and know-your-customer policies, crypto exchanges comprise very high money-laundering risks. Designated actors, for example, reportedly used Coinsfera, a cryptocurrency cashpoint, to make multiple crypto trades to transfer large sums of money (Nagarajan 2022). Coinsfera has offices in Istanbul, Kosovo, Dubai, and London. Compared to centralized exchanges, its users can execute trades by swapping offline crypto storage

solutions, buying crypto assets locally, and then selling them for instant cash in other locations. Money laundering through real estate is another attractive feature of many hubs of illicit trade.

Dubai's real estate market, for example, is associated with high risks for money laundering and tax evasion. Based on the 2020 Dubai Property Leaks database featuring 800,000 properties, its offshore real estate market was estimated at US\$146 billion in foreign wealth, which was twice as much as real estate held in London by foreigners through shell companies (Alstadsæter et al. 2022). Importantly, at least 10% of foreign property owners were from conflict-ridden and fragile countries located primarily in Sub-Saharan Africa and the Middle East and North Africa (Figure 18). Among the hubs of illicit trade, the largest number of Dubai property owners were from Ukraine (621), followed by Brazil (253) and Argentina (90) (ibid.). Although the number of real estate owners from Belize was relatively small, the value of their property was estimated at 1.32% of the country's gross domestic product (ibid.), which is the highest indicator among the hubs of illicit trade featured in this report.

Figure 18: Numbers of Dubai's property owners from conflict-affected and fragile states, 2020



Source: Author based on data from Alstadsæter et al. (2022).

3.4. Corruption, weak law enforcement, and poorly guarded borders




A common characteristic among all hubs of illicit trade is a high level of political and administrative corruption. Well-established illicit trade patterns often rely on a system of bribes to administrative officials, customs officers, and border guards in free trade zones, airports, seaports, national crossings, and checkpoints, while corrupt political and judicial systems provide them immunity from prosecution. Criminals operating in hubs also take advantage of corrupt systems in fragile countries along the supply chain. Zimbabwe, for example, is losing millions from illicit gold trade with Dubai due to the corruption of their customs officers and border guards. A recent investigation provides evidence of the use of gold smugglers by the current Zimbabwean regime to launder criminal proceeds and evade Western sanctions (Al Jazeera Investigative Unit 2023). Zimbabwe's gold-smuggling schemes were found to involve influential diplomats, businessmen, and politicians linked to President Emmerson Mnangagwa (Box 3). A similar situation is observed in other fragile and conflict-ridden economies in Sub-Saharan Africa. Thus, UN Security Council reports on Mali, South Sudan, the Central African Republic, Chad, and Libya document the convergence between corruption and illicit trade in gold, alcohol, drugs, vehicles, counterfeit goods, and trafficking in arms and persons (UN Security Council n.d.).

Box 3: The golden laundromat

A 2023 series by the Al Jazeera Investigative Unit shows how Zimbabwe turned the illicit gold trade into a profitable business providing money-laundering services for criminals all over the world. This business is run by multiple smuggling networks. One of them is allegedly headed by Zimbabwe's ambassador and a prominent pastor who uses his diplomatic immunity to smuggle dirty cash into the country. His network is linked to a niece of President Mnangagwa, who heads the country's mining association. Another network is reportedly run by a Kenyan businessman and also a pastor, who was involved in the 1990s Goldenberg scandal, a fraudulent gold export scheme that reportedly defrauded Kenya of up to 10% of its annual gross domestic product. Yet another network is allegedly headed by Zimbabwe's tycoon and co-owner of Gold Leaf Tobacco, one of southern Africa's popular cigarette brands often found in the black market. Although all of them deny any wrongdoing, the Al Jazeera Investigative Unit found that they had official licenses from Zimbabwe's central bank allowing them to sell gold in Dubai. The golden laundromat in Zimbabwe and other fragile African countries relies on shell and front companies set up in Dubai, fake invoices, and public officials on the gold mafia payroll.

Smuggling networks operating in the region often employ multiple air couriers who transport illicit gold in personal luggage (on average, 10 kg per flight and up to 40 kg per week). Gold smuggling is an extremely profitable business. For example, in Mazowe, located 40 km (25 miles) outside the capital Harare in Zimbabwe, artisanal miners are selling gold to local buyers as cheap as US\$40 for 40 grams. Simple calculations show that illicit traders can receive significant profits for smuggling one kilogram of gold to Dubai (Table 3), even after paying bribes and making other informal payments to facilitators. Miners, however, receive almost nothing, while their entire families, including children, have to work at the mine.

Table 3: Potential revenues generated by gold smuggling from Zimbabwe to Dubai, per one kilogram

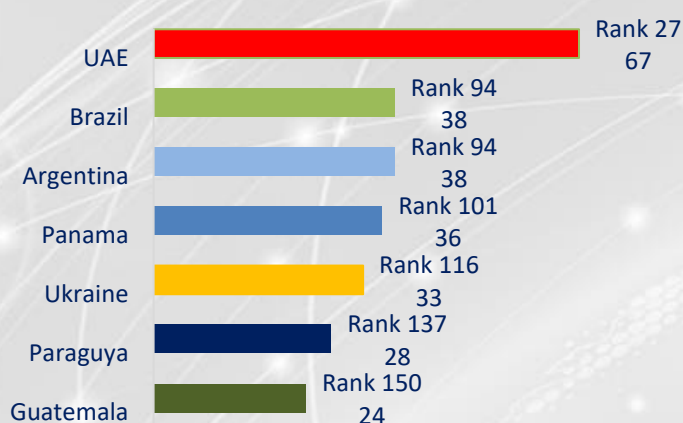
AMOUNT		COSTS
	US\$1,000	Costs of one kilogram of gold bought in Zimbabwe's mine
	US\$330	Air tickets from Robert Gabriel Mugabe International Airport (HRE) in Harare to Dubai International Airport (DXB)
	US\$45,930	Revenue from selling gold in a retail jewelry store in Dubai

Source: Calculations based on Kayak metasearch engine (www.kayak.com) and Mint (<https://mintjewels.ae/>), accessed April 2, 2022.

Sources: Al Jazeera Investigative Unit (2023); Chifamba (2020); Abderrahmane (2022).

Among the hubs of illicit trade featured in this report, the highest level of corruption is reported in Guatemala, followed by Paraguay and Ukraine (Figure 19). In 2022, Guatemala ranked 150th on the Corruption Perception Index among 180 countries (Transparency International 2022).

Figure 19: Corruption Perception Index (scores from 0-worst to 100-best and ranks of 180 countries), 2022



Source: Transparency International (2022).

In Guatemala, safeguards against corruption are particularly weak, while its judicial system is characterized by irregular applications of anti-corruption mechanisms and insufficient resources. Guatemala's criminal organizations involved in smuggling have control of many government agencies. The 2019 closure of the International Commission against Impunity in Guatemala (CICIG) stalled many prosecutions of officials and groups engaged in illicit operations. Many anti-corruption activists have themselves become targets of bogus investigations and have been forced to flee the country. In 2021, the Constitutional Court overturned a law that attempted to hold corrupt officials accountable and prevent the collision of smuggling networks and public officials. The *La Riviera* tax evasion case involving duty-free stores at La Aurora International Airport in Guatemala is an illustrative example of this collusion (Box 4).

Box 4: Tax evasion through duty-free stores in Guatemala and other countries

In 2015, the Office of the Prosecutor against Administrative Crimes of the Public Ministry of Guatemala closed ten duty-free stores of the chain known as *La Riviera* at La Aurora International Airport for alleged customs fraud. These shops were part of Grupo Wisa SA, a Panamanian company operating in more than 14 countries across Latin America. According to the 2014 data, apart from 133 entities in the largest cities in Latin America, Grupo Wisa, SA had 104 duty-free stores located at airports, border checkpoints, and ports. These stores were selling tobacco products, perfumes, cosmetics, watches, chocolate, and alcohol, among other things.

The *La Riviera* case came to light after a nongovernment organization filed a complaint against Tiendas Libres de Guatemala which managed *La Riviera* duty-free stores at La Aurora International Airport. Guatemalan investigators found that Grupo Wisa, SA and Tiendas Libres de Guatemala received authorization from the Superintendency of Tax Administration to operate a private customs warehouse at La Aurora International Airport exempt from paying taxes. This was done in violation of Guatemala's laws according to which only Congress has the power to grant this type of tax exemption. Using this unlawfully acquired tax exemption status, Grupo Wisa, SA and Tiendas Libres de Guatemala defrauded the State of Guatemala of GTQ 59 million (equivalent to US\$7.5 million). According to another source, an overall amount of budget losses, in this case, could have reached GTQ 198 million (US\$25.2 million). In 2015, Guatemala's authorities charged several high-ranking officials of the

Superintendency of Tax Administration with customs fraud, duty breach, violation of the Constitution, and usurpation of powers.

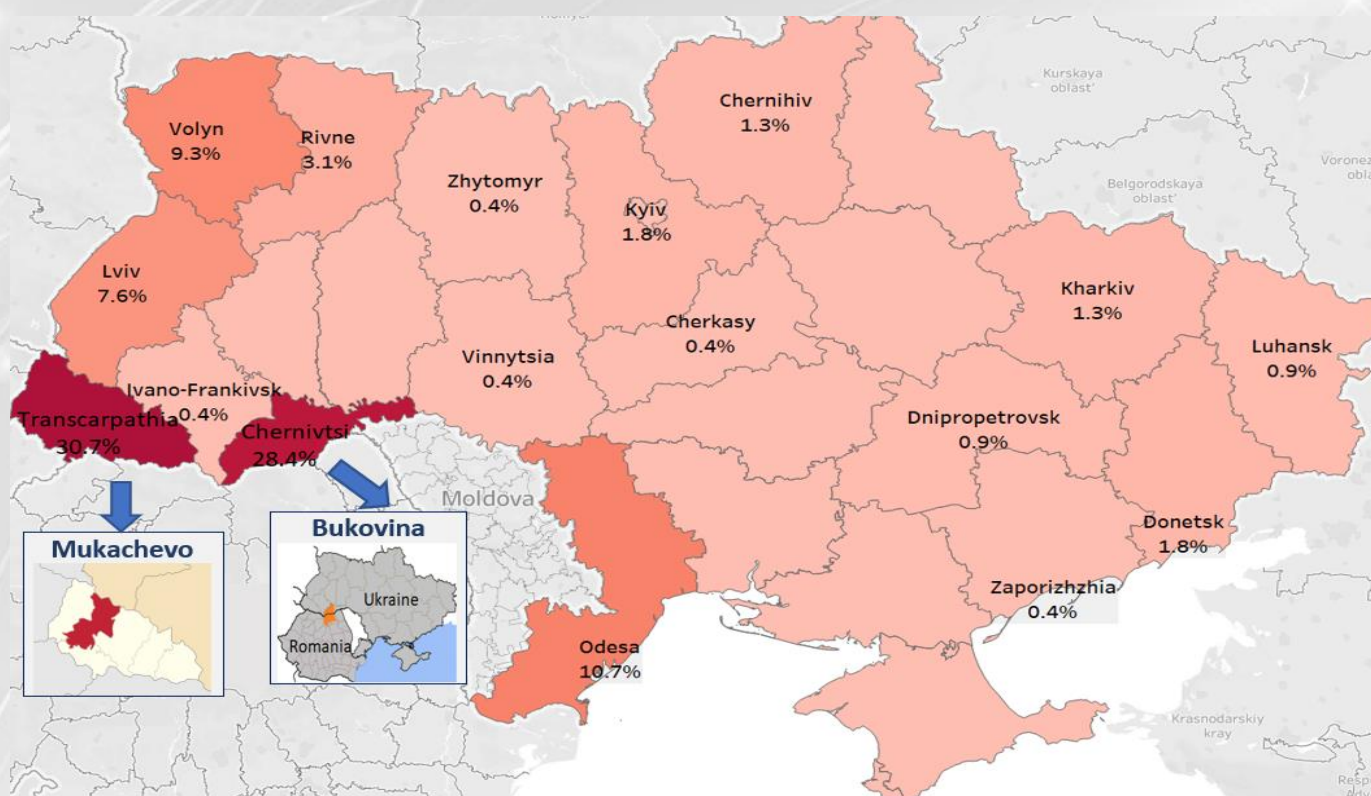
In 2016, the U.S. Treasury Department designated the Waked Group, a Colon Free Zone-based company, its leaders, and affiliated entities for laundering proceeds of the drug trade through duty-free retail, real estate, and financial operations. Grupo Wisa S.A. and La Riviera Panama SA were among the designated entities linked to the Waked Group. As a result, some of the Waked Group entities were sold to third parties who took over their operations. In 2021, the U.S. Treasury removed its designation of four of these affiliated entities. One of them — La Riviera Panama SA continues its operations in duty-free retail in Nicaragua, Colombia, Bolivia, Uruguay, Panama, Guatemala, Belize, Costa Rica, El Salvador, Honduras, and Mexico despite high tax evasion risks.

Source: Interviews with subject matter experts, Álvarez, C., & Patzán, J. (2016, October 13); Fernandez, E. (2015); U.S. Treasury (2016 May 5; 2021, September 30).

3.5. Mobility, diasporic cross-border smuggling networks, and transient populations

Hubs of illicit trade are characterized by ethnic diversity and high population mobility, with intensive movements of local residents, tourists, and migrants, both legal and illegal. Ukraine is an illustrative example, with its Transcarpathia and Chernivtsi regions serving as hotspots of illicit cigarette smuggling to the European Union (Figure 20). Transcarpathia is a historic region dividing Eastern and Central Europe. Situated in the Carpathian Mountains, it is the only Ukrainian region bordering four European Union member states. In Transcarpathia, the city of Mukachevo and the surrounding areas are the most frequent locations related to seizures of illicit tobacco products. In Ukraine's Chernivtsi region, a hotspot of illicit cigarette seizures is Bukovina, a historical region on the border between Central and Eastern Europe dividing Romania and Ukraine. In Ukrainian Bukovina, many residents have Romanian passports.

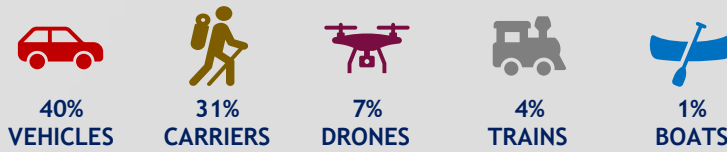
Figure 20: Ukraine's regions with large shares of cigarette seizures (%), 2020-2022



Source: Author based on a sample of cigarette seizures between 2020 and 2022 (n=225) derived from Ukraine's State Border Guard Services (n.d.).

Close ties between local residents, Hungarians, Slovaks, Romanians, and Polish citizens form the basis for diasporic smuggling networks and cross-border petty smuggling (TraCCC 2019). Small-scale smugglers often transport illicit goods with the aid of their relatives and friends who live across the border. A long history of trade relations in the border regions and the social acceptability of smuggled cigarettes and alcohol, among other commodities, are driving factors for this illicit business. Compared to legitimate businesses, Covid-19 restrictions on entry and exit from Ukraine had a less significant and only temporal impact on smuggling networks (RBC Ukraine 2021, July 15), and they had almost no effect on small local groups who operate outside designated border crossing points.

Figure 21: Popular petty smuggling methods (% of cigarette seizures), 2020-2022



Source: Author based on a sample of cigarette & drug seizures (n=225) by Ukraine's State Border Guard Services (n.d.).

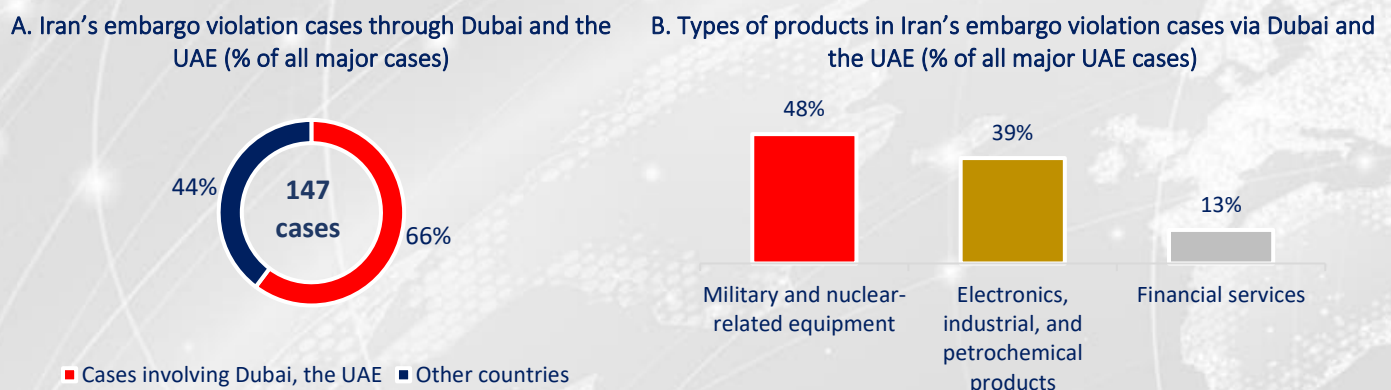
Among the most popular modi operandi of small local groups are hiding cigarettes in various parts of vehicles and transporting packages on foot in forested or mountainous areas and across river borders (Frontex 2022). They also use drones, trains, boats and rafts in rivers (Figure 21). The Covid-19 pandemic has proven the resilience of small local groups to external shocks. The financial recession, economic decline, and rising inflation and poverty due to both Covid-19 and the Russia-Ukraine war have

increased the demand for cheaper illicit goods, further stimulating smuggling activities in border areas.

Dubai is another illustrative example of ethnically diverse hubs where close ties between expatriates and their origin countries form the basis for diasporic cross-border smuggling networks. The largest expatriate network residing in Dubai is from India. About 3.5 million Indians live in the UAE, which constitutes more than 38% of the UAE population (Connor 2017). Indian expatriates in the UAE and Dubai come mainly from the four states of Kerala, Tamil Nadu, Karnataka, and Andhra Pradesh. The Kerala diaspora is considered the largest in the UAE, and this state remains a popular destination among gold smugglers operating from Dubai.

Dubai is also home to one of the largest Iranian diasporas in the world. According to an informal estimate, in 2019, their number reached 600,000 people (Taylor 2019), which constituted around 18% of Dubai's population in that year. Iranians in Dubai have a strong business community, with the potential to influence formal and informal practices to evade economic sanctions against Iran. There is a long history of the UAE being involved in smuggling various goods to Iran. As the Iranian economist Saeed Laylaz noted, "Dubai is the most important city on earth to the Islamic Republic of Iran, with the exception of Tehran" (cited in Krane 2009). Calculations based on a database of major U.S. export enforcement and embargo criminal prosecutions between January 2007 and November 2019 (U.S. Department of Justice n.d.) provide evidence that the vast majority of Iran's embargo violations were facilitated by individuals or front companies based in the UAE and Dubai, in particular (Figure 22A). Most embargo violations included transfers of military and nuclear-related equipment, followed by electronics, industrial and petrochemical products, and financial services (Figure 22B).

Figure 22: Major U.S. criminal cases related to Iran's embargo violations, 2007-2019



Source: Author based on major U.S. export enforcement and embargo-related criminal prosecutions by the U.S. Department of Justice between 2007 and 2019.

The Tri-Border Area in South America is also characterized by a high level of population heterogeneity, which facilitates the development of ethnic cross-border networks important for all forms of smuggling. For example, the second largest city in Paraguay and a hotspot of both licit and illicit trade, Ciudad del Este, hosts a large Brazilian diaspora together with other ethnic communities of Italians, Russians, Japanese, Germans, Chinese, Arabs, and Argentinians (Singh & Lasmar 2023). Each day, approximately 30-40 thousand people and 20 thousand vehicles cross the bridge Puente de la Amistad that connects Ciudad del Este with the Brazilian city of Foz do Iguaçu (ibid.). Most individuals crossing this bridge are small-scale traders, known locally as the *sacoleiros* (derived from the Portuguese *saco*, meaning 'bag') who take advantage of tax differentials between Paraguay and Brazil and very limited border control, particularly on the Paraguayan side (ibid.). This situation is similar to the one observed in Ukraine's Transcarpathia and Chernivtsi regions, which are also called tri-border areas concerning neighboring states.



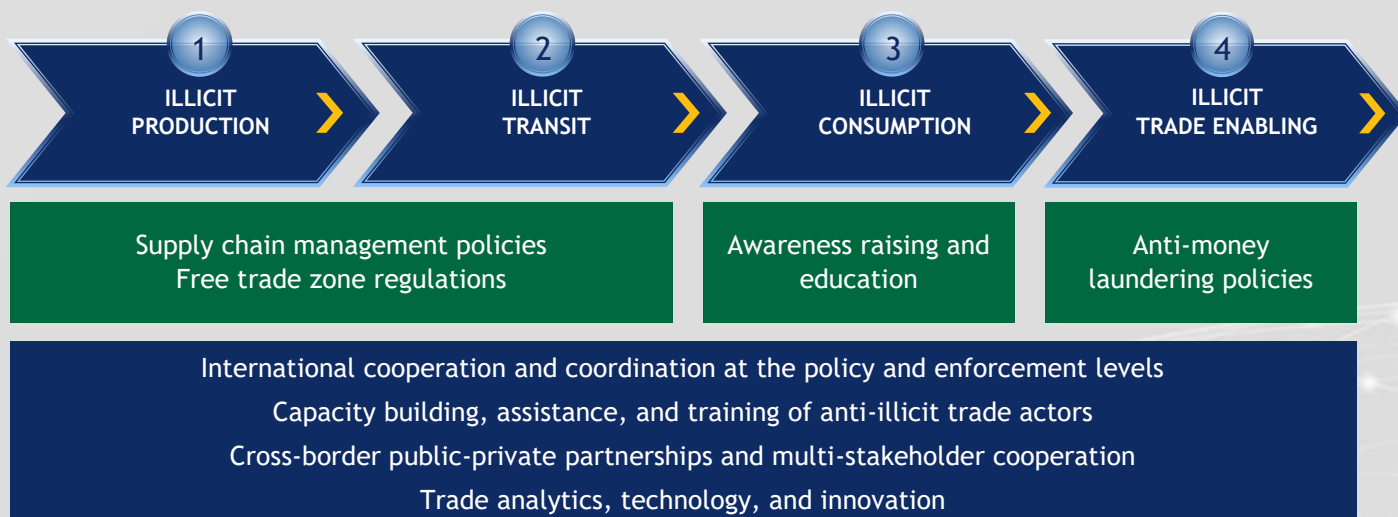
4. DISRUPTING HUBS OF ILLICIT TRADE

KEY TAKEAWAYS

- ❖ **Holistic strategy:** The disruption of hubs requires a holistic strategy based on a set of policies that simultaneously address their major functions, including illicit production, transit, consumption, and their enabling and facilitating functions, such as money laundering.
- ❖ **Enhanced international cooperation at the policy and enforcement levels:** Due to the transnational and dynamic nature of hubs of illicit trade, their disruption requires strengthening international cooperation and coordination both at the policy and enforcement levels.
- ❖ **Cross-border public-private partnerships:** A multitude of inter-jurisdictional issues associated with cross-border illicit supply chains require cross-border public-private partnerships convening representatives of public agencies, law enforcement, private-sector companies, and nongovernmental organizations from all affected countries.
- ❖ **Multi-stakeholder cooperation:** The effectiveness of national governments in disrupting smuggling networks and their enablers depends to a large extent on the contributions of all stakeholders — legitimate companies in the private sector, financial organizations, free trade zones operators, shipping and logistics agents, academia, and civil society, among other actors. Key policy domains that require their active participation include improvements in supply-chain management policies, free trade zone regulations, anti-money laundering policies, awareness-raising and education campaigns, and data analytics aimed at destroying criminal ecosystems in hubs of illicit trade.

Given a variety of illicit goods and services traded in particular hubs, their growing production facilities, and local demand for illicit goods and services, their disruption requires a holistic strategy based on a set of policies that simultaneously address major functions performed by hubs, including illicit production, transit, consumption, and their enabling and facilitating functions such as money laundering (Figure 23).

Figure 23: Policies to counteract illicit activities in hubs of illicit trade



Source: Author.

Enhanced international cooperation and coordination at the policy and enforcement levels is the cornerstone of the effectiveness of all other policy domains. Among the most critical steps are the ratification of international conventions and treaties regulating specific illicit trades, the harmonization of customs regulations, taxation, and penalties for smuggling between integrated trading countries, as well as joint law enforcement operations and data sharing. The holistic strategy also requires coordinated efforts among various government entities (a whole-of-government approach) and their cooperation with other stakeholders, including private-sector entities, academia, civil society organizations, and consumers (a whole-of-society approach). Table 4 summarizes key policies targeting various functions of hubs of illicit trade.

Table 4: Major policies addressing key functions of hubs of illicit trade

POLICY CATEGORY	EXAMPLES OF POLICIES
International cooperation and coordination at the policymaking and enforcement levels	<ul style="list-style-type: none"> > Ratification of international conventions and treaties regulating specific types of illicit trade. > Strengthening bilateral and multilateral diplomatic channels. > Providing access to international funding conditional on anti-illicit trade policy reforms. > Trade facilitation & harmonized policies related to taxation, penalties, customs procedures, FTZ regulations, etc. > Enhancing law enforcement cooperation, data sharing, and the integration of hubs-related analytics into early-warning systems.
Supply chain management policies	<ul style="list-style-type: none"> > Adopting policies to increase accountability and transparency in provenance jurisdictions of counterfeits. > Complying with track and tracing, labeling, and record-keeping requirements. > Adopting due diligence and know-your-customer practices along the supply chain to ensure that key inputs in illicit manufacturing are also controlled. > Outlining legal responsibilities and imposing stricter penalties on legitimate companies and actors who enable and facilitate operations of illicit manufacturers and distributors. > Complying with licensing requirements.
Capacity building, assistance, and training	<ul style="list-style-type: none"> > Establishing Joint Anti-Illicit Trade Task Forces. > Strengthening local anti-corruption capacity. > Launching new capacity building, assistance, and training initiatives at ports and other critical entry points for illicit trade.
Anti-money laundering policies	<ul style="list-style-type: none"> > Adopting beneficial ownership & anti-money laundering regulations based on international recommendations set by the Financial Action Task Force. > Coordination with regional bodies, e.g., the Financial Action Task Force of Latin America (GAFILAT), the Middle East and North Africa Financial Action Task Force (MENAFATF), and the Eurasian Group (EAG).
FTZ regulations	<ul style="list-style-type: none"> > Adopting and enforcing policies ensuring transparent and accountable practices for FTZs, drawing on recommendations developed by international and regional organizations, e.g., the WTO, the WCO, and the OECD.
Cross-border public-private partnerships & multi-stakeholder cooperation	<ul style="list-style-type: none"> > Enhanced cross-border public-private partnerships aimed at curbing illicit trade. > Multi-stakeholder initiatives putting pressure on hubs of illicit trade at the country, regional, and global levels.

POLICY CATEGORY	EXAMPLES OF POLICIES
Awareness-raising & education	<ul style="list-style-type: none"> > Awareness-raising campaigns on multiple harms and threats of hubs of illicit trade to sustainable development and global security. > Education on individual and organizational contributions to disrupting illicit trade hubs. > Investigative journalism that informs a broader public of the harmful products being shipped through hubs of illicit trade.
Trade analytics, technology, & innovation	<ul style="list-style-type: none"> > Applying artificial intelligence, machine learning, blockchains, and other technological advances to prevent and detect illicit trade transactions. > Collecting, analyzing, storing, and managing databases on all relevant aspects related to illicit products and services sold on online platforms and marketplaces.

Source: Author.

4.1. International cooperation & coordination at the policymaking & enforcement levels

Argentina, Belize, Brazil, Guatemala, Panama, Paraguay, Ukraine, and the UAE have made significant progress, ratifying major international conventions and treaties regulating illicit trades in drugs, arms, endangered species of wild fauna and flora, hazardous wastes, and cultural property (Table 5). Yet, only Panama, Brazil, and Paraguay have ratified the Protocol to Eliminate Illicit Trade in Tobacco Products (ITP), which is the first legally binding instrument adopted under the World Health Organization's Framework Convention on Tobacco Control (FCTC) that outlines specific provisions for countries to effectively tackle illicit tobacco trade in a coordinated manner.

Table 5: Ratification of international treaties regulating specific types of illicit trade

CONVENTION/TREATY	YEAR	IMPORT & EXPORT	TRANSIT & TRANSHIPMENTS	FREE ZONE ACTIVITIES	RATIFICATION BY 8 HUBS
UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances of 1988	1990	✓	✓	✓	All hubs
Arms Trade Treaty	2014	✓	✓	✗	All hubs
Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES)	1973	✓	✓	✗	All hubs
Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal	1992	✓	✓	✗	All hubs
UNESCO 1970 Convention on the Means of Prohibiting and Preventing the Illicit Import, Export and Transfer of Ownership of Cultural Property	1972	✓	✗	✗	All hubs
Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)	1995	✓	✗	✗	All hubs
Protocol to Eliminate Illicit Trade in Tobacco Products (ITP)	2018	✓	✓	✓	Panama, Brazil, & Paraguay

Sources: United Nations (n.d.); WTO (n.d.).

Illicit trade is a profitable business for many organized crime groups and networks. The United Nations Convention against Transnational Organized Crime, adopted in 2000, is the main international instrument in the fight against transnational organized crime. This convention has three supplementing protocols: The Protocol to Prevent, Suppress and Punish Trafficking in Persons, the Protocol against the Smuggling of Migrants (not ratified by the UAE), and the Protocol against the Illicit Manufacturing of and Trafficking in Firearms (not ratified by the UAE and Belize). The ratification of these protocols signals countries' commitments to eliminate illicit trade in these areas.

In many hubs of illicit trade, penalties for smuggling and its facilitation are not severe, and they differ significantly at the country and regional levels. A possible solution is the harmonization of penalties for smuggling at the regional level, particularly in integrated trading countries (e.g., the Gulf Cooperation Council Countries, the Common Market for Eastern and Southern Africa, and others). In terms of coordinated policies, it is also important to develop uniform customs rules, free trade zone regulations, and harmonized tax policies that remove incentives for smuggling excise and other goods between integrated trading countries. For example, in 2016, the Gulf Cooperation Council Countries agreed to implement a harmonized excise tax at the rate of 100% on all tobacco products.

International and regional organizations play an important role in developing recommendations on promoting transparency and strengthening border and regulatory controls through enhanced cooperation (e.g., the recommendations on tackling illicit trade adopted by the World Trade Organization and the guidelines for successful enforcement strategies developed by the World Intellectual Property Organization). Furthermore, international development organizations, such as the World Bank Group and the International Monetary Fund, increasingly use good governance practices and anti-corruption policies as a conditionality measure for financial aid. Bilateral and multilateral diplomatic channels are another important instrument for enhanced cross-country cooperation.

Law enforcement cooperation through mutual legal assistance and extradition treaties, joint operations, technical assistance, and information sharing is critical for the disruption of cross-border illicit trade transactions. The identification of such instances is impossible without the exchange and subsequent analysis of trade anomalies apparent by examining both sides of trade transactions. A good example is the Trade Transparency Unit program under the U.S. Department of Homeland Security's Immigration and Customs Enforcement. Within this program, the U.S. Trade Transparency Unit exchanges trade data with similar units in Argentina, Brazil, Guatemala, Panama, Paraguay, and some other countries, which helps identify and tackle trade-based money laundering (Box 5).

Box 5: The Trade Transparency Unit program and international data exchange

The Trade Transparency Unit program has two important components. One component is the high-technology computer system – known as the FALCON Data Analysis and Research for Trade Transparency System (DARTTS), an investigative tool to identify trade anomalies and quickly analyze huge amounts of data. Another component is the exchange of trade data by Trade Transparency Units in partnering countries formalized through Customs Mutual Assistance Agreements. In addition, the Trade Transparency Unit was integrated into a division of the U.S. National Targeting Center Investigations (NTC-I) Unit, which is a collaborative partnership with the U.S. Customs and Border Protection agency. This integration has increased the agencies' ability to share information in order to identify, disrupt, and dismantle smuggling networks.

The Trade Transparency Unit program also trained national customs in partnering countries on how to target and identify transactions to import large quantities of counterfeit and other illicit merchandise. This training, for example, helped the Paraguayan Customs to seize counterfeit cellular phones and accessories worth more than US\$5 million. The case involved trade fraud violations, including under-valued, undeclared, and mis-declared items. In another case, the Panamanian Trade Transparency Unit provided analysis to support an investigation that successfully disrupted a tobacco smuggling ring involving several Panamanian companies. The investigation led to four arrests and the seizure of over US\$10 million in cigarettes.

Sources: U.S. Government Accountability Office (2020); Smith (n.d.).

4.2. Supply chain management policies

Private-sector companies use a wide variety of supply chain management solutions to tackle the diversion of goods from legitimate supply chains, including due diligence and know-your-customer policies, licensing, record-keeping requirements, and the use of new technologies for ensuring supply chain transparency (Box 6). Another measure is track and trace systems that represent logistical technologies to enable localizing a product throughout its supply chain, which are used in many sectors, including aviation, retailing, and the pharmaceutical and tobacco industries.

Box 6: Supply chain management policies to curb illicit cigarette trade

The Protocol to Eliminate Illicit Trade in Tobacco Products (ITP) contains several supply chain control provisions, including licensing and due diligence (Articles 6 and 7); tracking and tracing (Article 8); record-keeping (Article 9); and security measures (Article 10). It also contains provisions regulating online transactions (Article 11) and free trade zone transactions (Article 12).

Licensing and due diligence cover various types of activities along the supply chain, including manufacturing tobacco products, their import and export, manufacturing equipment, growing tobacco, transporting, and wholesaling tobacco products, and know-your-customer policies. Yet, these measures do not cover the manufacturing or distribution of key inputs, which could help decrease illicit trade. Thus, acetate tow, used for filter manufacturing, can significantly aid illicit production.

Table 6: Paraguay's cigarette oversupply, 2020-2021

YEAR	IMPORTED ACETATE TOW (NET), KILOTONS	CIGARETTE PRODUCTION BASED ON ACETATE TOW IMPORT, BLN	OVERSUPPLY AFTER CONTROLLING FOR EXPORT, IMPORT, & CONSUMPTION, BLN
2020	6	54.4	53
2021	5	45.1	44

Source: Calculations based on UN Comtrade (n.d.); Tobacco Atlas (2022); World Bank (n.d.).

Calculations based on acetate tow imported by Paraguay in 2020-2021, for instance, point to significant production of illicit cigarettes, above legitimate demand, consumed both domestically and smuggled abroad (Table 6).

Acetate tow imported by Paraguay is produced by a few companies located mostly in the United States, China, and Brazil. The adoption of know-your-customer policies by these companies could help decrease the observed oversupply. Importantly, suppliers of key inputs should be subject to licensing, record-keeping, and other preventative measures. The legal responsibilities of key input suppliers should be enforced through stricter penalties applied to all legitimate companies and actors who enable illicit cigarette production and distribution.

The adoption of track and trace systems is aimed at enabling monitoring the movement of legal tobacco products along the supply chain and helping determine their diversion to illicit supply chains. Existing track and trace systems, however, have multiple inefficiencies. First, very few of them are interoperable, meaning that information cannot be shared between countries, often because they use paper-based tax stamps rather than digital systems. Second, they are rarely used effectively, as evidenced by the European Union track and trace system that became operational in 2019. Although it collects information on the legal supply chain of cigarettes and roll-your-own tobacco, it was criticized in the European Parliament for failing to be used to provide information on illicit tobacco products and their diversion from the legal supply chain. Although this system works across multiple jurisdictions, it does not cover the majority of illicit products identified in this region.

Record-keeping requirements for businesses in the supply chain include obtaining and storing data on manufacturing date and location, manufacturing facility, the first customer, an intended market of retail sale, and an intended shipment route of tobacco products but fall short of having the same requirements for key inputs.

Security measures are aimed at preventing the diversion of tobacco products into illicit trade channels, ensuring transparency of financial transactions, and providing legal procedures and effective sanctions for violations. To be effective, however, such measures should be part of wider anti-illicit trade programs and extended to key inputs, with adequate enforcement, monitoring, data exchange, and coordination mechanisms.

ITP impairment: The impact of the ITP on the illicit trade in tobacco products has been limited due to a relatively low ratification rate. As of April 2023, compared to 182 parties of the World Health Organization's Framework Convention on Tobacco Control, the ITP has been ratified only by 66 countries, including the European Union.

Sources: FCTC (2018); European Commission (2022); UN Comtrade (n.d.); European Parliament (2023).

4.3. Capacity building, assistance, & training

Detecting and investigating complex illicit trade transactions require sophisticated expertise in all relevant policy domains. Capacity building, assistance, and training of anti-illicit trade actors is, therefore, another cornerstone defining the effectiveness of law enforcement actions. These activities require cross-agency cooperation through establishing Joint Anti-Illicit Trade Task Forces involving experts on intellectual property infringements, taxation, illicit finance and money laundering, customs, and border protection, counter-terrorism, the transport and postal systems, intelligence, and law enforcement.

This research shows that the collusion between criminal groups and corrupt officials, including high-level politicians, law enforcement agents, customs officers, and border guards, is an important driver of illicit trade. Although all countries featured in this report have signed the UN Convention Against Corruption, its implementation remains ineffective in all hubs of illicit trade, particularly in Guatemala, Paraguay, and Ukraine (Transparency International 2022). Law enforcement and the judiciary in these countries are hindered by insufficient resources, as well as limited numbers of trained prosecutors and judges. In turn, a lack of effective anti-corruption mechanisms and safeguards is responsible for general public distrust in public agencies.

Guatemala's experience showed that the formation of international entities to fight against impunity can be a last resort for countries where state structures are captured by organized crime and clandestine security organizations. Created in 2006, the International Commission against Impunity in Guatemala (CICIG) represented an experimental approach to the fight against corruption in weak states, with the aid of international anti-corruption and law enforcement experts. Before its closure in 2019, CICIG had achieved numerous victories in reforming legal and judicial institutions and prosecuting corrupt officials in Guatemala. Several recommendations derived from the CICIG experience relate to the importance of cross-country assistance, local capacity building, and strategic approaches to criminal prosecution, with a focus on high-profile cases and clientelistic networks (Krylova 2018).

Capacity building, assistance, and training of customs and border guards at major ports is another important domain as more than 80% of the trade in most developing countries is transported in cargo containers (UNCTAD n.d.). A good example is the Container Security Initiative, which as of 2022, included 61 ports, covering over 80% of all containerized cargo imported by sea into the United States, including ports in Colón, Balboa, and Manzanillo in Panama, Santos in Brazil, and Dubai in the UAE (U.S. Customs and Border Protection 2022). Its core elements include the use of automated targeting tools to identify high-risk containers based on advanced information and intelligence and the use of technology (large-scale X-ray and gamma ray machines) for a rapid and effective cargo pre-screening

as early in the supply chain as possible, generally at the port of departure. The expansion of this initiative to other ports could be beneficial for other countries (Box 7).

Box 7: Guatemala Trade Security Initiative

The Guatemala Trade Security Initiative is a modification of the Container Security Initiative that applies its core elements to shipments of drugs, counterfeit commodities, and contraband to Guatemala's seaports. This initiative calls for an open international "Terminal Operation Concession" in all Guatemalan ports under international supervision and underlines the importance of sending U.S. officers to foreign ports to enhance security.

Requirements that the Customs Administration must meet within the Guatemala Trade Security Initiative:

- ❖ Inspect cargo using non-intrusive inspection equipment (large-scale X-ray and gamma-ray machines and radiation detection devices);
- ❖ Commit to establishing a risk management system to identify potentially high-risk containers and automate this system;
- ❖ Commit to sharing critical data, intelligence, and risk management information with the United States;
- ❖ Conduct a thorough port assessment to identify weak links in its infrastructure and resolve all vulnerabilities;
- ❖ Commit to maintaining integrity programs and combatting their breaches;
- ❖ Start a concession process for all the port terminal operations in Guatemala under international supervision.

Sources: Fernandez, E. (2022); U.S. Customs and Border Protection (2022).

4.4. Anti-money laundering policies

Money laundering and illicit finance are the drivers of organized crime and illicit trade. A lack of transparency in beneficial ownership and financial secrecy in offshore jurisdictions are fertile grounds for all types of smuggling. The Financial Action Task Force Recommendations set out a comprehensive and consistent framework of measures to combat money laundering, terrorist financing, and the financing of proliferation of weapons of mass destruction. Its regional bodies, e.g., the Financial Action Task Force of Latin America (GAFILAT), the Middle East and North Africa Financial Action Task Force (MENAFATF), and the Eurasian Group (EAG), help to raise awareness and offer technical aid in implementing these recommendations via peer pressure and mutual evaluations.

As noted earlier, Panama and the UAE remain on the Financial Action Task Force grey list of countries for increased monitoring. Recently, both of them have made high-level political commitments to work with the Financial Action Task Force to strengthen the effectiveness of their anti-money laundering regimes. Major reforms in the UAE include a mandatory registration framework for hawala providers and informal money transfer service providers, a new set of anti-money laundering laws setting obligations of financial actors to report suspicious transactions and conduct due diligence, the establishment of the financial intelligence unit, and new regulations on virtual assets. Similarly, Panama has made improvements through a set of new regulations establishing tax evasion as a precedent for money laundering and improving the transparency of corporations, foundations, and other legal arrangements. Yet, there is room for further improvement in all countries featured in this report.

Predicate crimes, such as drug trade, smuggling, human trafficking, and tax evasion, represent entry conditions for money laundering. The Financial Action Task Force recommends expanding national lists of such predicate crimes. In terms of supporting investigations and prosecutions, financial organizations play a critical role in providing evidence and data on financial flows supporting illicit trade activities. Since hubs represent areas with a high concentration of both illicit trade actors and enablers, financial data help identify hotspots of their suspicious activities. Furthermore, the confiscation of assets from smuggling networks operating in hubs can be used to compensate for damages generated by illicit traders.

4.5. Free trade zone regulations

Illicit trades in all hubs featured in this report are facilitated by free zones, including free ports (for example, Ukraine's Odesa Port) or special economic zones (for example, the special public economic development zone Puerta del Istmo in Guatemala or Ciudad del Este in Paraguay). Therefore, national governments must adopt policies ensuring transparent and accountable practices in free trade zones, drawing on provisions set by international and regional organizations. For example, the Practical Guidance on Free Zones developed by the World Customs Organization contains the following recommendations:

- ❖ providing customs with access to a free zone's digital records system containing information on inbound/outbound consignments, as well as inventory data for warehouses within free zones;
- ❖ authorizing customs to conduct audits within free zones, to search and seize consignments, and to conduct on-site checks and inspections of their occupants at any time;

- ❖ facilitating coordination among public agencies and customs administrations, including through regular outreach meetings with free zone occupants and operators; and
- ❖ ensuring cooperation between customs authorities at the regional level to ensure the exchange of relevant information, such as notifications of seizures and high-risk shipments (WCO 2020).

In addition, the OECD recommendations on enhancing free zones transparency include the following measures:

- ❖ ensuring that managers are trained on smuggling and fraud techniques and methods used by illicit traffickers and are aware that a lack of proactive action negatively affects the free zone reputation;
- ❖ prohibiting legal or natural persons convicted of illegal economic or financial activities from operating within free zones;
- ❖ ensuring that economic operators active in free zones maintain detailed digital records of all shipments of goods entering and leaving the zone, as well as all goods and services produced within it; and
- ❖ incentivizing electronic payments for all commercial and financial transactions occurring in free zones and ensuring the traceability of all cash transactions (OECD 2019).

Free trade zone regulations and anti-money laundering regulations are closely interconnected. Free zone actors need to ensure transparent and accountable financial transactions and use advanced digital practices to identify fraudulent documents that are often used to expedite products through free trade zones.

4.6. Cross-border public-private partnerships & multi-stakeholder cooperation

Cooperation and joint initiatives between public and private actors in hubs of illicit trade can lead to synergies necessary for disrupting transnational illicit supply chains. For example, in 2021, the Latin American and Caribbean Parliament (*Parlatino*), whose members include Guatemala and Panama, approved the Model Law to Combat Illicit Trade and Transnational Organized Crime. Among other things, this model law underscores the importance of cooperation between the private and the public sectors and coordination between various institutions within and beyond national borders. The adoption of national laws to combat illicit trade based on this model could signal countries' commitments to enhance international cooperation and public-private partnerships in this area. To be effective, however, they need to provide adequate monitoring and enforcement mechanisms.

This research shows that illicit operations carried out through trading hubs often rely on complex business structures and front companies located in multiple jurisdictions. Cross-border public-private partnerships with representatives of all countries along the supply chains could, therefore, help address many inter-jurisdictional issues and provide the synergies necessary to disrupt the interconnected hubs of illicit trade. In particular, law enforcement bodies from partnering countries can work with one another and with the private sector from different jurisdictions to accelerate cross-border trafficking investigations. Cross-border public-private partnerships, particularly in the policymaking area, should also be reinforced through the inclusion of multilateral organizations, banking institutions, civil society, academia, and media working on eliminating safe havens for smugglers and traffickers (Box 8).

Box 8: Human trafficking and cross-border public-private partnerships

Human trafficking represents a lucrative business in many hubs of illicit trade. The U.S. Department of State places Belize, Brazil, Guatemala, Panama, Paraguay, Ukraine, and the UAE among Tier 2 countries, meaning that their governments do not fully meet the trafficking victims' protection minimum standards. Russia's invasion and war-induced migration make many Ukrainians particularly vulnerable to human trafficking networks. As of April 2023, there were over 8 million refugees from Ukraine recorded across Europe, with over 5 million of them registered for Temporary Protection or similar national protection schemes. Despite social assistance provided by many European countries, a prolonged war will result in an increasing number of cases of exploitation. Socio-economic vulnerabilities in other countries fueled by the current economic recession also contribute to increasing human trafficking risks in all regions.

Cross-border human trafficking supply chains generate multiple inter-jurisdictional challenges, including conflicting obligations at the country level, different national interpretations of money-laundering risks linked to human trafficking, a lack of unified methodologies in case reporting between jurisdictions, and domestic barriers on reporting, among other issues. Addressing such complex inter-jurisdictional challenges is impossible without cross-border public-private partnerships. A good example of such partnerships is the **Global Coalition to Fight Financial Crime — Effectiveness Expert Working Group**, which was founded in 2018 to address inter-jurisdictional money laundering issues linked to other crimes. It brings together different stakeholders who specialize in combating financial crime to identify key weaknesses in the financial systems, advocate for tangible reforms at the political and policy levels, and make the global anti-money laundering framework more effective. Other members of this group include EUROPOL, Fintech FinCrime Exchange, the Institute of International Finance, the Middle East and North Africa Financial Crime Compliance Group, the Western Union, the World Economic Forum, the Basel Institute on Governance, the European Banking Federation, the Global Financial Integrity, INTERPOL, the Atlantic Council, and the European Association of Corporate Treasurers, among other organizations.

Sources: U.S. Department of State (2022); UNODC (2021); Frontex (2022); UNHCR (2023); Global Coalition to Fight Financial Crime (2022).

4.7. Awareness-raising & education

Governments in many hubs and other countries increasingly use awareness-raising and education initiatives to decrease demand for illicit goods and services and encourage individual consumers and organizations to report illicit activities to the appropriate authorities. In Brazil, for example, in response to increasing illicit trade, the government set up the National Council on Combating Piracy and Intellectual Property Crimes comprised of public and private sector representatives responsible for coordinating national efforts against piracy and counterfeiting. Apart from law enforcement activities, the National Council on Combating Piracy and Intellectual Property Crimes aims to combat piracy in Brazil through educational and awareness-raising activities amongst consumers (WIPO 2019).

This research, however, shows that awareness-raising and education initiatives need to go beyond a traditional focus on the impacts of illicit goods and services on final consumers in destination markets. It is critical to raise awareness among policymakers, government agencies, private-sector companies, and the general public about the myriad of negative impacts and spillover effects of hubs of illicit trade on their trading partners, neighboring states, and the entire global community. Countries along supply chains, for instance, face many consequences of illicit trades carried out in hubs, including increased criminal violence, illicit consumption, corruption, poverty, socioeconomic inequality, and reduced public health, among other negative implications. Furthermore, dumping due to cheap illicit commodities flooding countries along the illicit supply chains seriously hits their national economies and industries. As a result, legal manufacturers in these countries are often put in a dilemma to close their businesses or turn to informal practices themselves to survive under unfair competition against illicit trade.

Some effects of illegal activities concentrated in hubs of illicit trade go far beyond their partnering or neighboring states. Among the most obvious examples are environmental impacts that affect the entire global community. They include deforestation, the destruction of coastlines and maritime life, air, water, and soil pollution, biodiversity loss, and damages to ecosystem-based climate change adaptation, among many others. Another example is the illicit trade-terror convergence facilitated by hubs linked to multiple terrorist organizations, armed groups, and militias. Nowadays, there is a broad political consensus on the connections between illicit trade, organized crime, and terrorism (Shelley 2018: 214-215). This consensus, for instance, is reflected in resolutions 2195 and 2199 unanimously adopted by the United Nations Security Council in 2014 and 2015, condemning trade with terrorist organizations and expressing concerns about their profiting from involvement in transnational organized crime (ibid.). Specifically, resolution 2195 stresses that the links between illicit trade, transnational organized crime, and terrorism contribute to undermining security, stability, governance, and social and economic development at the country and global levels (UN Security Council 2014b). Awareness-raising and education campaigns focusing on these and other effects facilitated by hubs are essential for creating an atmosphere of absolute social intolerance toward smuggling, counterfeiting, and other illicit practices.

4.8. Trade analytics, technology, and innovation

Innovative technologies help brand owners to ensure supply chain integrity. Amazon Project Zero, for example, uses cutting-edge artificial intelligence technology and brand insights to detect and automatically remove counterfeits from the Amazon marketplace. As of March 2023, over 20 thousand brands were involved in Project Zero, with over eight billion listings monitored daily (Amazon 2023). Blockchain technologies also play a critical role in providing supply chain transparency, reliability, traceability, and efficiency through data collection and record keeping.

Due to the rapid growth of online illicit commerce, it is necessary to enhance multi-stakeholder partnerships aimed at collecting, analyzing, storing, and managing databases on all relevant aspects related to illicit products and services sold on online platforms and marketplaces. This analysis is essential for identifying counterfeiting and contraband, targeting illicit shipments, and other forms of illicit trade. Such databases could provide leads to law enforcement agencies and inform legitimate companies about intellectual property violations. This critical task requires multi-stakeholder cooperation of public and private entities, academia, and civil society.

5. CONCLUSION: A WAY FORWARD

Hubs of illicit trade represent a critical unit of analysis necessary for identifying priorities for policy and law enforcement responses. Yet, there have been limited efforts to date to map and analyze areas with a high concentration of illicit trade and illicit finance at the regional and global levels. The *Hubs of Illicit Trade* project was launched in 2022 to fill out this gap. This report summarizes its key findings and provides a general framework for analyses of illicit trade hubs. This research identifies that hubs of illicit trade provide an ideal criminal ecosystem that supports the convergence of different illicit trades with other crimes, such as money laundering, corruption, tax evasion, cybercrime, and terrorism. Moreover, hubs of illicit trade pose multiple threats to sustainable development and security not only within countries along the supply chains but also at the regional and global levels.

In terms of policy and law enforcement responses, hubs of illicit trade represent a challenging issue due to their dynamic nature, the scope of illicit trade activities, and a broad diversity of both criminal and legitimate beneficiaries and enabling actors. These challenges require a holistic strategy addressing various functions of hubs through enhanced supply chain management policies, improved free trade zone regulations, stricter anti-money-laundering regulations, and targeted awareness-raising and education campaigns focusing on the role of hubs in undermining sustainable development and security. A multitude of inter-jurisdictional issues associated with hubs of illicit trade also dictate the necessity to enhance international coordination both at the policy and law enforcement levels, including through cross-border public-private partnerships and multi-stakeholder cooperation in all relevant domains, including data exchange and trade analytics.

To date, illicit trade hubs remain an understudied area, with significant data gaps in their analysis. Further research in this area could benefit from creating cross-country databases with relevant indicators reflecting illicit trade activities and illicit finance flows. This task requires the development of new tools and instruments for mapping hubs of illicit trade and the use of sophisticated data analytics. Limited data in this area prevents designing targeted interventions to address the negative spillover effects of hubs of illicit trade on other countries and the entire global community. Limited data also make it difficult to assess the effectiveness of different strategies aimed at disrupting hubs of illicit trade. This research underscores that criminal networks operating in hubs of illicit trade are characterized by a high level of resilience to external shocks and law enforcement operations. Therefore, it is important to monitor their dynamics over time, particularly in response to law enforcement interventions to avoid the so-called balloon effect when the disruption of one hub of illicit trade results in the reallocation of its illicit activities to another hub. This task requires developing new approaches for assessing hubs' resilience and the effectiveness of various disruptive strategies.

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