POLITICAL ECONOMY REPORT

GLOBAL INITIATIVE
AGAINST TRANSNATIONAL ORGANIZED CRIME

ILLICIT FINANCIAL FLOWS IN BOSNIA AND HERZEGOVINA, MONTENEGRO AND SERBIA

Key drivers and current trends

ROBIN CARTWRIGHT | KRISTINA AMERHAUSER

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ACRONYMS AND ABBREVIATIONS

AML	Anti-money laundering
CSOs	Civil society organizations
EU	European Union
FATF	Financial Action Task Force
FDI	Foreign direct investment
FTZ	Free trade zone
GDP	Gross domestic product
GFI	Global Financial Integrity
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit
ICCS	International Classification of Crime for Statistical Purposes
IFF	Illicit financial flows
MONEYVAL	Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures
NGO	Non-governmental organization
OECD	Organisation for Economic Co-operation and Development
OSCE	Organization for Security and Co-operation in Europe
SDG	Sustainable Development Goal
TBML	Trade-based money laundering
UNODC	United Nations Office on Drugs and Crime

The Central Bank of Bosnia and Herzegovina. There is an identified need to improve anti-money laundering processes in the countries in the region.
© Mustafa Ozturk/Anadolu Agency via Getty Images

EXECUTIVE SUMMARY

This report completes our study of illicit financial flows (IFFs) in the Western Balkans. Our focus this time is Bosnia and Herzegovina, Montenegro and Serbia.[1] IFFs are the mechanisms by which money earned illegally is transferred into and out of economies to criminal beneficiaries worldwide. Each year, large sums of money are transferred out of developing and transitioning economies. These are funds that could have been used for public and private goods: public services, investment or jobs. The whole society suffers as a result of their loss.

These IFFs are cross-border financial transactions resulting from a host of predicate crimes, such as corruption, illegal markets or tax evasion. In accordance with UN guidance, we have studied them from the bottom up, by analyzing the predicate crimes – or components – separately and aggregating the results. We conducted extensive interviews with stakeholders across the region, completing 167 interviews in late 2020 and early 2021. From our discussions with experts like senior infrastructure advisers, anti-money laundering (AML) officials, local police officers and civil society representatives, we have produced a broad yet comprehensive view of the illegal flow of money into and out of the region. We have largely eschewed macroeconomic estimates of IFFs given their tendency to substantially misstate the situation. Bosnia and Herzegovina, Montenegro and Serbia have very different economies. Serbia's economy is by far the largest with US$51 billion in gross domestic product (GDP); Bosnia and Herzegovina's GDP is US$20 billion, while Montenegro's is US$5.5 billion. Serbia also has the strongest growth at 4.2% and the largest share of foreign direct investment: half of all Chinese investment in the Western Balkans goes to Serbia. Bosnia and Herzegovina is burdened with a huge public sector budget – 41% of GDP – due to its regional government structure. Nevertheless, there are some commonalities. All three countries, but especially Bosnia and Herzegovina, suffer from fragmentation caused by their mixed ethnic composition. At a time when all three countries are failing to make material progress against corruption and civil society freedoms are under pressure, European Union (EU) accession hopes appear to be receding. All remain lower cost and lower wage economies, with unemployment levels in Bosnia and Herzegovina and Montenegro at more than 16%. We will show that the informal sector makes up more than 25% of each of the three countries' economies, a fact that facilitates many of the IFF components.

IFF components

Corruption remains a key vulnerability of the Western Balkans' transition economies and an endemic feature of regional culture. IFFs related to corruption occur when financial gain is transacted abroad. In this report, we will focus on three key case studies. In Serbia, infrastructure attracts significant foreign investment. A number of project construction contracts have allegedly been awarded to Chinese and Russian contractors in exchange for loans. Additionally, major assets sold to European investors may have been subject to political influence and sub-optimal pricing. In Bosnia and Herzegovina, we found a proportion of public money is channelled to non-governmental organizations (NGOs) and civil society organizations (CSOs) based on political favouritism. In Montenegro, the defence industry is considered very high governance risk due to a number of scandals.

Tax evasion is a significant issue in all three countries. Serbia loses on average €100 million per year, while Montenegro, with an economy one tenth the size of Serbia's, loses up to €60 million. Bosnian employees receive up to half of their wages in cash. Whilst not all these flows are IFFs, the example of industry-wide abuse by agricultural 'guest workers' in Serbia undoubtedly leaks value from the economy.

Illegal markets drive large-scale IFFs. Drug trafficking IFFs result from the major Balkan route flows of heroin, cannabis, cocaine and synthetic drugs. Heroin doubles in value as it moves from the Western Balkans to the EU. Migrant smuggling produces significant IFFs to the smugglers taking millions of euros for passage across Serbia and Bosnia and Herzegovina's borders. Illicit trade in conventional goods like tobacco or clothes also remains a major driver of IFFs. Estimates provided point out that more than 20% of the tobacco markets in Montenegro and Bosnia and Herzegovina are illicit, and the countries also act as transit countries for the higher-profit EU destinations for illicit goods.

IFF channels

IFF channels are the methods by which illicit flows move value across borders. The financial system remains the key channel through which illicit proceeds are moved. All three countries have significant domestic and international banking sectors and all have problems with money laundering, including reports of significant money laundering through property transactions. In addition, microcredit organizations and cryptocurrencies are targeted by launderers. The most recent evaluations of money laundering governance identified a need to significantly tighten the AML processes in Bosnia and Herzegovina and Serbia.

Cash smuggling is another important IFF channel in all three countries, as hard currency moves across borders. Indeed, banknotes and coins (in different currencies and denominations) are often driven across borders.

Trade is another mechanism for moving illicit proceeds, conducted through deliberate misrepresentation of the details of a trade transaction. This tendency to under- or over-invoice or to create phantom shipments altogether is poorly evidenced. But our interviews found evidence of mis-invoicing in Bosnian, Montenegrin and Serbian trade transactions, particularly centred around free trade zones such as the Port of Bar.

Remediation

Bosnia and Herzegovina, Montenegro and Serbia have all invested increasing resources in anti-corruption, financial governance and public sector transparency. All three countries have legislated against money laundering and have improved their reporting and monitoring processes. However, tax compliance is still low compared to EU norms, fuelled by the continued strength of informal economies in all three, as well as cash payments to employees. Public procurement transparency has also been improved in Bosnia and Herzegovina, and Montenegro, although Serbian efforts to report public procurement do not appear to have improved the competitiveness of the bidding process. International cooperation in combating the components of IFFs is gaining significance.

Our recommendations focus first of all on improving the visibility and data-sharing on IFFs, particularly in the financial sector and trade 'channels'. Second, we encourage a far greater dialogue on IFFs in the region, focused on a clearer definition and with an explicit role for CSOs. Third, national IFF priorities should be agreed on, to ensure the responses are measured and meaningful, such as greater institutional information-sharing in Bosnia and Herzegovina, and updated AML frameworks for Montenegro and Serbia, with a particular focus on the construction sector. Fourth, the countries should also agree on and coordinate regional priorities, such as harmonization of measures to address tax evasion and a common policy to record and monitor beneficial ownership. Government anti-corruption activities need greater strength across the region. Finally, donor support for combating IFFs must be more closely aligned and coordinated to avoid duplication of effort.

A view of Belgrade. Serbia is a key node for drugs, migrants and illicit trade transiting the Western Balkans region. *© Veselolane/Shutterstock*

INTRODUCTION: LIFEBLOOD OF CORRUPTION

This report completes our study of IFFs in the Western Balkans. Our focus this time is Bosnia and Herzegovina, Montenegro and Serbia. IFFs are cross-border financial transactions resulting from a host of predicate crimes, such as corruption, illegal markets or tax evasion. In accordance with UN guidance, we have studied them from the bottom up, by analyzing the predicate crimes – or components – separately and aggregating the results. We conducted extensive interviews with stakeholders across the region, completing 167 interviews in late 2020 and early 2021. From our discussions with experts like senior infrastructure advisers, AML officials, local police officers and civil society representatives, we have produced a broad yet comprehensive view of the illegal flow of money into and out of the region. We have largely eschewed macroeconomic estimates of IFFs given their tendency to substantially misstate the situation.

FFs are the lifeblood of crime and corruption. They facilitate the dominance of corrupt elites that maintain power structures across the region. They are perhaps the most significant obstacle to equality, fairness and opportunity in transitioning economies like those of the Western Balkans. As the UNODC puts it:

> [IFFs] allow wealthy and exploitative elites and criminal actors to launder the profits of their ill-gotten gains, to evade taxes, use political power for personal gain, [and] conceal the ownership of assets. They thereby undermine efforts to limit wealth inequality, reduce governments' capacities to support development and inclusive growth goals, and significantly undermine the rule of law.[2]

This report is a companion piece to our August 2020 report on IFFs in the Western Balkans, which covered Albania, Kosovo and North Macedonia.[3] As previously reported, the UN's Sustainable Development Goals (SDGs) emphasize the need for financial resources to be dedicated to development and 'significantly reduce' IFFs in SDG target 16.4.[4]

Countries at a glance

Bosnia and Herzegovina

Bosnia and Herzegovina, with a population of 3.8 million, was recognized in 1992. The country combines two entities – the Federation of Bosnia and Herzegovina and the Republic of Srpska. There is also an arbitration agreement for Brcko – a semi-autonomous district. Each of these regions has its own administration, including government and parliament.

It is a member of the UN, OSCE and Council of Europe and submitted its EU membership application in 2016. Unemployment is high at 16.9%, with a higher poverty level than its neighbours.

Corruption is widespread and has been connected to organized crime, making Bosnia and Herzegovina an attractive transit route for trafficking in weapons, human beings and drugs. Governance is perceived as weak, not least due to the country's complex public sector.[5]

Montenegro

Montenegro has a population of only 620 000. Montenegrins make up 45% of the population, while 29% are Serbs. From 2006, when Montenegro declared independence from the State Union of Serbia and Montenegro, until 2020, politics in the country were dominated by a single party led by Milo Đukanović.

Montenegro is a member of the UN, OSCE and Council of Europe and has been an EU candidate country since 2010. Since 2017, it is also a NATO member state. Montenegro adopted the euro as its currency. It has an unemployment rate of 15.9%. Montenegro relies on heavy industry and tourism.

The port of Bar is one of the biggest Adriatic seaports in the Balkans and is a major entry point for illicit goods crossing the region. The country has seen a significant decrease in criminal offences, but no sign of a reduction in financial ones given the large informal economy.[6]

Serbia

Serbia has the highest GDP and population (6.9 million) of any country in the Western Balkans. Its unemployment rate is the lowest at 9.1%. It is a parliamentary republic, with a president and prime minister.

A member of the UN, OSCE and Council of Europe, Serbia received EU accession candidate status in 2012. The country became a stand-alone republic in 2006 after Montenegro voted to leave the State Union, the last of the secession of the six republics of the former Yugoslavia. Serbia has so far not recognized Kosovo's independence, which was unilaterally declared in 2008.

After the fall of Yugoslavia, a significant number of organized crime groups flourished in the area. Serbia has long been a key route for drugs, migrants and illicit trade crossing the Western Balkans region.[7]

What are IFFs?

The study of IFFs looks at criminal activity through the lens of movements of the value of underlying (or predicate) crimes. It 'follows the money' to assess and help curb the criminal enterprises that profit from illegal trade, trafficking and exploitation. It is therefore concerned with monetary flows. Money is defined as a medium of exchange, store of value and unit of account and must be: acceptable, portable, divisible, durable, homogenous and recognizable. Money exists across a spectrum of liquidity from notes and coins, through money vested in bank accounts to time deposits (less liquid) to assets such as land (least liquid).[8] Any analysis of illicit financial flows must therefore concern itself with any store of value that can be transferred.

IFFs redefined

IFFs:

- are illicit in origin, transfer, or use;
- represent an exchange of value, not only a financial transfer;
- cover a flow of value over time; and
- cross an international border.

This is a new UN definition, elaborated following a lengthy consultation and development process.[9] As mentioned in our previous report on IFFs, the challenge of assessing IFFs was complicated by the lack of a commonly agreed definition and measurement methodology. The new UN IFF conceptual framework goes a considerable way to rectifying this problem. It is an improvement on the previous working definition: 'money that is illegally earned, transferred or used, that crosses borders'.[10] This remains a valid summary of the core principles of the IFF concept, but suffers from a lack of clarity and specificity.[11] We understand this report to be the first study to be published using the new definition.

Core to the UN's new conceptual framework is also the notion of the breadth of the definition. For example, not all IFFs stem from illegal activity – some may stem from licit activity that is transacted in an illicit way.[12] The UN work also highlights that IFFs emerge at two different stages:

- Illicit income generation, which means cross-border transactions generally made in the process of producing illicit goods or services.
- Illicit income management, which covers cross-border transactions that use illicitly derived money for investment, goods or services.

In terms of a methodology for analyzing IFFs, the UN recommends a 'bottom up' approach that takes the key predicate crimes, assesses each and aggregates them. The UN concedes that as IFFs are deliberately hidden, measuring them is challenging 'both conceptually and in practice'. But the UN also points to a wide range of data available from multiple sources, from national accounts to police authorities.[13]

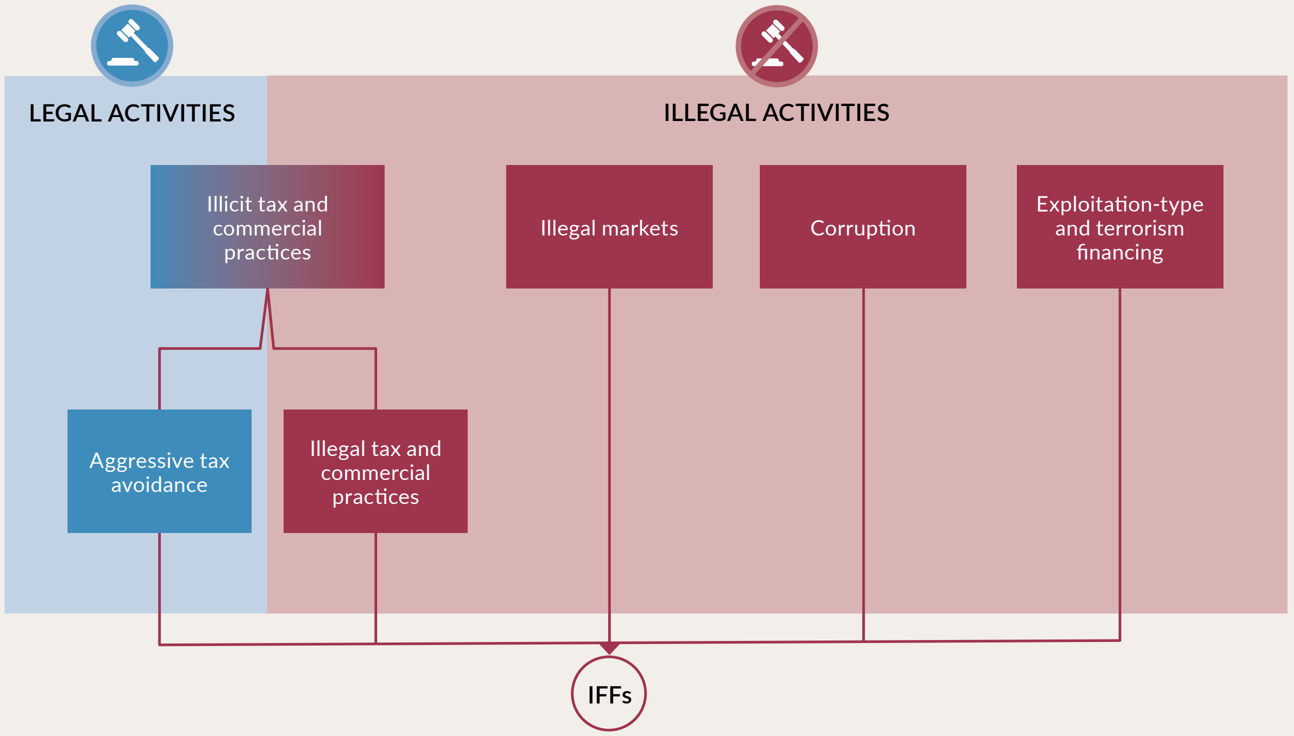


FIGURE 1 Categories of activities that may generate illicit financial flows.

SOURCE: United Nations Office on Drugs and Crime, Conceptual framework for the statistical measurement of illicit financial flows, October 2020, https://www.unodc.org/documents/data-and-analysis/statistics/IFF/IFF_Conceptual_Framework_for_publication_15Oct.pdf

This approach contrasts with historic studies that attempted to use macroeconomic indicators to derive estimates of IFFs. These methods have often met with considerable criticism and are discussed in more detail in the annex.

The categories of IFFs correspond to our previous methodology:

- corruption;
- tax evasion and avoidance; and
- illegal markets and exploitation.

CATEGORIES OF IFFS	EXAMPLES OF ACTIVITIES BY ICCS CATEGORY
Tax and commercial practices	08041 Tariff, taxation, duty and revenue offences 08042 Corate offences including competition and inport/export offences; acts against trade regulations 08045 Market manipulation or insider trading, price fixing
Exploitation-type activities and terrorism financing (parts of sections 02, 04, 09)	020221 Kidnapping 0203 Slavery and exploitation 0204 Trafficking in persons 0302 Sexual exploitation 02051 Extortion 0401 Robbery 0501 Burglary 0502 Theft 09062 Financing of terrorism
Illegal markets	ICCS includes a long lists of activities, including for example drug trafficking (060132), firearm trafficking (090121), illegal mining (10043), smuggling of migrants (08051), smuggling of goods (08044), wildlife trafficking (100312)
Corruption (section 0703)	07031 Bribery 07032 Embezzlement 07033 Abuse of functions 07034 Trading in influence 07035 Illicit enrichment 07039 Other acts of corruption

FIGURE 2 Examples of activities generating illicit financial flows, by International Classification of Crime for Statistical Purposes (ICCS) category.

NOTE: ICCS is the standard UNODC framework for defining illegal activities generating IFFs.
SOURCE: UNODC, Conceptual framework for the statistical measurement of illicit financial flows, October 2020, https://www.unodc.org/documents/data-and-analysis/statistics/IFF/IFF_Conceptual_Framework_for_publication_15Oct.pdf

A significant debate took place within the UN on the inclusion of tax avoidance in the current definition, which can, by some analyses, equate to legal but tax-efficient structures. These tax strategies are deemed aggressive given the savings to the parent companies that exploit them.[14]

The UN is also careful to distinguish between in- and outflows of IFFs to any economy. Even though such flows may 'net' each other, this does not reduce the extent of IFFs. Rather, both in- and outflows should be recognized and recorded separately as contributing to the overall IFF picture.

Methodology

The Global Initiative Against Transnational Organized Crime (GI-TOC) has maintained the same theoretical methodology as used in our previous IFFs report.[15] It remains valid and ensures consistency and comparability, and is in line with the new UN concept. As shown in Figure 3, the core principle is to assess both the underlying crimes of IFFs (tax, illegal markets and extortion, and corruption) and the channels through which they flow (financial system, trade system and cash). The key benefit of this dual approach is that it represents two distinct and independent sources of evidence on IFFs.

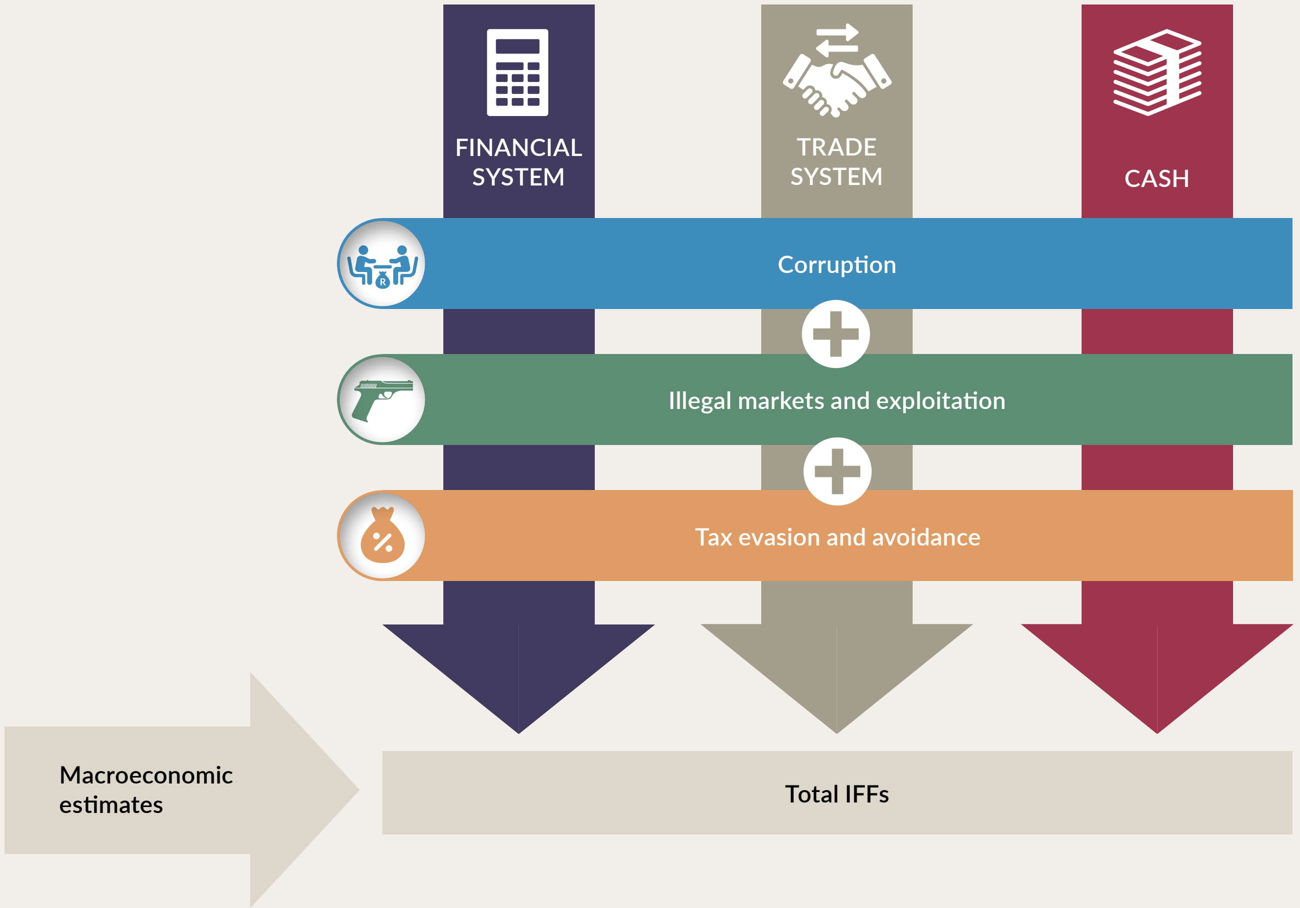


FIGURE 3 Components and channels of IFFs.

The most recent UN conceptual framework de-emphasizes channel analysis, given its focus on the components that make up IFFs. Yet the three channels – the financial system, trade system, and cash – are the mechanisms that allow IFFs' transfer of value. We believe they remain an important lens though which to assess and analyze IFFs. Of course, a key risk of this 'dual focus' is that of duplicate counting. IFFs present myriad opportunities for the duplication of reporting on a single transfer. But in terms of coverage, the dual focus provides a means of double-checking financial flows related to underlying crimes.

The same flow can, in theory, be captured multiple times through these different lenses on the problem. For example, a payment for drugs trafficked through a country might be assessed by the police when estimating the scale of the crime and then picked up as a suspicious transaction by the money laundering officers in a financial institution. The degree of overlap is often unknown, but the conceptual diagram in Figure 4 illustrates possible duplications. In our assessments, we have sought to avoid this type of double reporting.

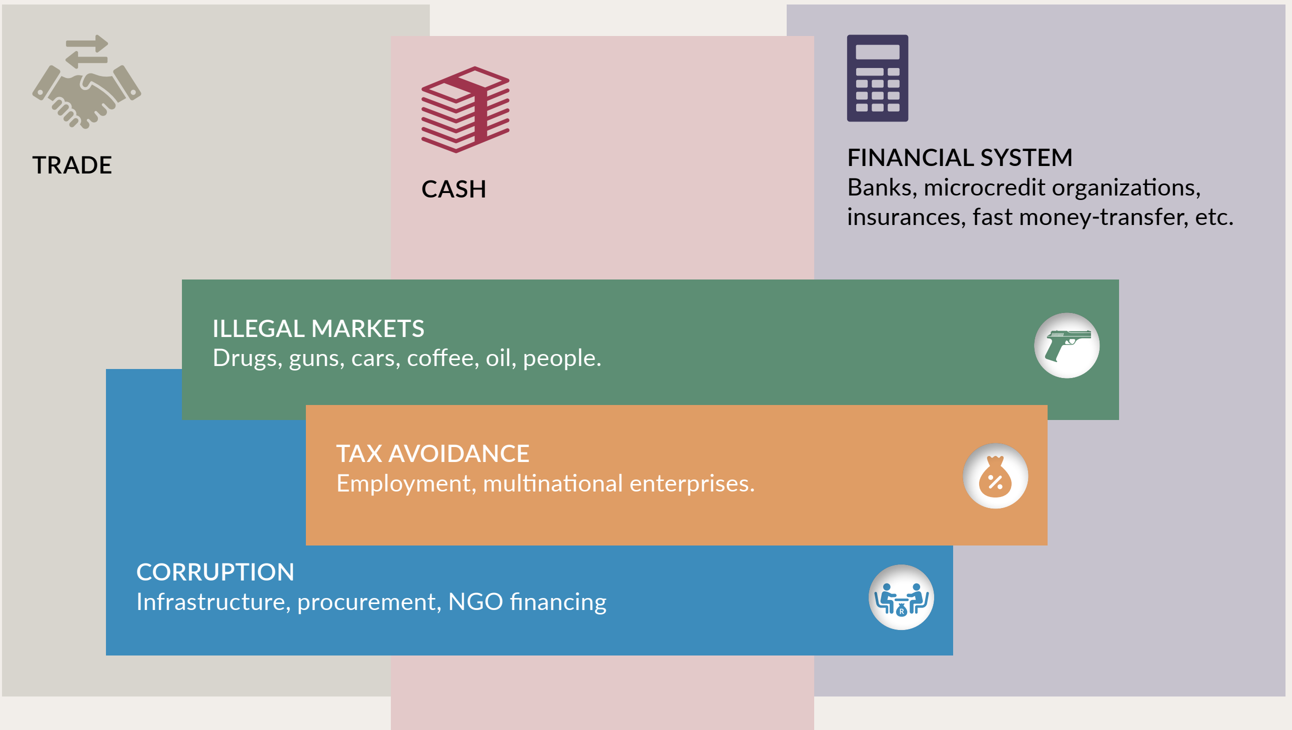


FIGURE 4 Overlaps between underlying crimes and channels.

Our research process was similar to that of our previous IFFs report. We combined an extensive interview programme with a literature review to establish areas of consensus and dispute. Expert interviews are a commonly used qualitative interview method, which have been often cited as an accepted empirical research method in political and social research since the 1990s.[16] Our approach can be summarized as follows:

- Initial literature review: We conducted a brief review of the key literature on the IFF key components in Bosnia and Herzegovina, Montenegro and Serbia, including Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures (MONEYVAL) literature, *Financial Times* investor intelligence, etc.
- Phase one interviewee identification: Our south-east Europe team identified and recruited a wide range of civil society, government and private sector representatives.
- Phase one interviews: 132 interviews were conducted from December 2020 to January 2021.
- Phase one thematic analysis of interviews: We analyzed all interviews to identify key themes per country, crime and channel, such as infrastructure corruption in Serbia and tobacco crime in Montenegro, in order to choose focus areas for phase two interviews.
- Detailed literature review: We undertook a lengthy search of the IFF literature and specific political economy reporting on the three countries.
- Combined thematic analysis of the literature and interviews.
- Phase two interviewee identification: We contacted a wide variety of stakeholders, often senior-level experts with direct experience of IFFs; we made particular use of industry contacts in areas like infrastructure, consumer goods and money transfers.
- Interviews were conducted with 35 senior stakeholders from late February to April 2021.
- Phase two interview thematic analysis was conducted as for phase one.
- Report drafting, consultation and feedback were completed in April and May 2021.

Our interview programme drew on experts from civil society, industry and government, as shown in Figure 5.

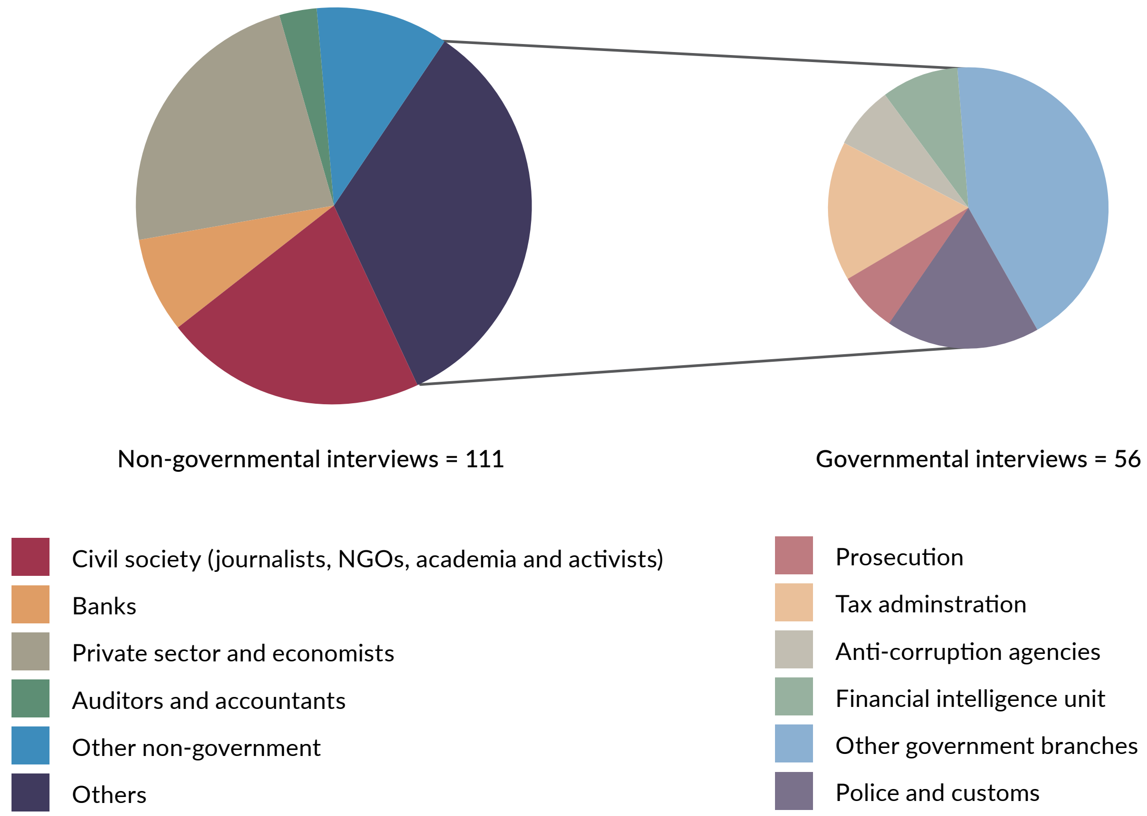


FIGURE 5 Overview of interview partners.

This study has limitations. We have considered IFFs at a comparatively high level, with a range of largely secondary sources and interview feedback as validation. This is not a firm or fixed measurement of individual IFFs. We were hampered in our overall research by the COVID-19 pandemic, which meant that travel was restricted and interviews were more difficult to arrange. We also had limited access to government financial professionals who are responsible for combating IFFs.

Voters line up in a voting station in Podgorica, 30 August 2020. *© Pierre Crom via Getty Images*

CONTEXT

Bosnia and Herzegovina, Montenegro and Serbia have very different economies. Serbia's economy is by far the largest with US$51 billion in gross domestic product; Bosnia and Herzegovina's GDP is US$20 billion, while Montenegro's is US$5.5 billion. Serbia also has the strongest growth at 4.2% and the largest share of foreign direct investment: half of all Chinese investment in the Western Balkans goes to Serbia. Bosnia and Herzegovina is burdened with a huge public sector budget – 41% of GDP – due to its regional government structure. Nevertheless, there are some commonalities. All three countries especially Bosnia and Herzegovina, suffer from fragmentation caused by their mixed ethnic composition. At a time when all three countries are failing to make material progress against corruption and civil society freedoms are under pressure, European Union accession hopes appear to be receding. All remain lower cost and lower wage economies, with unemployment levels in Bosnia and Herzegovina and Montenegro at more than 16%. We will show that the informal sector constitutes more than 25% of each of the three countries' economies, a fact that facilitates many of the IFF components.

Political context

The words 'tension' and 'mistrust' have often been used to describe the countries' governance systems, which are marked by political fragmentation and polarization.[17] This is probably most evident in Bosnia and Herzegovina, which is officially split into two entities and a self-governing administrative unit (Brcko district) and is represented by a three-member rotating presidency as a result of the 1995 Dayton Accords.[18]

Division and polarization also play a role in Montenegro, which is struggling to include its Albanian minority in government[19] and in Serbia, where the opposition boycotted the 2020 Parliamentary elections.[20] Kosovo declared unilateral independence from Serbia in 2008, but the relationship between the two remains unresolved, despite numerous international mediation attempts.[21] In the three countries, many institutions do not function as they should.

All three countries held elections in 2020. Serbia was the first to hold parliamentary elections, in June 2020, during which the ruling Serbian Progressive Party won two-thirds of the votes amidst boycotts by the opposition. In October 2020, new elections were announced for April 2022.[22] Montenegro went to the polls in late August 2020; the opposition won by a small majority, triggering considerable change in the institutions.[23] Bosnia and Herzegovina held local elections in November 2020 which served as an important 'temperature check' in the decentralized country. These elections were also the first local elections in Mostar in 12 years.[24]

The importance of electoral integrity for democratic governance and the rule of law is repeatedly emphasized by EU reports on Bosnia and Herzegovina, Montenegro and Serbia.[25] These reports also highlight limited government transparency in all three countries and describe the negligible progress being made in the fight against corruption, as well as the lack of independent anti-corruption agencies. Corruption and bribery remain widespread.

Numerous interviews for this report described corruption as the single most important factor facilitating IFFs and organized crime.[26]

EU accession hopes: backsliding to 'transition regimes'?

Montenegro has been an EU candidate country since 2010 and officially started accession negotiations in 2012. Serbia received EU candidate status in 2012 and opened negotiations in 2014, while Bosnia and Herzegovina submitted its EU membership application in 2016.[27] Since then, all countries have worked to pass new regulations that make their legal frameworks compliant with the necessary standards for EU accession. Out of 35 negotiation chapters, 18 have been opened in the negotiations with Serbia (and two provisionally closed) and 33 chapters have been opened for negotiation with Montenegro (and three provisionally closed).[28] Nevertheless, EU accession appears to be still many years down the road, not least because of EU enlargement fatigue.

All three countries have been criticized for backsliding on key democratic indicators. Indeed, Freedom House, a leading international NGO researching democracy, political rights and civil liberties, no longer describes Serbia and Bosnia and Herzegovina as democracies, but as 'governments in transition or hybrid regimes'.[29] Just like in other parts of the world, it appears that that AML frameworks have been (mis)used to increase control over civil society as governments increasingly depict the money flows received and sent by NGOs as a potential source for the financing of terrorism.[30] For example, in July 2020, the Administration for the Prevention of Money Laundering of the Serbian Ministry of Finance published a list of media employees and CSOs whose bank records it wanted to review for money laundering or connections to terrorist financing.[31] This has made it increasingly challenging for NGOs to access funds as they face operational and legal restrictions due to the tightening rules around AML measures.

This is just one example of how governments are currently restricting civil society's room for manoeuvre. Furthermore, journalists are under pressure as governments restrict freedom of expression and limit funding. In 2020, more than 120 attacks on journalists were recorded in five of the six Western Balkan countries.[32] In December 2018, two television channels with national coverage in Serbia were purchased by an individual connected to the ruling party.[33] Civil society is not only being challenged by the governments, but also by so-called GONGOS – NGOs and media houses set up, controlled or closely allied with the ruling elite and aimed at furthering their interests.[34]

Economic context

The road that has led Bosnia and Herzegovina, Montenegro and Serbia from communist systems to market-based democracies continues to be bumpy, not only from a political but also from an economic point of view.

Indicators	Bosnia and Herzegovina	Montenegro	Serbia	Western Balkan 6 average
Population (million), 2019	3.3	0.6	7	2.9
GDP (current US$, billion), 2019	20.1	5.5	51.5	18.8
GDP per capita, purchasing power parity (current US$), 2019	16 289	24 036	19 495	17 408
GDP growth (annual %), 2019	2.7%	4.1%	4.2%	3.4%
Tax revenue (% of GDP), 2019	20.1%	not available	24.1%	19.9%
Imports of goods and services (% of GDP), 2019	55.2%	64.8%	61.0%	59.9%
Exports of goods and services (% of GDP), 2019	40.1%	43.7%	51.0%	43%
Average time to clear exports through customs, days, 2019	1	1	2	2
Foreign direct investment, net inflows (% of GDP), 2019	1.9%	7.5%	8.3%	5.6%
Net average monthly salary, local sources	€492 (2020)	€515 (2019)	€508 (2020)	not available
Unemployment (% of total labour force, International Labour Organization estimate), 2020	16.9%	15.9%	9.1%	12.0%
Net migration (per 1 000 inhabitants), 2017	−107.0	−2.4	−20.0	−34.1

FIGURE 6 Key economic indicators at a glance.

SOURCE: World Bank open data, https://data.worldbank.org/; Average salary almost 10 percent higher in Serbia, N1 News, 25 December 2020, https://rs.n1info.com/english/news/a687577-average-salary-almost-10-percent-higher-in-serbia/; Wages – Data, Statistical Office of Montenegro, https://monstat.org/eng/page.php?id=1270&pageid=24; Y.Z., What is the average salary in Bosnia and Herzegovina?, *Sarajevo Times*, 16 November 2020, http://www.sarajevotimes.com/what-is-the-average-salary-in-bosnia-and-herzegovina/.

The Belgrade Tower under construction, February 2021. *© Andrej Isakovic/AFP via Getty Images*

According to the *Financial Times*, the public sector budget is currently equivalent to 41% of GDP in Bosnia and Herzegovina, due to the cost of running 14 national and subnational governments, each with its own parliament, a total of five presidents and almost 150 ministries.[35] Monthly wages across the region remain far below the EU average, unemployment continues to be high and most likely increased significantly since the start of COVID-19. In October 2020, the World Bank suggested that an additional 300 000 people from Albania, Kosovo, Montenegro and Serbia had fallen into poverty due to the pandemic.[36] However, reports have expressed some hope that at least the endemic trend of qualified young people leaving the region (brain drain) can be lowered, as many young people who had previously lived and worked abroad returned home during COVID-19 and are expected to stay.[37]

With little local industry or agriculture, more than half of the countries' GDP is based on the tertiary (service) sector. Serbia has been more successful than its Western Balkan neighbours in terms of attracting investment. A combination of political stability, low costs, improving transport links with the EU and its neighbours and strong human capital have put Serbia firmly on the radar of foreign investors.[38] Foreign direct investment (FDI) is significant also in Montenegro, despite the continuing complaints about bureaucracy.[39] While the EU is the Western Balkans' key trade and foreign investment partner, China, Russia, Turkey and the United Arab Emirates have also increased their engagement, most notably in connection to various infrastructure projects. For example, since 2012, Serbia has received US$9.5 billion of publicly announced Chinese funding and investment, more than half of China's stated investment for the region.[40]

This has led to dependence, for example in Montenegro, where large infrastructure investments have raised the country's debt to 80% of GDP, because of loans from China.[41] The media have often raised concern about the lack of transparency involving public tenders, some of which have led to a dramatic increase in the cost of the projects and public debt.[42] Chinese financing is notoriously opaque, completed through non-competitive contracts and reinforcing low governance standards.[43]

The informal and illicit economies

A large portion of both licit and illicit economic activity takes place in the informal economy. Tax evasion is widespread, especially in cash-intensive businesses and the construction industry where large numbers of workers do not have official contracts.[44] On average, just under 10% of GDP is sent annually to the Western Balkans in the form of remittances.[45] Cash also underpins the largest portion of daily transactions in the legitimate economy.

Indicators	Bosnia and Herzegovina	Montenegro	Serbia	Western Balkan 6 average
Personal remittances received (% of GDP) 2019	11.2%	10.5%	8.5%	9.7%
Informal economy	25–35%	± 24.5 %	±27%	Not available

FIGURE 7 Key economic indicators at a glance.

SOURCE: World Bank open data, https://data.worldbank.org/; European Commission (2019 reports)

As we observe across transitioning economies everywhere, the Western Balkan criminal economy benefits from increasing global trade and globalization. The unsettled conflict with Kosovo and porosity of borders facilitates an active black market and widespread smuggling of goods. Organized crime in the Western Balkans is not limited to the region, but actors from the region who are involved in drug trafficking, migrant smuggling and cybercrime have spread their tentacles globally. There are numerous reports of arms trafficking, trade in counterfeit goods, illegal logging and money laundering in the Western Balkans.[46]

Illicit proceeds are then transferred abroad or laundered in the region. A significant portion of flows never enter the Western Balkans in the first place. In the following section, we will look at the key components of IFFs in the Western Balkans (corruption, tax evasion and illegal markets and exploitation) in more detail.

Migrants near a makeshift shelter in an abandoned warehouse in Belgrade, November 2016. *© Andrej Isakovic/AFP via Getty Images*

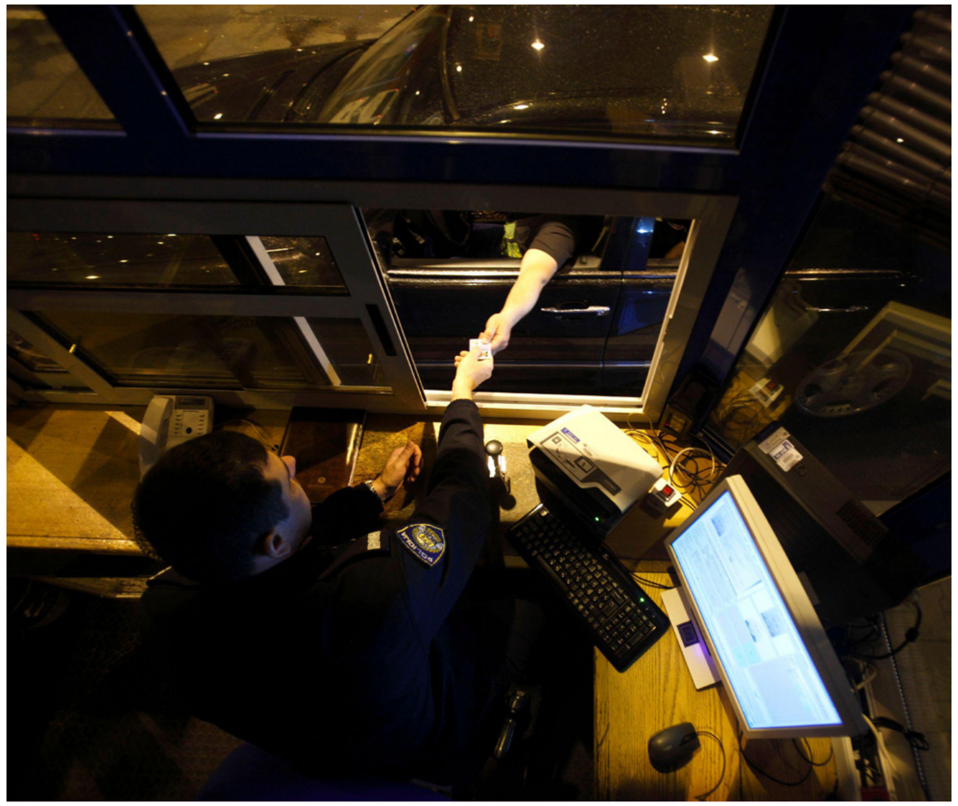
COMPONENTS OF IFFS

IFFs are the mechanisms by which money earned illegally is transferred in and out of economies to criminal beneficiaries globally. Each year large sums of money are thus transferred out of developing and transitioning economies. These are sums that could have been used for public and private purposes: whether that be public services, investment or jobs. The victims of IFFs therefore include everyone: society as a whole suffers from this exfiltrated economic value.

Assessing the totality of IFFs remains problematic even after the clarification work undertaken by the UN.[47] There are three fundamental perspectives one can take to assess IFFs, as shown in Figure 8, all of which are considered in this report and discussed below.

Analysis method for IFFs	Strengths	Weaknesses
Assessing the **components of IFFs:** corruption, illegal markets and exploitation and tax evasion/avoidance	Most comprehensive approach, recommended by the UN	Very broad and time-consuming approach; difficult to estimate what proportion of crime becomes an IFF; often repeats earlier work on predicate crimes
Analyzing the **channels** through which IFFs have to travel to exit countries: money laundering through the financial system, trade-based laundering and cash	Enables focus on actual international monetary flows, rather than total crime	Exceptionally limited research, due to legal confidentiality of channels; difficulty in establishing scale and matching to predicate crimes
Assessing **macroeconomic** data to estimate total losses to IFFs	Offers potential of providing overall estimate of IFFs from readily available macroeconomic data	Often methodologically flawed, leading to huge misstatements and overstatements of IFFs

FIGURE 8 Perspectives on how to assess IFFs.



A border police officer inspects documents at the Croatia-Serbia border.
© Antonio Bronic/Reuters via Alamy

From the analysis in Figure 8, the weakest perspective is arguably the macro-economic, which we discussed in the introductory section.[48] The econometric approach developed by Tax Justice Network is nevertheless worthy of mention. According to the Network's IFF vulnerability tracker, of the various financial flows (securities, portfolio investments) the three countries under review were deemed to be most vulnerable to inward FDI as an IFF channel.[49] This reflects our interview findings to a considerable degree: in Serbia, we found corrupt practices led to higher prices paid to foreign infrastructure investors by up to 20–30%.[50]

	Bosnia and Herzegovina	Montenegro	Serbia
Most vulnerable channel	Inward FDI	Inward FDI	Inward FDI
Vulnerability score	56/100	58/100	58/100
Lost tax	US$19.0 million	US$107.1 million	US$74.6 million

FIGURE 9 IFF vulnerability in the focus countries.
SOURCE: IFF Vulnerability Tracker, Tax Justice Network, https://iff.taxjustice.net/#/

As mentioned, our principal approach has been to assess IFFs from a crime component and channel perspective. This produces point estimates of specific crimes and channel abuses that can offer a broad picture of IFFs when aggregated. In terms of limitations, the estimates are partial, and are not necessarily comparable, given the different methods used to derive them.

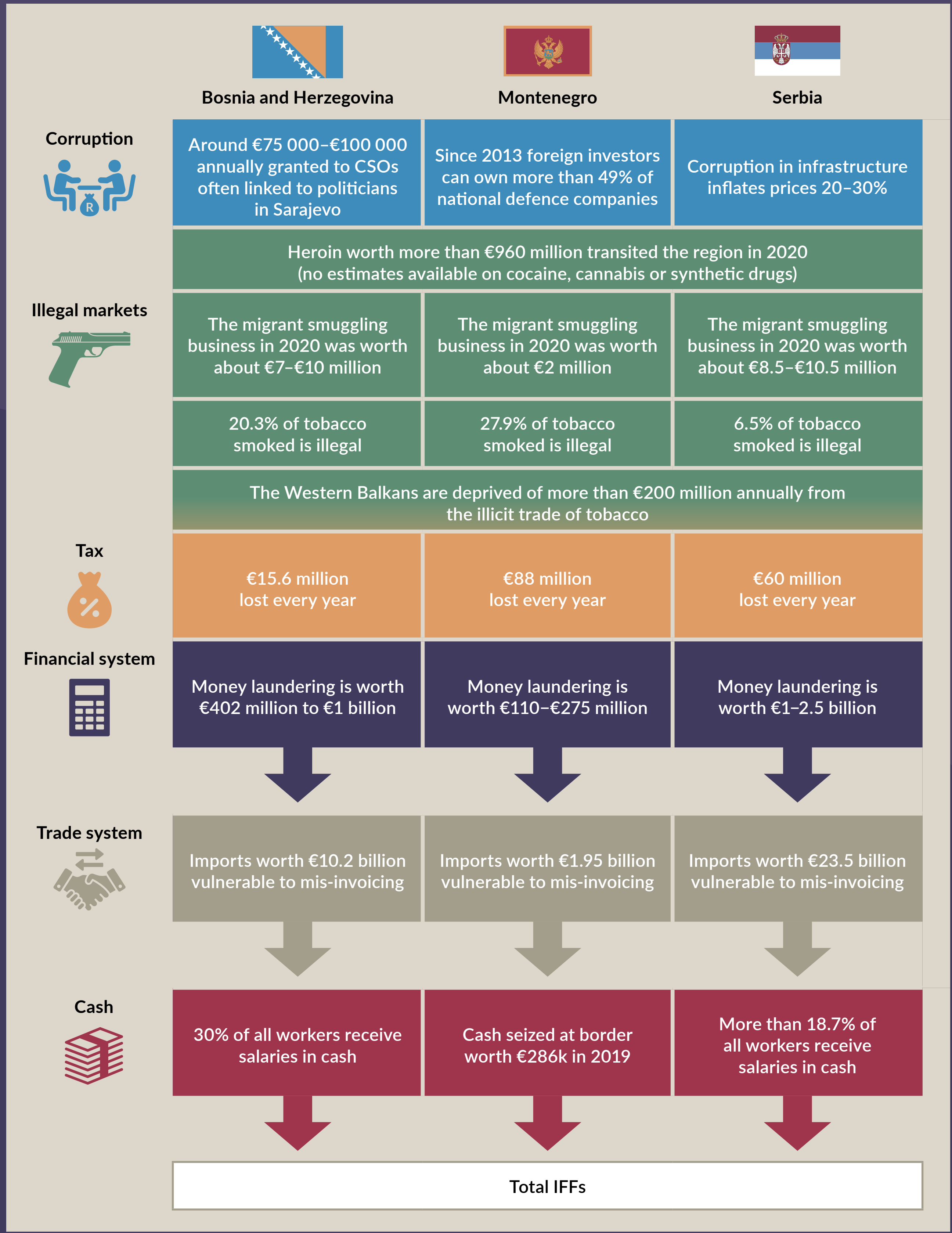


FIGURE 10 Estimates of IFF underlying crimes and channels.
NOTE: The data displayed in Figure 10 cannot be regarded as a true aggregate view, due to incomplete data on IFFs in the three countries under review. However, it serves to illustrate the breadth of IFFs considered in this study.

In the following sections, we discuss each crime component and channel in more detail, in order to assess the IFFs associated with each. Our evidence is derived from third-party research, official estimates and our extensive interview programme conducted across the region.

Corruption

Corruption remains a key vulnerability of the Western Balkans' transition economies. IFFs related to corruption occur when financial gain is transacted abroad. In this report, we will focus on three key case studies. In Serbia, infrastructure attracts significant foreign investment. A number of project construction contracts have allegedly been awarded to Chinese and Russian contractors in exchange for loans. Additionally, major assets sold to European investors may have been subject to political influence and sub-optimal pricing. In Bosnia and Herzegovina, we found a proportion of public money is channelled to non-governmental organizations (NGOs) and civil society organizations (CSOs) based on political favouritism. In Montenegro, the defence industry is considered very high governance risk due to a number of scandals.

Corruption is, at its simplest, 'the abuse of entrusted power for private gain'.[51] This definition is broad and reminds us that corruption extends from the minor official taking a small bribe to expedite a parking permit to the wholesale capture and exfiltration of billions of dollars in wealth from the privatization of state companies.

The ICCS lists the following crimes in its corruption category: bribery, embezzlement, abuse of functions, trading in influence and illicit enrichment.[52] UNODC defines corrupt IFFs as follows: 'IFFs related to corruption take place when the economic returns from these acts, directly or indirectly, generate cross-border flows and when financial assets are transferred across borders to commit these crimes.'[53] This, technically, rules out purely domestic corrupt flows, including those smaller-scale domestic bribes. But many of the smaller-scale corruption examples mentioned in our interviews featured a cross-border connection, including payments to border guards to allow passage during COVID-19[54] and bribes paid in support of migrant smuggling.[55]

The Western Balkans have long been considered especially vulnerable to corrupt practices. A major UNODC survey cited bribery and corruption as the most important problem (after poverty) facing the region.[56] As a landmark Transparency International study commented: 'A consistent feature across all [six] countries is the phenomenon of state capture – whereby powerful executive branches and political parties dominate all other institutions – coupled with a lack of cooperation between state organisation.'[57] This duality compromises the ability of governance and enforcement efforts to combat corruption. The outcome is largely unsanctioned corruption in public office.

Our three focus countries all feature elements of this description. Transparency International's 2020 Corruption Perception Index puts two of the three countries in the lower half. Serbia moved to 94th place (out of 180) and Montenegro rose to 67th place, while Bosnia and Herzegovina slipped to 111th.[58]

The mechanisms and incidence of bribery and corruption are difficult to assess at an aggregated level, although a UNODC report (see Figure 12) showed the impact of bribery as most significant in the largest economy – Serbia (at 17%), with the trade sector being the most significant driver. While much of this 'everyday' bribery may not constitute an IFF (because it never crosses a border), it is indicative of a generally high level of normalization of corruption.

Indicators	Bosnia and Herzegovina	Montenegro	Serbia	Western Balkan 6 Average
Corruption Perception Index 2020	score 35/ rank 111	score 45/ rank 67	score 38/ rank 94	score 37.5
Human Development Index 2020	0.780	0.829	0.806	0.797
World Press Freedom Index 2020	score 28.5/ rank 58	score 33.8/ rank 105	score 31.6/ rank 93	score 30.8
Doing Business score 2020	65.4	73.8	75.7	72.8

FIGURE 11 Key corruption indicators at a glance.

SOURCE: Transparency International, Corruption Perception Index, 2020, https://www.transparency.org/en/cpi/2020/index/nzl; UNDP, Latest Human Development Index ranking, http://hdr.undp.org/en/content/latest-human-development-index-ranking; Reporters Without Borders, 2020 World Press Freedom Index, https://rsf.org/en/ranking; World Bank, Doing Business, https://www.doingbusiness.org/en/doingbusiness.

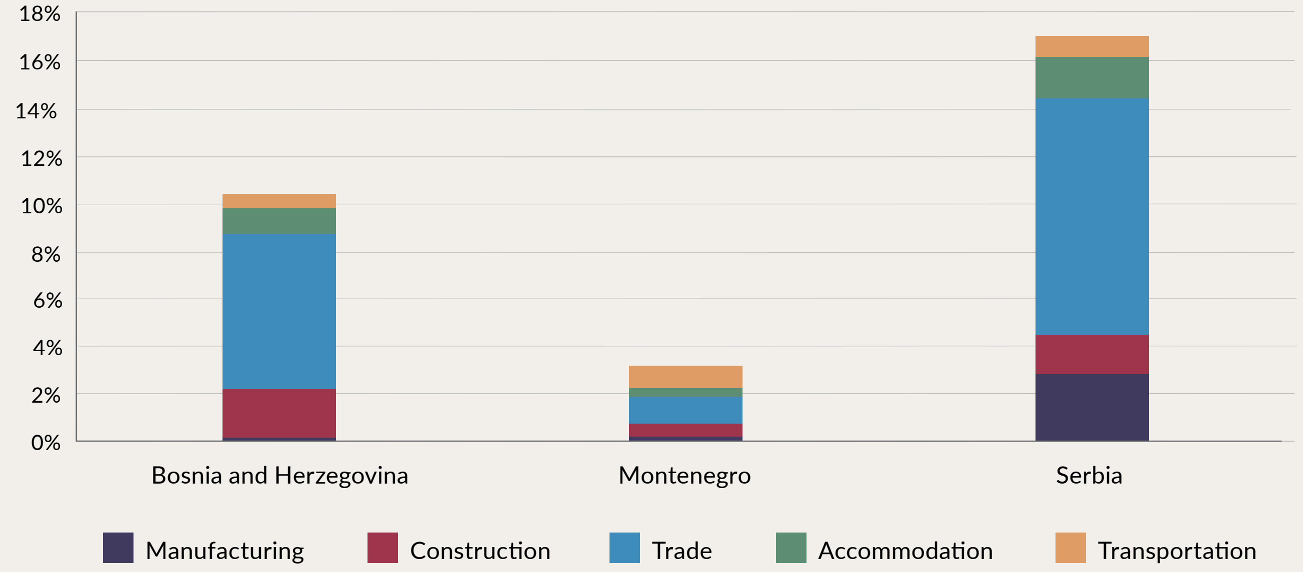


FIGURE 12 Bribery disaggregated by industry and country.

SOURCE: UNODC, Business, corruption and crime in the Western Balkans: The impact of bribery and other crime on private enterprise, 2013

Despite how widespread it is, corruption is exceptionally difficult to analyze and assess, given its hidden nature and the vested interests that sustain its secrecy. In our extensive interviews, three corruption case studies came up repeatedly: infrastructure development in Serbia, funding of NGOs in Bosnia and Herzegovina and defence industry corruption in Montenegro.

Serbian construction and infrastructure – undue international influence

Serbia is a significant market for FDI in major infrastructure projects. With a fast-growing economy (more than €50 billion), Serbia is of significantly more interest to international investors than Bosnia (€20 billion) or Montenegro (€5 billion). Our senior business interviewees commented that Serbia is looking more to Russia and especially China as business partners, as well as the Gulf, than it is towards the EU – although the EU remains the largest investor and donor. Nevertheless, EU accession continues to be perceived as a long way down the road.[59]

Russia is a major investor in the energy sector, with Russian investors buying oil wells in Serbia. Chinese investors bought a Serbian steel facility for a token US$1 after US Steel exited. Other investments include a privatized copper mine and Air Serbia, now 49% owned by Etihad.[60] Some of these transactions have been investigated for illegal state aid.

Russia and China both offer large loans for infrastructure projects in exchange for appointing Russia or Chinese contractors. For example, one rail development contract, worth $1.2 billion, is funded largely by a Russian loan and 70% of the work has been awarded to Russian rail contractors. Said one interviewee: 'Because for most of these projects, according to memoranda of understanding or financing agreements, it is clearly stated that we borrow 85% of the project amount from a Chinese bank. Serbia finances the other 15% from additional funds.'[61]

A study of the costs of highway construction in Serbia revealed a bewildering pricing differential between prices paid to Chinese infrastructure partners and bid prices by competitors who were not selected. In one case, prices paid were allegedly 30% higher than the unsuccessful competitor:[62]

> Corruption in infrastructure is widespread and harmful and most money gets lost in bribes to public officials and political representatives. The works' price is inflated above the actual price by 20% or 30%, sometimes even higher. First, construction contracts go to companies closely associated with the regime ruling party and a good proportion of those earnings is returned to the Serbian Progressive Party and/or its top officials in one way or another.[63]

Unethical practices are not limited to Chinese and Russian intervention. French infrastructure giant VINCI won Serbia's Belgrade airport contract at a suspiciously good price ($501 million for a 25-year concession). President Macron made a specific intervention on VINCI's behalf.[64] In the hotly contested bidding process, 27 bidders were whittled down to five in June 2018. According to advisers on the deal, it was sold for '€1 more than the next highest bidder' (implying that the bid prices were leaked to the favoured bidder).[65] In addition, a leading Serbian businessman, Stanko Subotic, is due to profit significantly from VINCI's plans to expand the airport. Subotic is alleged to have a criminal history of cigarette smuggling and organized crime connections (often seen as a 'gateway crime'). He will profit significantly as the largest landowner of the land surrounding the airport.[66]

These 'soft power' practices may not all be technically illegal, but they suggest a misuse of power by international investors.

Bosnian NGO corruption – public money for political support

Bosnia's complex ethnic composition has led to a multiplicity of representative organizations and burgeoning public sector spending.

According to available information, there are around 25 000 civil society organizations registered in Bosnia and Herzegovina, yet experts report only 15 000 are active. In addition, 1 300 NGOs exist in Bosnia and Herzegovina, which are estimated to have spent €64 million in 2007 with few demonstrable results. Around 40% of funding for these organizations is granted without public consultation.[67]

A representative example of this sort of cronyism can be found in a small canton of Sarajevo. The 2021 budget for the municipality was €20 million, of which (according to confidential information) around €410 000 is routinely given to CSOs without a public consultation or competition. Those grants that do follow a more transparent process are still liable to undue influence. Around €100 000 to €150 000 annually is directed to youth organizations, cultural and sports associations granted via a public process. But both types of recipient CSOs are frequently connected to political parties or to the mayor himself. While not all corruptly paid sums are IFFs, as they may not cross borders, we are confident that a proportion do. The 'non-public' annual grants handed out without a public consultation or competition are often given to war veteran organizations and ecology-based organizations, all of whom are supportive of the ruling party and ready to speak out in favour of or opposition to specific policies.

In another specific case, Brcko – a self-governing district seen as 'a microcosm of Bosnia and Herzegovina'[68] – reportedly suffers significant financial corruption. According to our interviews, there were many examples of Brcko political parties connected to corrupt financing of CSOs. For example, of the €2 million planned for allocation to NGOs in 2018, one official granted more than €325 000 to different fictitious organizations.[69]

At ministry level, there is further evidence of corruption. One interviewee from the Indirect Taxation Authority cited significant fraud around taxation of oil products over the past years, which had been exposed but not properly investigated due to the political patronage of the authority's director.[70]

Bosnia remains a complex ethnic melting pot, which makes it vulnerable to exploitation given the sheer scale of the public, NGO and CSO sectors compared to the size of its economy and population.

According to the Serbian Ministry of Finance, tax crime generates significant illegal revenues – over €450 million from 2013–2017.

Montenegro's defence industry

Concerns have been raised about the risk of corruption in Montenegro's defense industry. A recent Transparency International defence governance index gave Montenegro a 'very high risk' grading,[71] given its poor controls over defence procurement risk and financial and operational risk management.

In 2013, Montenegro abolished a law that restricted foreign investment of more than 49% in national defence companies. This allowed foreign companies to enter a market already affected by corruption scandals related to a widespread lack of transparency. There have been several allegations of arms trafficking to Libya and the Levant over the years, but no prosecution of specific cases.[72]

Other forms of corruption

Our interviews identified widespread public procurement corruption in all three countries, which tends to go unprosecuted. These include a Bosnian case of procurement of COVID-19 respirators, in which the urgent procurement procedures were allegedly misused.[73] In fact, it appears that large construction projects are continuously linked to major corruption scandals in the Western Balkans and they are almost always connected to the misuse of public procurement. A recent report also confirms that the construction sector is among the most vulnerable to organized crime and corruption.[74]

Tax

Tax evasion is a significant issue in all three countries. Serbia loses on average €100 million a year, and Montenegro, with an economy a tenth the size of Serbia's, loses up to €60 million. Bosnian employees receive up to half of their wages in cash. Whilst not all these flows are IFFs, the example of industry-wide abuse by agricultural 'guest workers' in Serbia undoubtedly leaks value from the economy.

Tax is a financial obligation imposed on citizens and corporations by a taxing authority. The principal mechanisms of taxation include income tax, corporation tax, capital gains and inheritance taxation, property and sales taxes.[75]

Taxation abuses are considered IFFs and are included in the UN's definition. They are considered IFFs for both tax evasion – which are clearly illegal abuses of prevailing tax legislation – and aggressive avoidance, where organizations take advantage of mismatches or technicalities of the tax regimes of different jurisdictions to minimize payable tax on economic activities. In the latter case, these activities are not illegal but are considered illicit and hamper the achievement of the SDGs.

The tax/GDP ratio for Serbia and Bosnia and Herzegovina is respectively 24% and 20% (Montenegro figure unavailable), which compares favourably to a euro-zone average of 19.9%. However, the size and scale of the informal activities in the Western Balkan economies contribute to opportunities for large-scale tax evasion.[76]

Our interviews in the three countries revealed significant evasion of income taxes. In Bosnia and Herzegovina and Serbia, employment tax evasion was widely reported: employees were officially paid minimum wage, which was supplemented with cash payments,[77] or taxi fares were simply underreported.[78] Business owners in Bosnia and Herzegovina also reported how entrepreneurs reduced their legal profit by using fake invoices and employment contracts.[79]

Serbian interviewees reported similar abuses, particularly in seasonal industries, plus some more sophisticated evasion using techniques to reduce the effective corporate tax rates and profit manipulation for small companies.[80] 'Approximately 2% of GDP is a loss for the budget due to tax evasion. From 0.9 to 1% of tax evasion is related to VAT evasion, from 0.8 to 0.9% to tax and contribution avoidance'.[81]

According to the Serbian Ministry of Finance, tax crime generates significant illegal revenues – over €450 million from 2013–2017. From 2013–2018, criminal proceedings were initiated against six organized crime groups, which consisted of a total of 176 persons who were charged with tax evasion and abuse of the position of a responsible person.[82]

In Bosnia and Herzegovina, a similar picture emerges. A former Bosnian financial crime unit officer reported that tax evasion is widespread. 'Evasion is facilitated by:

- a dependence on cash in payment operations;
- widespread avoidance of customs control, facilitating smuggling;
- high rates of tax and contributions on paid salaries and low rates of tax and contributions on employment contracts;
- tolerance of the state towards the grey economy;
- inadequate capacity work of inspections, customs authorities, courts, prosecutor's offices and police;
- a complicated and inadequate tax system, with regulations that change too frequently; and
- incorrect determination of the value of imported goods (discussed further in the subsection on trade).'[83]

The prevailing attitude in Bosnia and Herzegovina is one of tax non-compliance, where the state is viewed as 'stealing' from individuals. One Bosnian accountant estimates up to 50% of income tax is evaded through cash payments made on top of the minimum wage.[84]

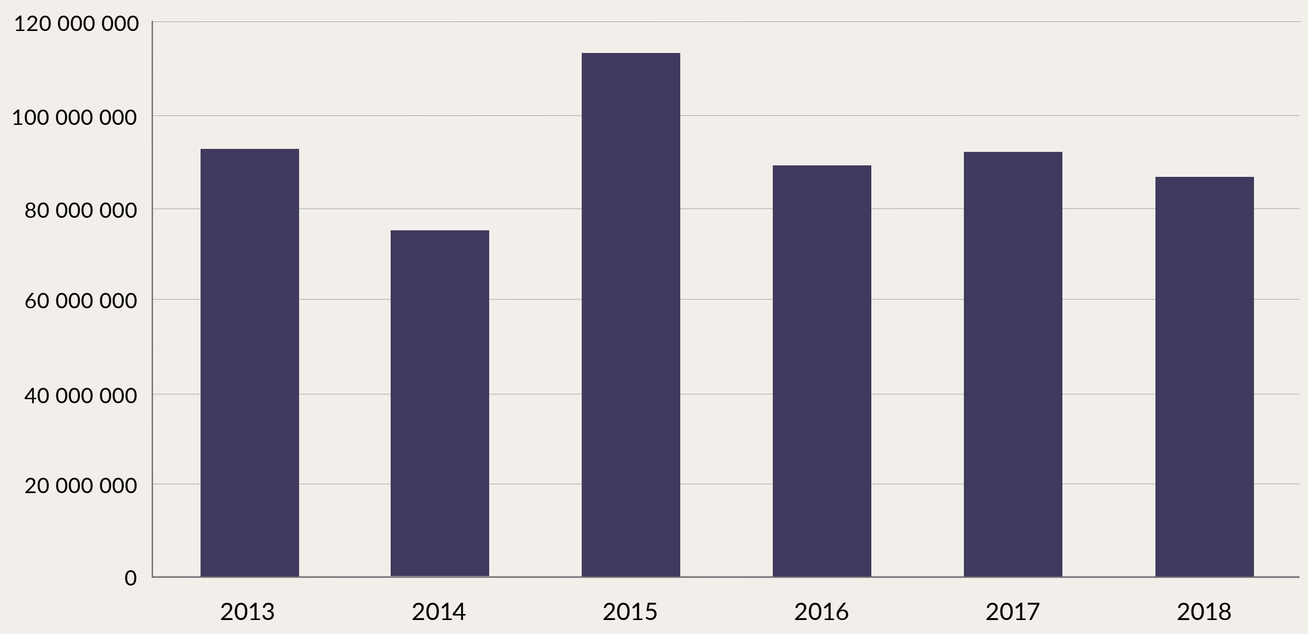


FIGURE 13 Budget damage to Serbia caused by tax crime, in euros.

SOURCE: Official response by the Serbian Ministry of Finance, April 2021

Montenegro suffers similar widespread avoidance, according to interviewees. 'The amount of lost tax from evasion is at least €60 million per year. Over 50% of economic entities in Montenegro officially have only one employee. Tax evasion in terms of income is measured in the millions.'[85]

A significant literature has emerged on corporate tax avoidance (rather than evasion), arguing that the corporate tax rate is reduced by up to 1% by aggressive tax planning.[86] Another study indicated that 4–10% of corporate tax revenue could be 'lost' through this form of avoidance.[87] Serbian interviewees referenced transfer pricing as one mechanism used locally to decrease the tax burden.

Tax evasion in the informal economy in Serbia

The underreporting and partial reporting of employment is rife in Serbia, according to our interviewees.[88] The issue is particularly widespread in small- to medium-sized enterprises and the agricultural sector. The National Alliance for Local Economic Development, a leading Serbian NGO, campaigns against misuse of the informal economy. It believes the informal economy is between 15% and 20% in Serbia. European Commission estimates are higher at about 27%.[89]

Casual workers represent the largest category of actors in the informal economy. Around 500 000 casual workers, many in agriculture, are employed in Serbia each year, where tax evasion is widespread. Some 95% of these workers were engaged informally. This annual pattern has become a very visible element of widespread tax avoidance in the Serbian economy. A new electronic system was introduced in 2018 to enable much easier registration of seasonal workers' employment, which has seen a significant uptick in compliance to 42 000 registrants.[90]

In addition, Serbia receives huge remittances from overseas nationals sending money home. Around €3 billion per year is returned to Serbia, a significant proportion of which is likely to have underpaid taxes.

For both incoming and outgoing flows, it seems Serbia remains a major informal economy player, with a significant tax evasion problem.

		2015	2016	2017	2018	2019	2020
Total employed persons (thousands)	Total	2 574.2	2 719.4	2 794.7	2 832.9	2 901.0	2894.8
	Without agriculture	2 022.1	2 093.9	2 179.9	2 268.0	2 329.5	2347.5
	Agriculture	552	625.5	614.8	564.9	571.5	547.3
Formally employed (thousands)	Total	2 050.2	2 120.2	2 215.4	2 279.1	2 371.8	2421.1
	Without agriculture	1 834.9	1 888.0	1 965.7	2 056.1	2 138.3	2187.9
	Agriculture	215.3	232.2	249.8	223.0	233.5	233.1
Informally employed (thousands)	Total	523.9	599.2	579.2	553.8	529.2	473.7
	Without agriculture	187.2	206.0	214.2	211.9	191.2	159.6
	Agriculture	336.7	393.2	365.0	341.9	338.1	314.1

FIGURE 14 Formally and informally employed persons in Serbia.

SOURCE: Official data received from the Serbian Office of Statistics, 2021

Illegal markets

Organized crime is a key component of IFFs in Bosnia and Herzegovina, Montenegro and Serbia.

Illegal markets drive large-scale IFFs. Drug trafficking IFFs result from the major Balkan route flows of heroin, cannabis, cocaine and synthetic drugs. Heroin doubles in value from the Western Balkans to the EU. Migrant smuggling produces significant IFFs to the smugglers taking millions of euros for passage across Serbia and Bosnia and Herzegovina's borders. Illicit trade in conventional goods like tobacco or clothes also remains a major driver of IFFs. Estimates provided point out that more than 20% of the tobacco markets in Montenegro and Bosnia and Herzegovina are illicit, and the countries also act as transit countries for the higher-profit EU destinations for illicit goods.

Organized crime has a long history in the Western Balkans, with groups engaging in the principal European illegal markets: trafficking in drugs, people and weapons, smuggling of migrants and illicit trade. Enabled by the region's interconnectedness and porous borders; corruption, poor governance and a protection economy; as well as well-connected trade routes and large diaspora, the groups are active on a regional and global level.[91] It is a significant business and key component of IFFs in Bosnia and Herzegovina, Montenegro and Serbia, generating hundreds of millions of euros annually in illicit proceeds.[92]

However, analyzing the extent of IFFs related to crime is no mean feat. No comprehensive attempt has been made to estimate the value of illicit proceeds gained by organized criminal groups engaged in the Western Balkans. And no attempt has been made to determine what proportion of those proceeds represent IFFs (i.e. a cross-border flow of value over time).

Nevertheless, a good starting point is the GI-TOC Western Balkans crime index, which takes a range of proxy measures to assess the relative importance of crime types. This section will therefore focus specifically on drug trafficking, illicit trade and human smuggling, given their position as the top three crimes measured.

Police oversee the destruction of drugs at an aluminium plant in Podgorica. Montenegro is on the Balkans drug-trafficking route.
© Savo Prevelic/AFP via Getty Images

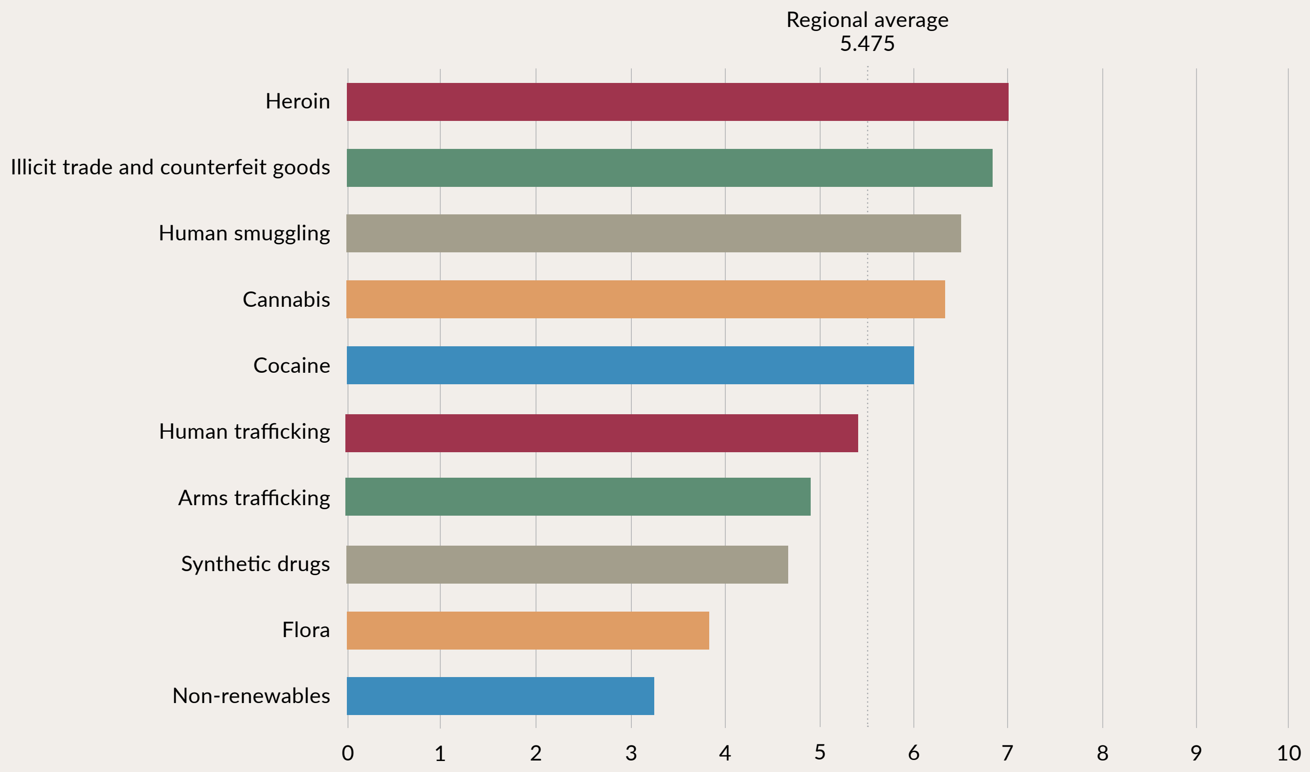


FIGURE 15 Ranking the scope and impact of illicit markets in the Western Balkans.

NOTE: The Balkans Organized Crime Index was undertaken as a pilot exercise in 2018/2019 based on an assessment of 2018 data. Albania, Bosnia and Herzegovina, Montenegro, North Macedonia and Serbia are also included in the Global Organized Crime Index which was launched in September 2021. For more information see www.ocindex.net.
SOURCE: GI-TOC, Western Balkans Organized Crime Index

Drug trafficking

The Balkan route is a long-established drug trafficking corridor, especially for heroin, which enters the region from Turkey on its way to Western Europe. The UNODC previously estimated that 60–65 tonnes of heroin flow through south-eastern Europe each year – worth more than €960 million in 2020.[93] Clearly, given the Western Balkan role as a transit route, these financial flows are likely to represent IFFs.

Major flows of heroin pass through North Macedonia and Serbia, with Nis in the south of Serbia being a key trafficking hub. Rozaje in Montenegro was also identified as a key heroin storage and distribution centre.[94] Heroin presents significant profit opportunities for criminal groups, as they transport, process, store and repackage it along the way. A kilogram of heroin is worth approximately twice as much in the Western Balkans as it is in Turkey; it doubles in value again when it is sold in the EU.[95]

Cannabis is the most commonly used and seized drug in the Western Balkans. Although Albania remains the region's largest producer, indoor cultivation has also been recorded in Bosnia and Herzegovina and Serbia. In Bosnia and Herzegovina, cannabis growing facilities have been discovered in Srbac in July 2019, in Banja Luka in June 2020 and in Prijedor, Posavina and Semberija in the North.[96] In Serbia, the Jovanjica case in November 2019 has attracted significant attention, as 1.6 tonnes of high-quality psychoactive cannabis were discovered at a large farm with 60 000–65 000 plants.[97] Wholesale prices range from €1 000 per kilogram in Montenegro to €1 550 in Bosnia and Herzegovina and €1 900 in Serbia, depending on quality and availability.[98]

Profit margins for cocaine are reportedly quite high, but cocaine seizures in Bosnia and Herzegovina, Montenegro and Serbia remain low.

Synthetic drugs are trafficked into and through Bosnia and Herzegovina, Montenegro and Serbia. Most come to the region from the Netherlands, Belgium, the Czech Republic and Bulgaria,[99] but also local laboratories have been discovered in the Western Balkans. Indeed, more than 140 synthetic drug laboratories were discovered in Serbia between 2009 and 2019. One of the biggest discoveries was in 2003 in the small town of Stara Pazova, Vojvodina, where police found around two million Ecstasy tablets valued at over €4 million, as well as approximately 20 tonnes of acid for Ecstasy production, estimated to be worth over €10 million.[100]

What seizures tell us about market size

Seizures are imperfect indicators to estimate the size of drug markets as no causal relationship between an increase in seizures and illicit substance available in a market (nor their associated IFFs) can be established. After all, rising seizures may not only be the result of increasing availability, but can also be the consequence of increased law enforcement capacity and new technology, for example to screen and check containers. It is widely accepted that only a small fraction of all drug shipments is found.

Nevertheless, coupled with the wholesale value of drugs, the numbers give an indication of what is at stake.

2020									
	BOSNIA AND HERZEGOVINA			MONTENEGRO			SERBIA		
Substance	Amount seized	Wholesale value of 1kg	Wholesale value of seizures in 2019	Amount seized	Wholesale value of 1kg	Wholesale value of seizures in 2019	Amount seized	Wholesale value of 1 kg	Wholesale value of seizures in 2019
Cannabis	1 158,59 kg	€1 700	€1 969 603	2 290 kg	€1 700	€3 893 000	7 100 kg	€2 100	€14 910 000
Cocaine	2.8 kg	€31 000	€86 800	93.2 kg	€35 000	€3 262 000	13.6 kg	€42 000	€571 200
Heroin	2.5 kg	€17 000	€42 500	23.3 kg	€15 000	€349 500	35 kg	€19 000	€665 000
Synthetic drugs	92.2 kg	€2 000 (for 1 000 Ecstasy pills) €3 000 (amphetamines)	€4 000 (Ecstasy) €276 000 amphetamines	0.27 kg	€2 000 (for 1 000 Ecstasy pills)	€350	31 kg	€2 500 (for 1 000 Ecstasy pills)	€77 500
Total Value of Seizures	€2 378 903			€7 504 850			€16 223 700		

FIGURE 16 Drug seizures, wholesale prices and estimated value of seizures, 2020.

SOURCE: Data on drug seizures was compiled from national police records; data on prices was gathered through interviews by GI-TOC country experts in the last quarter of 2020 and supplemented by UNODC, DataUNODC, Retail and wholesale drug prices (in US$), https://dataunodc.un.org/drugs/prices

Tobacco seized by the Bosnia and Herzegovina border police without excise documentation. The illicit tobacco market has doubled in the country in the last five years. *© Photo: Prosecutor's Office of BiH*

Except for a few pilot studies conducted in Serbia,[101] there is no coherent data on drug use in the Western Balkans. Cannabis remains the most commonly consumed drug across all three countries, although the quality of this and other drugs is reported to be low. This suggests that there is a difference in profit for smaller-scale operators catering to the local market and bigger groups and networks active in the more lucrative international markets for which the Western Balkans is a transit region. It also confirms that in addition to local profit, big money is also made outside of the region.

Many organized criminal groups involved in drug trafficking in the Western Balkans are described to be poly-criminal and involved in trafficking various types of drugs. They are quick to adapt to changing market preferences and sometimes pay in kind for different drugs (e.g., exchanging cannabis for heroin). This is also confirmed by multiple police operations where a range of different drugs is often seized.[102]

Illegal trade in licit and counterfeit goods

The three countries also have a vibrant informal market, where smuggled legal goods (food, car parts, livestock – even fishing equipment) and illegally produced or traded products (counterfeit clothing, tobacco) are readily available. Given that these illegal goods are imported they are, by definition, IFFs. Trade routes that were created decades ago (when the three countries were still part of Yugoslavia) continue functioning today. 'It looks like an "ants trail" – a seemingly never-ending flow of people, carrying food, oil, car parts and other goods back and forth without declaring their value or purpose to sell on the black market', said a Serbian businessman.[103]

In 2019, the Organization for Economic Cooperation and Development (OECD) estimated the trade in counterfeit and pirated goods at 3% of global trade (which does include contraband or grey goods).[104] It is also a key component of the illicit markets in Bosnia and Herzegovina, Montenegro and Serbia, where counterfeit products enter the region through the port of Bar in Montenegro and through Bulgaria and Romania.

Customs officers regularly intercept counterfeit goods such as in February 2021, when more than 6 000 pieces of counterfeit clothing worth €10 000 were intercepted on a truck from Turkey at the border between Serbia and Bulgaria.[105] In April 2018, officials of the Bosnian Indirect Taxation Authority seized more than 7 000 pairs of slippers in a container from China.[106] Montenegro destroyed more than 900 pieces of counterfeit apparel in 2018 (which it had seized in 2017), intended for local companies from Podgorica and the towns of Budva, Niksic and Bijelo Polje.[107]

Illicit tobacco – a gateway crime in the Western Balkans

The illicit tobacco trade has a significant impact on Bosnia and Herzegovina, Montenegro and Serbia, especially in terms of distortion of the local economy and lost duty and taxes. According to a 2019 study, two out of five adults smoke in Bosnia and Herzegovina, as do one out of three adults in Montenegro and Serbia.[108] The level of illegal tobacco consumption (contraband, counterfeit, cheap whites and fine cut tobacco) varies across the region, with 6.5% in Serbia, 20.3% in Bosnia and Herzegovina and 27.9% in Montenegro.[109] A government employee interviewed in Bosnia and Herzegovina stated that due to a sharp increase in excise taxes (and therefore prices), the illegal market almost doubled in the last five years.[110] In the first six months of 2021 alone, the Bosnian Indirect Taxation Authority confiscated cigarettes and cut tobacco worth twice as much as the total confiscated in 2020.[111] Another interviewee added: 'The high excise tax in Bosnia and Herzegovina is the reason for at least 50% of the illicit local cigarette market'.[112]

The tobacco industry has a long tradition, especially in Bosnia and Herzegovina, where it was long one of the most important crops cultivated. Serbia is the only European country where three of the big global tobacco companies have factories.[113] It is widely known that in the 1990s in Montenegro, cigarette smuggling was effectively a government-sponsored means of financial survival amid the war and sanctions of Yugoslavia's collapse and many of the high-ranking business and political elite today continue to be connected to cigarette smuggling.[114]

There appear to be two key markets for illicit cigarettes in the three countries. The first is the transnational smuggling market, which is well-organized and flourishes under an 'umbrella of protection'. Indeed, it is the large-scale tobacco cases which attract the most attention. For example, in May 2019, it was revealed that up to 840 million so-called 'cheap white' cigarettes had been exported from Montenegro by a group of mostly offshore firms using similar routes and often the same 'ghost' fishing boats or small cargo ships, sailing the Mediterranean without transmitting their positions.[115] In another recent case, almost 300 000 boxes of cigarettes were confiscated at the border entering Bosnia and Herzegovina from Montenegro.[116]

But there is also a significant local market (primarily for cheap whites), which is fuelled by the price differential driven by countries' excise regimes, which make legal cigarettes often unaffordable to consumers. This market has also expanded to online platforms, where illicit tobacco is increasingly offered.[117] Given that the consumption and sale of illicit tobacco is widely socially accepted, this market especially attracts opportunistic groups and individuals, creating a gateway into the wider world of organized crime in the region. 'I often sell the tobacco I get from my friend on the side. He produces it in a local garage,' said one entrepreneur.[118] Where these cheap whites are imported – often from China – they represent IFFs. Where they consist of locally grown tobacco products, they are domestic flows.

While it is widely accepted that there are significant proceeds annually associated with the illicit trade of tobacco in the Western Balkans, the available estimates could not be verified.[119]

FIGURE 17 Official and unofficial tobacco flows.

SOURCE: Davor Mikulić and Goran Buturac, In what measure is public finance sustainability threatened by illicit tobacco trade: The case of Western Balkan countries, Institute of Economics, Zagreb, 2019, https://www.mdpi.com/2071-1050/12/1/401

Migrant smuggling

Since 2015, the Balkan route has become a key migration channel to Western Europe. While initially many migrants could pass with few border restrictions within the region (numerous reports described how they literally 'walked across the Western Balkans'), increasing vigilance at borders, including the construction of border fences and COVID-19 protective measures, have created a lucrative market for migrant smuggling.[120]

Most money from migrant smuggling appears to be made outside of the region – especially in Turkey or Greece or the countries of origin – as migrants seek out smugglers to facilitate their journey to Western Europe. However, human smuggling services are also offered within the Western Balkans, particularly in the north at the borders with the EU. There, smuggling services are commonly offered at certain 'chokepoints', such as the Una-Sana canton in Bosnia and Herzegovina (to cross to Croatia), or the northern border of Serbia (to cross to Hungary and Romania), which are particularly difficult to pass. A recent GI-TOC report estimated that in 2020 alone, the value of the migrant smuggling market ranged between €7 and €10.5 million to cross from Bosnia and Herzegovina to the EU and between €8.5 and €10.5 million between Serbia and Hungary and Romania.[121] The cross-border nature of smuggling means the associated financial flows are inevitably IFFs.

Migrant smuggling in Montenegro

When researching migrant smuggling along the Balkan route, little attention is usually paid to Montenegro. Though the western migrant route passes directly through the country, there are only two migrant reception centres (in Bozaj and Spuz) and migrants interviewed stated that they try to move north as quickly as possible. According to the UNHCR, 2 898 migrants were present in Montenegro in November 2020.[122]

FIGURE 18 Migrant routes through Montenegro.

Migrants usually enter Montenegro in the south from Albania and often head directly towards the town of Pljevlja with help of smugglers or in autonomous groups. This can include bus rides from Bozaj to Podgorica, taxi trips from Podgorica to Pljevlja or similar options. From there, they continue to Bosnia and Herzegovina or Serbia. Depending on the smuggling service they require and the sophistication (and assumed success rate) of the smuggling network, this leg of the trip can cost between €150 and €5 000 per person. Crossing the Adriatic from Montenegro directly to Italy via boat is significantly more expensive.[123] The total migrant smuggling market for Montenegro was estimated to be around €2 million in 2020.[124] While a relatively minor contribution to IFFs in aggregate, the individual payments offer an important example of an IFF in practice.

In contrast to 2015, recent interviews show that migrants no longer carry large amounts of cash for fear of being robbed. They pay smugglers with the funds they wire or withdraw from fast money-transfer mechanisms such as Western Union or MoneyGram once they arrive at the agreed destination.[125] In theory, this creates a more easily detectable IFF. However, low detection and prosecution rates encourage the participation of regular citizens in the smuggling business, further distorting the local economy.

Arms smuggling

South-eastern Europe is saturated with weapons left over from the wars in former Yugoslavia, the civil unrest in Albania in 1997 and those used in Kosovo in 1999 and North Macedonia in 2001. According to UN and Europol estimates, there are more than three million illicit weapons in the six countries of the Western Balkans plus Croatia.[126] Weapons also continue to be produced in the region, including anti-tank weapons, explosives, mortars, hand-held rocket launchers and light anti-aircraft guns mostly for export. In total, Serbia and Montenegro record 39.1 (legal and illegal) weapons per 100 residents.[127]

The average price of weapons in the Western Balkan countries ranges from €10 for a hand grenade to €150–400 for a pistol. Semi-automatic rifles cost between €150 and €300, while automatic rifles are around €200 to €400. Explosives from the Western Balkans can also be found on the black market: plastic C4 explosive costs between €1 500 and €4 000 per kilogram.[128]

Many of these weapons are hidden in people's homes, available on the black market or in the possession of criminals. However, it is important to note that the weapons are not only used by criminal groups within the region,[129] but are also smuggled across Europe, often by groups that are also engaged in the trafficking of other illicit goods. They also end up in the hands of terrorists.[130] These cross-border transactions create associated IFFs.

Organized crime in the Western Balkans is centred around key hotspots, which are usually places of economic vulnerability and weak governance. Hotspots are also located along key transit routes, ports, airports and airstrips and free trade zones. The scale of the business also suggests a high degree of sophistication and collusion with logistics companies. Most of the illicit goods are moving in trucks, ships or buses working for legal companies. Some of these loads also require significant storage space and facilities, for example to cut and repackage tobacco and drugs, or store counterfeit apparel before it is delivered to its final destination. As will be shown below, cash used to pay for these goods is often transported through the same channels – just in the opposite direction.

This section has shown that organized criminal activities in Bosnia and Herzegovina, Montenegro and Serbia each show clear country specific trends, with flows criss-crossing routes that are part of regional illicit flows. Although this section only focused on selected illicit activities (drug trafficking, migrant smuggling and illicit trade), this does not necessarily mean that financial flows from other types of crime do not have a detrimental effect on these geographic areas and therefore should not be discounted.

Corruption in infrastructure and civil engineering procurement has been observed in the region, sometimes linked to FDI. *© Savo Prelevic/AFP via Getty Images*

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CHANNELS OF IFFS

The channels of IFFs are the methods by which illicit flows move value across borders, including money laundering, trade mis-invoicing, cash transfers and capital account channels. Each channel takes various forms. This section considers three of the main channels used to facilitate IFFs in Bosnia and Herzegovina, Montenegro and Serbia.

IFFs need systems in order to 'flow'. The three mechanisms are the financial system, in all its myriad forms, the international trade system and cash transactions.[131] The breadth of the financial system definition cannot be understated: the system includes the conventional regulated banking sector in each country, as well as many non-traditional actors such as microcredit organizations and cryptocurrencies. Money transacted as investment in property, securities or other assets is also included in this category. Trade is a key channel for IFFs, given the opportunities to hide crime amongst legitimate trade flows. A wide range of over-, under- and mis-invoicing offer myriad mechanisms for IFF abuse. Finally, despite its decline as a conventional channel, cash remains a significant feature of IFFs. Given its physicality, cash is potentially more detectable than its electronic equivalents, but significant cash sums are frequently trafficked across Western Balkans borders.

Financial sector

The financial system remains the key channel through which illicit proceeds are moved. All three countries have significant domestic and international banking sectors and all have problems with money laundering, including reports of significant money laundering through property transactions. In addition, microcredit organizations and cryptocurrencies are targeted by launderers. The most recent evaluations of money laundering governance identified a need to significantly tighten the AML processes in Bosnia and Herzegovina and Serbia.

In this section we consider to what extent the legitimate financial system, including related sectors such as real estate, acts as a channel for IFFs. This includes, but is not limited to, money laundering – that is the process by which proceeds of crime are entered into the legitimate financial system and disguised to sever them from their illegal origin.[132] This happens in a three-stage process:

- Placement: the illicit proceeds are introduced into the financial system in a way that disguises the true ownership of those funds and seeks to avoid activating the financial industries' AML systems.
- Layering: in which there is an attempt to transfer the proceeds of crime through a series of complex financial transactions that serve to disguise the true origins of the funds.
- Integration: in which the illicit funds re-enter the economy in an altered character and disguised as legitimate assets.[133]

The financial sector is a key channel by which illicit flows move across borders and are laundered into local economies. In fact, banks, exchange offices, insurance brokers, investment companies, microcredit institutions and real estate firms are key elements of most forms of money laundering, as they do not only facilitate the movement of money across countries but also hide the illegal origin of the profits, distance the criminal from the original transgression and inject the funds into the local economy. Money laundering is usually estimated at between 2–5% of GDP,[134] an equivalent of €402 million–1 billion in Bosnia and Herzegovina, €110–275 million in Montenegro and €1–2.5 billion in Serbia in 2020 alone. As IFFs are per definition transnational, the section below focuses on money laundering schemes that cross borders.

Banks hold a key position in the financial system, as they provide a range of services, including accepting deposits, making loans, exchanging currency and managing wealth. The fact that funds can be withdrawn in cash and readily transferred overseas makes retail banking highly attractive to money launderers.

Banks, exchange offices, insurance brokers, investment companies, microcredit institutions and real estate firms are key elements of most forms of money laundering.

The Financial Action Task Force, and reports on Bosnia and Herzegovina, Montenegro and Serbia

The FATF is an inter-governmental body working to set international standards that aim to prevent money laundering and terrorist financing and the harms caused to society. It works together with nine FATF-style regional bodies. To ensure a coordinated global response and support authorities to go after the proceeds of organized crime, it has developed the so-called 'FATF Recommendations'.[135] The regional body covering Europe and the Western Balkans is MONEYVAL – the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism – a permanent monitoring body of the Council of Europe based in Strasbourg, France.

FATF and these regional bodies also conduct peer reviews (mutual evaluation reports) of each member on an ongoing basis to assess technical compliance and effectiveness of the FATF Recommendations and immediate outcomes, providing an in-depth description and analysis of each country's system for preventing criminal abuse of the financial system. The latest reports on Bosnia and Herzegovina and Montenegro were adopted in 2015, while Serbia's was adopted in 2016.

Looking at the effectiveness of their compliance is particularly helpful to understand the countries' capabilities. For example, Serbia's effectiveness was rated 'low' on money laundering investigations and prosecution; preventive measures and financial sanctions on financing of terrorism; and financial sanctions on proliferation financing. It was rated 'moderate' on all other aspects, including preventive measures and confiscation of assets.[136] Given these limitations, Serbia was placed under enhanced follow-up.

Since then, all three countries have completed and adopted numerous follow-up reports and have made significant progress in addressing the AML threats and vulnerabilities.[137] Nevertheless, the countries' exposure to cross-border illicit flows remains significant. Authorities' track record of investigating, prosecuting and convicting money laundering cases remains low. The diagram below summarizes some of the key money laundering risks.

Specifically for Bosnia and Herzegovina, the reports emphasized that the financial market only offers very basic financial services and products and does not therefore enable the use of sophisticated techniques to cover illicit assets. In this regard, a further factor increasing the country's vulnerability to money laundering is the frequent use of cash for purchases.[138]

FIGURE 19 Money laundering risks in Bosnia and Herzegovina, Montenegro and Serbia.
SOURCE: MONEYVAL assessments and primary information

As observed in Figure 20, the overwhelming majority of individuals and businesses in Montenegro and Serbia appear to own a bank account, although interviewees emphasize that considerable distrust in the system – especially in online banking tools – remains: 'People are afraid that criminals break into their bank account and steal their money'.[139] The cost to hold and maintain bank accounts and cards was also mentioned as a deterrent. The situation appears different in Bosnia and Herzegovina, where as much as 40% of the adult population is assumed to not own a bank account.[140]

Therefore, most money laundering schemes involve the use of the financial system at some stage in the transaction process. AML programmes have therefore focused a significant amount of effort on the counterparty 'know your client' process. This is also why banks require a proof of the money's origin for amounts above a certain threshold (€15 000 in all three countries) and larger transactions automatically trigger a suspicious transaction report. However, this system is commonly circumvented as criminal actors divide the transaction into many smaller ones and transfer the money between different accounts, both local and abroad, in order to increase the appearance of legality.[141]

Bank loans and loan guarantees are a common method to hide the real origin of illicit money. In Montenegro, experts reported that it is common to take out loans guaranteed by companies based in tax havens, such as the Seychelles or Cayman Islands, and then to default on these loans. Montenegrin banks often have to simply write-off this debt.[142] In Bosnia and Herzegovina, local (fictitious) companies reportedly borrow money from abroad, including from companies based in the Persian Gulf, where the source of the funds cannot be established by local authorities. They then use these loans to invest in local real estate, open other companies or buy equipment.[143] MONEYVAL assessments for all three countries confirm the use of 'internal loans' between companies belonging to the same owner as well as 'phantom firms' being used to legalize and redirect funds.

Most money laundering schemes involve the use of the financial system at some stage in the transaction process.

	Bosnia and Herzegovina (2019)	Montenegro (2020)	Serbia (2020)
Population (2019)	3 300 000	600 000	7 000 000
Number of accounts of individuals	2 100 000	960 602	16 468 360 (dinars) 5 341 401 (foreign)
Number of total legal entities active	n/a	37 255	400 672
Number of accounts of entrepreneurs and legal entities	879 607 entrepreneurs / 76 994 legal entities	670 859	2 840 152 (dinars) 541 812 (foreign)

FIGURE 20 Overview of bank accounts in Bosnia and Herzegovina, Montenegro and Serbia in 2020.

SOURCE: Figures on Bosnia and Herzegovina from the Central Bank of Bosnia and Herzegovina; figures on bank accounts in Montenegro and Serbia were obtained from the respective central banks on 28 and 29 April; information on legal entities was obtained from the Business Registry Agency of Serbia and MONSTAT.

Financial assets held by:	Bosnia and Herzegovina (2014)	Montenegro (2013)	Serbia (2013)
Banks	84%	97%	92.4%
Other (investment funds, microcredit institutions, etc.)	16%	3%	7.6%

FIGURE 21 The financial markets of Bosnia and Herzegovina, Montenegro and Serbia.

SOURCE: MONEYVAL, Report on fourth assessment visit – Bosnia and Herzegovina, September 2015, https://rm.coe.int/report-on-fourth-assessment-visit-anti-money-laundering-and-combating-/1680715b43; MONEYVAL, Serbia – fifth round mutual evaluation report, April 2016, https://rm.coe.int/anti-money-laundering-and-counter-terrorist-financing-measures-serbia-/1680715fdb

Banks	Bosnia and Herzegovina (2014)	Montenegro (2013)	Serbia (2013)
Total number	27	11[144]	30
Foreign owned (more than 50%)	17	9	– [145]

FIGURE 22 Number of banks in Bosnia and Herzegovina, Montenegro and Serbia.

SOURCE: MONEYVAL, Report on fourth assessment visit – Bosnia and Herzegovina, 17 September 2015, 10, https://rm.coe.int/report-on-fourth-assessment-visit-anti-money-laundering-and-combating-/1680715b43; MONEYVAL, Serbia – fifth round mutual evaluation report, 13 April 2016, 9, https://rm.coe.int/anti-money-laundering-and-counter-terrorist-financing-measures-serbia-/1680715fdb

In addition to banks, MONEYVAL assessments have previously highlighted the role of real estate, valuable moveable property, gambling, the hospitality industry and investment in securities as preferred money laundering methods.[146] For Bosnia and Herzegovina, the securities sector, linked to the privatization process, was even the second largest sector at risk.[147] Although the most recent MONEYVAL assessments were concluded between 2015 and 2016, the main money laundering methods observed today remain largely the same.[148]

The role of real estate in money laundering

MONEYVAL assessments stress the widespread vulnerabilities of the construction and real estate sectors across the three countries. As described in other GI-TOC reports, investments in construction and real estate have a long history of absorbing illegal revenue in the Western Balkans, given that the sector is both meaningful in terms of economic share and poorly regulated. [149]

The real estate industry in Serbia has grown at an unusually high rate since 2018. Construction continued despite COVID-19 in 2020, although many of the newly constructed buildings remain empty. For example, the Belgrade waterfront project not only continued in 2020, but there was an increase in the amount of construction materials procured and used.[150] One reason could be that they are built rather to launder money than to provide housing. 'You construct an apartment building and then you get your team members to buy an apartment in that building at deliberately inflated prices'.[151] In 2020, the average price of new real estate per square metre in different neighbourhoods of Belgrade was €2 172 in Vracar; €3 365 in Savski Venac and €2 499 in Stari Grad. Serbia has an average monthly salary of €508.[152]

In Montenegro, authorities voiced concern over the fast development of this sector in 2009 and 2010, which attracted predominantly foreign investors.[153] The Kavač and Škaljari clans reputedly own different types of real estate across the country, valued at €27 million by the prosecution. Members of the clans allegedly also own construction companies which are connected to others owned by organized crime groups from abroad. Many properties and companies are registered in the name of relatives or friends.[154]

In Sarajevo, Bosnia and Herzegovina, many of the newly constructed buildings remain empty or unfinished. It is reported that the local real estate market has attracted not only local criminal actors, but also internationally-operating drug-trafficking groups and foreign investors. According to the Centre for Investigative Journalism, since 2012, investors from Saudi Arabia, Kuwait, the United Arab Emirates and other countries, have purchased 15.3 million square metres of land, including 524 condos.[155] Bosnia and Herzegovina still lacks a unified comprehensive real estate register, which makes it difficult to establish the real owner of a property.

Bar, Montenegro. Authorities have expressed concern about the vulnerabilities of the real estate sector to money laundering.
© biggunsband/Shutterstock

Gambling is legal in all three countries. In Serbia, a growing number of casinos has raised concern about the industry's vulnerability to money laundering. In Montenegro, the only company that holds an official licence to organize 'lottery games of chance' has previously been connected to organized crime.[156] Online betting and gambling appear to be attractive, too – in Serbia, betting shops are assumed to be closely connected to political parties and fan groups, while in Montenegro members of the Kavač and Škaljari clans are reported to have owned several licences for online gambling and slot machines.[157]

One of the fastest-growing industries across the three countries is tourism, which also offers widespread money laundering opportunities through bars, restaurants, hotels, holiday apartments, clubs, souvenir shops, car rental or taxi companies.[158] Members of organized criminal groups from Montenegro are reported to own several such companies, especially along the coast. In Bosnia and Herzegovina, interviewees explained that taxi companies are commonly used to launder money, as it is impossible to accurately measure the number of passengers on a monthly or yearly basis: 'They can declare that they have carried more or fewer passengers than they actually did, pay taxes accordingly and like this easily launder their money'.[159]

Microcredit institutions are classified as medium risk by MONEYVAL. In Bosnia and Herzegovina, where microcredit businesses previously accounted for 2.5% of the financial sector,[160] the business was booming particularly during COVID-19 as they handed out short-term loans at high interest rates. However, despite occasional reports of money laundering connections,[161] there is little comprehensive evidence that such companies are misused for money laundering. There is also widespread concern about foreign exchange offices, despite the fact that the MONEYVAL assessments consider the sector as medium to low risk. This assessment is surprising, given that in Bosnia and Herzegovina, there is no prohibition or restriction for any legal or natural person to be involved in currency exchange and/or money transfer services, which means that any person may engage in these activities without being duly licenced or registered.[162] In Serbia, exchange operators require certification by the Tax Administration,[163] while in Montenegro, money exchange can only be performed by banks or legal entities under contract with a bank. The official currency in Montenegro is the euro, which makes it highly attractive for the purpose of moving funds (especially cash) but also exposed to money laundering techniques through currency exchange offices.

Money-laundering schemes are changing rapidly and criminals are often quick to adapt to new technologies and techniques. Institutions across the region continue to have a poor track record of investigation, prosecution and conviction of money laundering cases. This is partly due to the fact that money laundering cases are difficult to prosecute without the predicate criminal act; even if the predicate criminal act is proven, investigations often fall short of including money laundering specific investigations and charges. In addition, while financial investigations in parallel with legal investigations are generally possible, in practice they remain very limited.[164]

'Abuse of power and position' continues to be the prevalent predicate criminal act, said an interviewee during this research. 'In 2013–2017, in Serbia almost 70% of all persons against whom an investigation was initiated for money laundering committed abuse of power as a predicate offence.'[165] Another said: 'The lack of knowledge and capacity to deal with money laundering is particularly worrisome in light of the increased importance of cryptocurrencies, which could be a serious threat to the integrity of the three countries' financial systems.'[166]

	2020		
	Bosnia and Herzegovina	Montenegro	Serbia
Judgments related to money laundering	100 verdicts	1 judgment	42 judgments
Convictions related to money laundering	105 persons convicted	1 conviction	41 convictions
Prison sentences related to money laundering	7 prison sentences	1 prison sentence	21 prison sentences 20 suspended sentences
Fines related to money laundering	98 fines imposed		31 fines
Asset confiscations			10 asset confiscations

FIGURE 23 Money laundering convictions and sentencing, 2020.

SOURCE: Public Prosecutor's Office (Serbia) and Ministry of Justice (Bosnia and Herzegovina)

Evidence of mis-invoicing centred particularly around free trade zones.

Trade

Trade is another mechanism for moving illicit proceeds, conducted through deliberate misrepresentation of the details of a trade transaction. This tendency to under- or over-invoice or to create phantom shipments altogether is poorly evidenced. But our interviews found evidence of mis-invoicing in Bosnian, Montenegrin and Serbian trade transactions, particularly centred around free trade zones such as the Port of Bar.

Trade is one of the three mechanisms or 'channels' identified for transferring value illegally, alongside cash movement and the financial system (including money laundering). Illicit use of the trade channel is often referred to as trade-based money laundering (TBML). The FATF President referred to the potential of these sham trade deals: 'One criminal network using TBML was able to move €400 million over several years'.[167]

The FATF defines trade-based money laundering as the 'deliberate movement of illicit proceeds through the exploitation of trade transactions.'[168] Illegal transfers of value are achieved in four key ways within trade channels, according to the FATF:

- Over- or under-invoicing the value of goods: This price misrepresentation often requires both exporter and importer to be complicit.
- Over- or under-invoicing the quantity of goods: This includes phantom shipments where products do not move at all; again, it requires collusion.
- Multiple invoicing for the same goods: Documentation of the same shipment is reused – often across different financial or trade institutions, thereby making detection difficult.
- Falsely describing goods: For example, shipping a low-quality item as an expensive one in order to justify the transfer of value.[169]

Goods that are especially vulnerable to TBML include those that have wide pricing margins or extended trading cycles and which are difficult for customs authorities to examine.[170] FATF highlight the following key trade categories as particularly vulnerable to TBML:

- gold and precious metals;
- auto parts and vehicles;
- agricultural products and foodstuffs;
- clothing and textiles; and
- portable electronics.

The mechanisms of achieving an illicit transfer of value are therefore varied, and this complexity, combined with the difficulties of surveillance of trade systems, makes discovering and assessing TBML difficult. One legal adviser has described tracking TBML as 'like trying to find a yellow needle in a haystack'.[171]

Legal advisers have also commented that TBML is more likely to thrive as other methods, such as cash, become harder to deploy. Attempts to raise awareness of TBML amongst private and public sector stakeholders is part of FATF's mission, but most regulatory attention is focused on the banking rather than the trade sector.

This trade-related mechanism of IFF transmittal should not be confused with the Global Financial Integrity's (GFI) 'trade mis-invoicing' methodology.[172] GFI's claim is that most of the mismatches between macro trade flows are explained by trade mis-invoicing. Their statistical analysis relies largely on macro mismatches in international trade data, which do not automatically imply the crime of mis-invoicing.[173] A critique of these methods concludes:

> Trade mis-invoicing certainly is a real phenomenon. Businesspeople in China have used overpayments for imports as a means to get around the country's currency controls, and build up a nest egg of savings outside China. Companies in South Africa smuggle in shipments of clothing from China, evading import duties. But it is not clear that the influential and widely quoted [GFI] figures – based on adding up gaps and mismatches in trade data – can be directly interpreted as trade mis-invoicing.[174]

All three countries under consideration rely heavily on imported goods, making all vulnerable to TBML.

	2018		
	GDP (US$ billion)	Imports (US$ billion)	Exports (US$ billion)
Bosnia and Herzegovina	20	10.2	6.2
Montenegro	5	1.95	0.25
Serbia	50	23.5	17.0

FIGURE 24 GDP, imports and exports, Bosnia and Herzegovina, Montenegro and Serbia, 2018.

SOURCE: Tax Justice Network/World Bank, https://iff.taxjustice.net/#/profiles

Both Serbia, and Bosnia and Herzegovina have several free trade zones (FTZs), although Serbia has by far the largest number. FTZs offer significant benefits to businesses by temporarily suspending tariffs and taxes on imports to and exports from each special zone.[175] There are currently 15 active free zones in Serbia which, in 2019, had a turnover of about €5 billion. Over 200 multinational companies with more than 37 000 employees operate in Serbian FTZs, while the volume of investments in the zones in 2019 amounted to €3 billion. Exports of goods from FTZs are increasing from year to year and account for over 13% of Serbia's total exports. But the OECD has noted that many FTZs have a reduced customs presence which can offer opportunities for illicit trade and IFFs.[176]

Unsurprisingly, our interviews picked up largely anecdotal cases of TBML, rather than estimates of value. In Serbia, interviewees cited cases of significant under-invoicing of goods – in one case, in a trade with Turkey, goods worth €8.5 were invoiced at €0.42.[177] Serbian goods exploited in this way include agricultural produce such as tomatoes and lemons. In Bosnia and Herzegovina, examples cited were of cars from China and Turkey that are under-invoiced, although official trade records show only a handful of exports. Under-reporting also exists, with one interviewee citing 'Croatia recording tens of thousands more transactions with the Republic of Srpska than it declared'.[178]

Over the last years an increase in the number of applications to transfer cash into and out of Montenegro can be observed.

In Montenegro, an interview with the head of a trading company revealed that trade mis-invoicing is widespread. Most irregularities happen in the national territories, as inspectors are not sufficiently trained to conduct efficient controls:

'Trade mis-invoicing is widespread and most of it happens where companies are based, for example, in the Podgorica area. Generally, the goal is quite obvious: increasing profits and extracting cash from transactions.' The Port of Bar, one of the biggest regional ports located in Montenegro is a free trade zone with a significant reputation for illegal trade. 'At least 20% of transactions are in some way incorrect – different invoicing concerning the actual situation, sale of other goods or different quantities of goods compared to invoiced, acceptance of cash payments and similar'.[179]

Cash

Cash smuggling is another important IFF channel in all three countries, as hard currency moves across borders. Indeed, banknotes and coins (in different currencies and denominations) are often driven across borders. In addition, we also look at the role that fast-money transfer companies play as they allow users to deposit and withdraw cash across the world within just a number of minutes.

In the Western Balkans, the cash channel is facilitated by the large informal sectors of the local economies. According to the International Labour Organization, more than 18.7% of all workers in Serbia[180] and 30% in Bosnia and Herzegovina[181] are informally employed and therefore receive their salaries in cash. An interviewee confirmed this common practice also for Montenegro, noting that 'tens of thousands of employees receive at least a significant part of their salaries in cash'.[182] Cash therefore plays an important role in daily transactions – both licit and illicit.

A large amount of cash, which includes coins and banknotes, is transferred by driving it across the border. Indeed, a police officer from Montenegro explained that they find undeclared currencies on a daily basis. He also described that cash mostly follows the same routes as drugs or migrants (and is facilitated by the same corrupt border guards) – just in the opposite direction.[183] It is usually hidden in special compartments of cars, in tour buses or trucks or hidden among other goods. Cash is also intercepted at seaports and airports, although they are less used to smuggle cash, due to tighter controls.[184] Over the last years an increase in the number of applications to transfer cash into and out of Montenegro can be observed. In 2019, currencies worth €286 000 were confiscated at the Montenegrin borders (both exiting and entering the country).[185]

The most smuggled foreign currency in the Western Balkans is the euro,[186] although US dollars, Swiss francs and British pounds are regularly intercepted. Interestingly, representatives of Montenegrin authorities report that the most smuggled denominations are €500 (to reduce the volume), while in Bosnia and Herzegovina mostly smaller denominations are found.[187] To transport larger amounts, several consecutive trips are made, either by the same person or a group of people. The Serbian national risk assessment also highlights the risks of cross-border cash movements.[188]

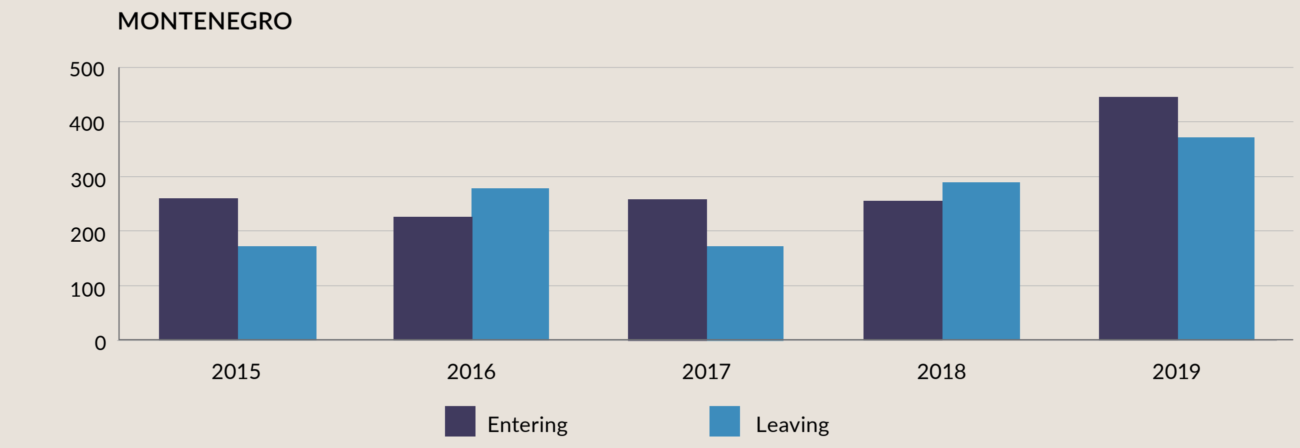

FIGURE 25 Number of applications for the transfer of cash at the Montenegrin border.

NOTE: According to information received from th Bosnian Indirect Taxation Authority, 152 cash transfer breaches were recorded in 2020; 72 breaches were recorded in the first six months of 2021.

SOURCE: Montenegrin Financial Intelligence Unit

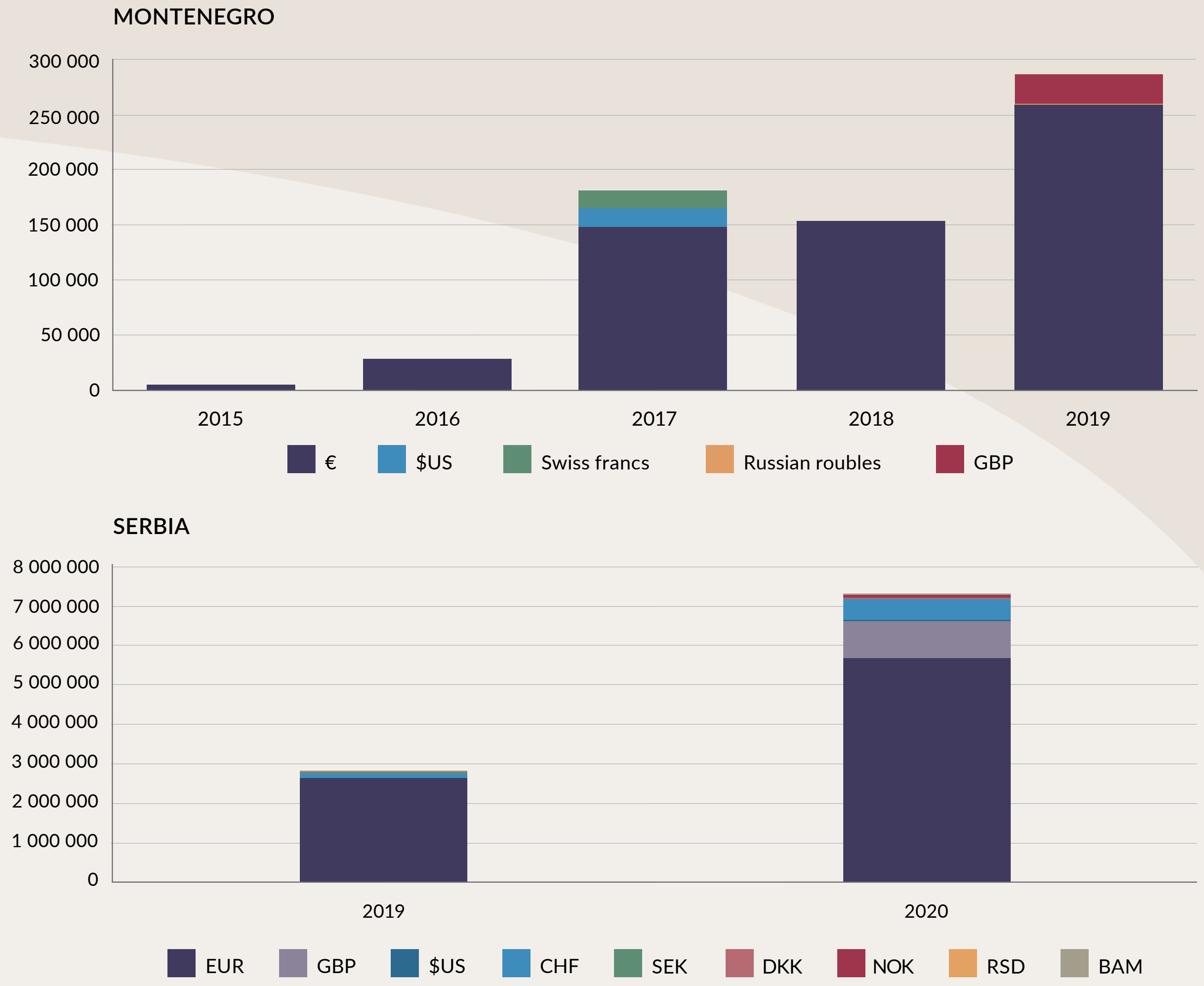

FIGURE 26 Currencies seized at the Montenegrin borders (2015–2019) and Serbian borders (2019–2020) (entering and exiting). All currencies are displayed with the respective euro value.

SOURCE: Montenegrin Financial Intelligence Unit and the Serbian Ministry of Finance, 2021.

Cash is not only carried across borders, but also sent by mail or entered into the financial system.

Cash entering the three countries is often connected to travels of the diaspora, especially during the summer. Border police reported higher amounts of cash entering or transiting the countries in the summer.[189] There is no information on seasonal distribution of cash leaving the country, although it is often linked to illicit proceeds from corruption. As an economic analyst explained, 'Politicians withdraw large amounts of cash to "pay for services"'.[190]

All three countries have a threshold of cash declaration of €10 000 at the border: Controls on cash are, however, sporadic at best. Lack of personnel, knowledge, equipment and cooperation with other police agencies make it difficult to intercept cash. In Bosnia and Herzegovina, police officers have also explained that they mostly focus on intercepting migrants – with little time left to focus on something else. Another reason might be the division of responsibility between border police and customs – as border police usually check luggage and passengers, while detecting illicit cash is the responsibility of customs.[191] Despite comprehensive legal frameworks, competent authorities are often not clear about their powers which leads to inconsistencies in enforcement.[192] Even in cases where undeclared cash is found, there are few consequences. 'People often get away with administrative fines and only in selected cases the cash is preliminarily seized'.[193] In addition, there is usually no investigation into the origin of the money that is intercepted. 'You simply claim that the money comes from the sale of an apartment – that's enough.'[194]

Cash is not only carried across the borders, but also sent by mail or is entered into the financial system by being taken to banks and put on credit cards.[195] For example, migrant smugglers in the region often pocket the hundreds (or at most a few thousand) euros they earn for personal use, put the funds they obtain into bank accounts and credit cards to later pay off loan instalments, purchase vehicles and real estate.[196] Cash can also first be converted into jewellery, watches and art and then converted back into cash upon arrival. Another common form of cash transfer is via hawala brokers or fast money-transfer companies. In the Western Balkans, hawala systems are often used to pay for migrant smuggling services as they allow the payment only to be released after successful arrival.[197] While cash might lose its primacy due to use of the financial system and cryptocurrencies, it will remain a key channel to move money.

Looking at business transactions, it was estimated that approximately 17% are paid in cash in Serbia, given that almost every third company is active in the informal economy.[198] 'In Montenegro, we see cash payment particularly common in the service sector, that means in transportation or catering'.[199] A taxi driver explained: 'I do not register all my rides and ask the customers to pay in cash. I then report the registered amount to my boss, who reports a fraction to the tax authorities.'[200] Interviewees also described how illiquidity of a large number of business entities in Bosnia and Herzegovina made them vulnerable to cash injections (e.g., through loans or fictitious business relationships) of 'ambiguous' origin – a phenomenon which is assumed to have increased during the economic hardships of COVID-19, when criminal actors were the only ones left lending money at extremely high interest rates.[201] It is therefore no surprise that across the region, a large number of daily transactions (licit and illicit) take place in cash. This makes it easy for illicit actors to move, extract and absorb high criminal proceeds – further fuelling the informal and illicit economy.

Fast money-transfer companies

Fast money-transfer companies are commonly used in the Western Balkans, both to receive and send money. There are several service providers available across the region, including Western Union, MoneyGram, post-cash services, microcredit institutions and conventional banks, which have opened a significant number of subsidiaries – not only in cities, but also in smaller towns. Single transactions usually range from several hundred to a few thousand euros per transfer.

Country	% of transactions paid out	% of transactions sent
Bosnia and Herzegovina	12%	4%
Montenegro	7%	2%
Serbia	65%	12%

FIGURE 27 Transactions of a fast money-transfer company: during one week in March 2021.

SOURCE: Online interview with a fast money-transfer company representative based in Austria in March 2021.

Fast money-transfer companies offer a number of legitimate and attractive services. Yet it is no secret that they have also been (mis)used to transfer illicit proceeds. For example, a leading money-transfer company operating across the region officially estimates that approximately 1% of all transactions globally are illicit, but an interviewee working at that company explained that the percentage for the Western Balkans is probably much higher. Fast money-transfer companies sometimes do not have their own operator's licence in the countries of the Western Balkans, but operate through other parties, which restricts their internal information on what is going on locally.

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REMEDIATION

Bosnia and Herzegovina, Montenegro and Serbia have all invested increasing resources in anti-corruption, financial governance and public sector transparency. All three countries have legislated against money laundering and have improved their reporting and monitoring processes. However, tax compliance is still low compared to EU norms, fuelled by the continued strength of informal economies in all three, as well as cash payments to employees. Public procurement transparency has also been improved in Bosnia and Herzegovina and Montenegro, although Serbian efforts to report public procurement do not appear to have improved the competitiveness of the bidding process. International cooperation in combating the components of IFFs is gaining significance.

Over the past decade, Bosnia and Herzegovina, Montenegro and Serbia have progressively invested resources and directed efforts towards the fight against organized crime, enhancing transparency in the public sector and democratization, and the establishment of fair fiscal systems. Indeed, the Western Balkans have always looked at Western European democracies and governance as role models.[202] However, their recent history makes the alignment with such standards challenging.[203] The continued presence of organized criminal networks, the financial sector's vast exposure to money laundering and corruption, as well as pervasive cash-based economies negatively affect the socio-economic development of Western Balkan countries.[204]

As mentioned earlier, organized crime in the Western Balkans is a significant business, generating hundreds of millions of euros in illicit proceeds annually.[205] However, investigating and detecting these crimes are arduous tasks, not least because of the sophistication of criminal networks and the transnational nature of trade patterns. To be successful, agencies tasked with combating crime require a high degree of collaboration within countries, regionally and internationally.

Western Balkan countries tend to lack resources for monitoring and quantifying the effects of IFFs.

Existing quantitative indicators reported annually by the ministries of interior of Bosnia and Herzegovina, Montenegro and Serbia are largely restricted to seizure records – which are imperfect performance indicators – or the number of migrants registered, detained and deported, without an examination of the modus operandi of smuggling networks or the degree to which the system is facilitated by border officials turning a blind eye.[206]

Western Balkan countries tend to lack resources for monitoring and quantifying the effect of illicit activity.[207] This might include the adoption of non-traditional indicators able to assess organized crime and measure (or even reward) collaboration between various agencies to investigate and estimate the amount of illicit proceeds that are injected into the informal economy every year.[208]

Informal economy

The informal economy still prospers in the region, not least because tens of thousands of employees still receive at least a significant part of their salaries in cash.[209] Tax revenues range from 20% of the GDP in Bosnia and Herzegovina to around 24% in Serbia and are slightly above the euro area average (19.9%).[210] However, the cash economy is rather pervasive in the three countries. A general mistrust in the management of public funds is, in fact, accompanied by slow official responses to emerging business sectors. Montenegrin law, for instance, does not recognize the terms 'freelancer' or 'self-employed': 'even though I've been working as a photographer for more than a decade, officially I'm jobless', a freelancer recently reported to the Balkan Investigative Reporting Network.[211]

National authorities seem to be slowly acknowledging the loss of value from underpayment of taxes and are currently taking positive steps towards the establishment of effective control mechanisms. In Montenegro, for instance, the government is currently in the process of redefining the institutional framework for tax policy, including merging different institutions and creating a new tax administration.[212] This has already allowed for the recovery of around €30 million in recent years.[213]

Financial system

The following section briefly illustrates the shortcomings and related operational and legislative remedies for the detection of IFFs in the financial systems of Bosnia and Herzegovina, Montenegro and Serbia. In particular, it provides for an overview of weaknesses and strengths in the national fights against money laundering, corruption in public procurement and beneficial ownership.

Money laundering

According to macro estimates, illicit proceeds worth 2–5% of GDP are estimated to be laundered into the local economies annually – equivalents of €402 million–1 billion in Bosnia and Herzegovina, €110–275 million in Montenegro and €1 billion–2.5 billion in Serbia. While these numbers continue to suggest widespread exposure to money laundering across the region, significant efforts have been made to curb this trend.

Figure 28 lists AML and counter-terrorist financing (AML/CTF) laws in Bosnia and Herzegovina, Montenegro and Serbia and shows how the three countries have made substantial progress, not only in strengthening their AML regimes, but also, such as in the case of Bosnia and Herzegovina, in harmonizing laws across legal systems in compliance with FATF recommendations.[214] In addition, Bosnia and Herzegovina and Serbia were removed from the list of high-risk countries with strategic AML shortcomings in July 2019 and July 2020, respectively.[215] However, the FATF noted that financial institutions still needed assistance in their determination of which countries apply internationally-recognized standards in terms of AML/CTF activities.[216] Newly adopted laws are also the result of the momentum generated by follow-ups on the Council of Europe's MONEYVAL mutual evaluation reports. In Montenegro, based on the MONEYVAL committee's recommendations on Article 268 of the criminal code, the provisions were adapted in 2019 in line with the Vienna and Palermo conventions.[217] In Serbia, the AML law was updated in 2017/2018 and, according to the mutual evaluation report, the country understands some of its money laundering and financing terrorism risks and has demonstrated progress in its understanding of threats and vulnerabilities.[218]

NATIONAL LAWS ON ANTI-MONEY LAUNDERING AND COUNTER-TERRORIST FINACING	
Bosnia and Herzegovina	• Law on Preventing Money Laundering and Financing of Terrorist Activities (Official Gazette, no. 47/14– AML) • Amendments to the Law on Prevention of Money Laundering and Financing of terrorist activities (Official Gazette, no. 46/16) • Law on Foreign Exchange Operations (Official Gazette, no. 47/10)
Montenegro	• Prevention of Money Laundering and Terrorism Financing Act (Official Gazette, no. 33/2014, 44/2018, and 73/2019) (the 'AML Act') • Articles 28 and 29 of the Prevention of Money Laundering and Terrorism Financing Act (Official Gazette, no. 14/2007, 4/2008 and 14/2012)
Serbia	• The Anti-Money Laundering and Financing of Terrorism Act, adopted in 2017 and amended in 2018 and 2019 (the 'AML Act') and supporting bylaws • Limitation of Disposal of Property to prevent Terrorism and trade in Weapons of Mass Destruction Act adopted in 2015 and amended in 2017 and 2018 (the 'Limitations Act') and supporting bylaws • The Central Registry of Ultimate Beneficial Owners Act adopted in 2018 and amended ('UBO Act') and supporting bylaws

FIGURE 28 Overview of national laws on AML/CTF in Bosnia and Herzegovina, Montenegro and Serbia.

SOURCE: Anti-Money Laundering Forum, Bosnia and Herzegovina, https://www.anti-moneylaundering.org/europe/Bosnia_and_Herzegovina.aspx; CMS, AML and CTF law and regulation in Montenegro, https://cms.law/en/int/expert-guides/cms-expert-guide-to-aml-and-ctf-in-central-eastern-europe/montenegro; CMS, AML and CTF law and regulation in Serbia, https://cms.law/en/int/expert-guides/cms-expert-guide-to-aml-and-ctf-in-central-eastern-europe/serbia

Efficient AML regulations also require reliable reporting mechanisms. All three countries have procedures in place to report suspicious transactions. National general directorates for the prevention of money laundering are continuously improving their performance in detecting and publishing suspicious transaction reports. Since the introduction of amendments to the AML law in 2016, Bosnian law enforcement authorities have been progressively focusing on active cooperation with financial institutions, such as banks, which immediately report all suspicious activities and transactions.[219] Furthermore, the list of entities required to report is not limited to financial actors: a total of 1 213 suspicious transactions were reported by car dealership owners in 2019 alone.[220]

Western Balkan countries tend to lack resources for monitoring and quantifying the effect of illicit activity.

In Montenegro, the Police Directorate for the Prevention of Money Laundering and Terrorist Financing and the central bank are the authorities responsible for monitoring and controlling the suspiciousness of payments and transactions. According to the most recent data, increased collaboration between agencies led banks to report 149 suspicious transactions by banks in 2020.[221] However, according to a bank employee, mechanisms in place are not efficient enough and need to be strengthened through the introduction of new digital tools able to trace transactions made, for example, through cryptocurrency trade.[222]

In Serbia, when the Directorate for the Prevention of Money Laundering identifies suspicious transactions, it asks banks for information on the account balance, persons authorized to access the account and account turnover.[223] Banks then submit this information to the Directorate and communication takes place directly and electronically through a secure communication channel. Banks, notaries, lawyers, accountants, auditors and brokers are required to report suspicious transactions to the Directorate, which further collects information at its discretion.[224] Serbian banks and payment institutions reported a total of 2 277 suspicious transactions in 2020.[225]

The efforts of the Western Balkans to improve their suspicious activity reports need to be highlighted – although with caution. The number of suspicious activity reports gives a quantitative indication of reports and does not speak to the quality of the reports or the effectiveness of the system.[226] The introduction of thresholds and an increased availability of metadata on the suspicious transaction reports complement financial regulations in place, especially in vulnerable sectors such as cryptocurrency and real estate.[227]

Beneficial ownership

Ensuring transparency in beneficial ownership registries is a key policy tool in the Western Balkans. Guaranteeing access to such information, in fact, lets governments promote corporate accountability and limit the presence of anonymous companies. For this reason, it has also been part of the anti-corruption commitments pledged as part of the Berlin Process. Yet, the three countries did not sign up to further shape their legislation or adopt specific action plans as part of the anti-corruption pledges.[228] Nevertheless, progress has been made.

In 2019 and 2020 about 50% of all public procurements in Serbia were conducted with only one bid.

Specifically, in 2018 Serbia adopted the Act on Central Records of Ultimate Beneficial Owners and established a public database following up on a recommendation of the MONEYVAL committee.[229] In the same year, Montenegro took progressive steps with the adoption of a new AML law which also included specific regulations regarding the records of ultimate beneficial owners.[230] Bosnia and Herzegovina does not yet have a central registry for beneficial owners and its legislative tool titled 'Act on Prevention of Money Laundering and Financing Terrorist Activities' is still in the drafting phase.[231]

At the regional level, the topic has gained a certain degree of momentum in the last two to three years, not least because of an event organized by the Open Government Partnership in collaboration with the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) and the Organization for Security and Co-operation in Europe (OSCE) in June 2021, which encouraged governments to share their work on beneficial ownership transparency and expressed a desire to convene a broader group of stakeholders for further peer exchanges.

Corruption

Corruption and a general lack of transparency in public procurement continue to be significant in the three countries, as indicated by an analysis of the 2020 European Commission communication on regional matters, where the word 'corruption' appears 88 times.[232]

Reports show that Serbia continues to have weak investigative capabilities and often fails to avoid undue influence in bidding processes. A new Law on Public Procurement entered into force in July 2020 brought further alignment with EU legislation, backed by a significant consultation process with agencies (more than 30 workshops with 1 200 participants).[233] However, in 2019 and 2020 about 50% of all public procurements in the country were conducted with only one bid.[234] Investigative journalists also discovered, for example, that each metre of the Turkish Stream channel on Serbian territory costs Serbian citizens around €2 000.[235] 'Construction supervisory bodies are directly appointed by the government and work according to political instructions only'.[236]

Similarly, in Montenegro, since 2017 most information on procurement is available online thanks to a new law on public procurement which defines procedures for inspection control in cases of suspicious bidding processes.[237] The media continue to be active in uncovering malpractices, but are frustrated that suspicious activities are hardly investigated by law enforcement authorities and that crimes are not prosecuted.[238]

In Bosnia and Herzegovina, the adoption process of a new law on public procurement has been delayed, although measures have been taken to enhance transparency in bidding processes, such as the adoption of e-procurement systems and the establishment of a proactive cooperation with civil society and the judiciary.[239] Further positive steps have been taken in Bosnia and Herzegovina at the local level: an office mandated to monitor anti-corruption efforts and quality management has been active in Sarajevo for years, paving the way for efforts in other areas, such as in Tuzla canton.[240]

The transition of the three countries' economies remains a work in progress, as they still need to introduce legal and operational instruments able to make tangible progress. Economic development priorities cannot, however, avoid consideration and adoption of regulations on IFFs. Deploying resources to those sectors of the economy that are exposed to IFFs is a first step to addressing the many facets of the phenomenon. A holistic approach requires the involvement of financial actors, AML agencies and prosecutors' offices. Serbia, for instance, actively engages in MONEYVAL consultations and reviews. Serbia's Administration for the Prevention of Money Laundering is a member of the Egmont Group of financial intelligence units and has observer status in the work of the Eurasian Group on Combating Money Laundering and Terrorist Financing.[241]

International cooperation

In addition, the international donor community is putting increasing emphasis on combating IFFs in the Western Balkans. Since 2019, the GIZ has been active through its programme on combating IFFs in the Western Balkans. It has already produced progress by strengthening cooperation between law enforcement agencies, purchasing specially trained cash-sniffing dogs and introducing beneficial ownership registers.[242] This report is a one element in the GIZ initiative.

Bosnia and Herzegovina, Montenegro and Serbia are also involved in an EU-funded initiative on Supporting a More Effective Administration of Justice in Corruption and Organised Crime Cases in the Western Balkans, which launched in January 2021. It builds on OSCE trial-monitoring expertise and experience in conducting trial monitoring of serious corruption and organized crime cases in south-eastern Europe.[243]

The OSCE has also recently launched a programme for 2019–2022 aimed at supporting the entire cycle of asset tracking in south-eastern Europe, focusing on three areas of intervention: investigation, asset seizure and asset confiscation; asset management; and asset reuse.[244] The UNODC is also active in the region, with a number of programmes for south-eastern Europe. Since 2018, it has been assisting regional jurisdictions in raising their financial investigation capacities by implementing a train-the-trainer programme on financial investigations.[245] During the tenth meeting of the programme's steering committee in Vienna, the UNODC also launched a 'Regional Programme for South Eastern Europe (2020–2023)'. This programme was developed with the governments of the region and has 'strengthening the fight against organized crime and countering illicit financial flows' among its top objectives.[246] Bosnia and Herzegovina, Montenegro and Serbia have, in addition, recently been involved in a biennial project aimed at enhancing the ability of the six Western Balkan jurisdictions to detect, deter and prosecute money laundering and financing of terrorism, among other goals.[247]

Interviews and consultations with experts on the state of the art of IFF remediation mechanisms have helped to better understand national strengths and weaknesses. Further, such assessment becomes a necessary introduction to the following section which provides a set of specific recommendations for stakeholders involved in preventing, detecting and investigating IFFs.

A man purchases Bitcoins from a cryptocurrency machine, Belgrade.
© BalkansCat/Shutterstock

CONCLUSION

IFFs are the mechanisms by which money earned illegally is transferred into and out of economies to criminal beneficiaries worldwide. This report's focus on Bosnia and Herzegovina, Montenegro and Serbia revealed significant flows resulting from corruption, illegal markets and tax evasion in each country. Our analysis and interviews focused on evidence of both the predicate crimes and the channels of IFFs.

Bosnia and Herzegovina, Montenegro and Serbia have very different economies, yet all remain lower cost and lower wage economies, with unemployment levels in Bosnia and Herzegovina and Montenegro at more than 16%. The informal sector represents more than 25% of each of the three countries' economies, a fact that facilitates many of the IFF components discussed in this report. Exacerbating these problems, all three have failed to make material progress against corruption.

We focused on three key case studies of corruption, which had been highlighted by the thematic analysis of our interviews, including political favouritism in the allocation of public money for NGOs in Bosnia and Herzegovina, defence industry corruption in Montenegro and undue influence in the construction and infrastructure sector in Serbia.

We found that tax evasion is a significant issue in all three countries. Serbia has lost on average €100 million per year, while Montenegro, an economy one-tenth the size of Serbia's, loses up to €60 million. In Bosnia and Herzegovina, employees receive up to half their wages in cash. While not all these flows are IFFs, they undoubtedly leak value from the countries' economies.

On the topic of illegal markets, we focused on drugs, migrant smuggling and illicit trade. Drug trafficking IFFs result from the major Balkan route flows of heroin, cannabis, cocaine and synthetics. It is lucrative, as demonstrated by the fact that heroin doubles in value from the Western Balkans to the EU. Migrant smuggling also produces significant IFFs for the smugglers taking millions of euros for passage across the borders of Serbia and Bosnia and Herzegovina. Illicit trade in conventional goods, such as tobacco and clothes, is another major driver of IFFs. Estimates point out that more than 20% of the tobacco markets in Bosnia and Herzegovina and Montenegro are illicit, while the countries also act as transit countries for the higher profit EU destinations of illicit goods.

The financial system remains the key channel through which illicit proceeds are moved. All three countries have significant domestic and international banking sectors and all have problems with money laundering, including reports of significant money laundering through property transactions. In addition, microcredit organizations and cryptocurrencies are targeted by launderers. The most recent evaluations of money laundering governance identified a need to significantly tighten the AML processes in Bosnia and Herzegovina and Serbia.

We found cash smuggling to be another major IFF channel in all three countries, as hard currency is moved across borders. Indeed, banknotes and coins (in different currencies and denominations) are often driven across borders in the region.

We also found evidence of trade-based money laundering. This tendency to under- or over-invoice, or to create phantom shipments altogether, is poorly evidenced. However, our interviews did find evidence of mis-invoicing in Bosnian, Montenegrin and Serbian trade transactions, particularly centred around FTZs like the Port of Bar.

Regarding the countries' efforts to combat IFFs, they have all invested increasing resources in anti-corruption, financial governance and public sector transparency. They have also legislated against money laundering and improved their reporting and monitoring processes. But tax compliance remains low compared to EU norms, fuelled by the continued strength of the countries' informal economies, as well as cash payments to employees. Bosnia and Herzegovina and Montenegro have improved public procurement transparency; Serbian efforts to report public procurement, however, do not appear to have improved the competitiveness of the bidding process. International cooperation in combating IFF components is gaining significance.

Recommendations

The following recommendations specifically address the Western Balkans' vulnerability to IFFs and have been drafted under the assumption that targeted recommendations on specific IFF components or channels have already been shared widely in previous reports. These recommendations are designed to allow for an integrated and coordinated regional approach, while at the same time taking into account the specific needs of Bosnia and Herzegovina, Montenegro and Serbia to address IFFs. The recommendations are grouped into five focus areas.

Improve collection and sharing of data on IFFs

As noted throughout the report, there is little data available on IFFs across the Western Balkans and government information on the topic is inherently difficult to access. Freedom of information requests sent to governments for the purpose of this report were sometimes not answered at all or only after filing a complaint.

There is a significant need to increase the quantity and quality of data available on all components and channels of IFFs, but particularly on money laundering and trade channels. It is key to ensure that publications on the topic (e.g., national risk assessments or AML strategies) are regularly and transparently gathered and made accessible to the general public. These publications should clearly explain and describe the main sources, destinations and channels of national and regional IFFs, as well as their impact on society. Sufficient resources and personnel need to be made available to analyze and prepare the data and guarantee a smooth process of access to information. In addition, objective and independent media reporting on new trends should be encouraged.

Identify and raise awareness on IFFs

Also due to a lack of definitional clarity on IFFs, the phenomenon is a relatively new concept in the Western Balkans, which is not widely understood nor used. Discussions often focus on single components or channels, but rarely look at the broader damage IFFs have on societal development as funds are drained out of the economy.

There is a clear need for fresh dialogue opportunities between state officials, the private sector, civil society and the general public on the topic. Information sharing should be encouraged among all relevant stakeholders. The role of civil society is key, as it should be actively engaged in assessing risks and presenting people's experiences on IFFs as well as their impact on society, democracy and development.

Identify national priorities

Addressing IFFs as a whole may be too vague and overly ambitious in the short run. However, there is a clear need for specific operational priorities in each country that could serve as a starting point.

Bosnia and Herzegovina

Key challenges to address IFFs arise given the divided political system of the country. Therefore, on the way forward, a key priority will need to be to ensure the exchange of information between institutions of all entities in Bosnia and Herzegovina and allow for the creation of registries (of businesses, properties and bank accounts, among others) at a central level.

In addition, there is a clear need for increased governance and surveillance of national and regional funding priorities, including making available more resources to monitor possible politically motivated payments to CSOs.

Montenegro

To adequately address and prevent IFFs, an update of the national money laundering and terrorist financing risk assessment will be key, also to allow the finalization of an up-to-date and risk-based strategic framework on preventing and fighting money laundering. A particular focus should be the construction sector. Throughout the process, active participation of civil society needs to be encouraged.

In addition, it is important for the government to increase its fight against illicit trade, including through its FTZ, to combat significant illegal movement of tobacco and other products.

Serbia

Serbia launched a strategy against money laundering and terrorism financing in 2020, valid until 2024. In the future, it will be important for the government to fulfil its reporting requirements on the strategy and continue working towards its implementation, particularly to minimize the risk of IFFs in the construction industry. Additional emphasis should be put on reducing tax evasion and corruption in the infrastructure sector.

Select regional priorities and work on a coordinated, integrated and holistic regional approach to address IFFs

Given that the countries of the Western Balkans share common vulnerabilities to IFFs, important synergies can be found in a coordinated and integrated approach to dealing with IFFs. Frameworks require international and regional harmonization, particularly within the EU enlargement process and the Berlin Process. Common regional priorities would also allow for the exchange of information and experience, as well as the opportunity to learn from regional best practices. The following recommendations should be applied not only in Bosnia and Herzegovina, Montenegro and Serbia, but also the other three Western Balkan countries. They could initially focus on the following elements:

Make tax evasion a regional priority and close discrepancies in tax policies and enforcement capacities within the region that create the space for perpetrators or criminal actors to manoeuvre and exploit loopholes. Work towards regional harmonization of legislation (e.g., AML laws), taxation and fiscal strategies, and ensure their compliance with international and FATF standards.

All six countries should build on recent legislative progress, to increase their visibility of beneficial ownership of assets. Following Serbia's example, the other Western Balkan countries should establish public databases of beneficial owners and use the information to promote transparency and investigate wrongdoing.

Exposing corruption and illicit activity requires an active civil society and media. But the government's capacity to combat corruption also needs to be strengthened. It will be key for the countries to remain engaged in reforms leading to creation of an independent and autonomous judicial system. They should also encourage greater transparency within the financial sector and public administration, especially of senior public officials, and continue improving horizontal coordination and technical knowledge of public authorities dealing with financial investigations. Emphasis should be put on adopting a risk-based approach when implementing AML measures, to ensure that unintended consequences are minimized to the extent possible.

Exposing corruption and illicit activity requires an active civil society and media.

Responses to IFFs also need to reverse the widespread sentiment that criminals 'will always get away with it' and/or a feeling of helplessness that 'nothing will ever change'. One way to address this sense of impunity could be an increased focus on and improved capacity for asset recovery, which would also encourage the social reuse of assets through transparent assignment processes. Lessons on how to ensure the integrity and accountability of the recipients of reused seized assets can be learned from dynamics already in place in various EU countries. Close collaboration between local courts, governmental offices and CSOs is essential to send a clear sign that there are consequences to criminal behaviour, and at the same time to show that 'giving back to society' is also in the public interest and agenda.

Align donor support

Increased focus on addressing IFFs in the Western Balkans has raised the profile of this issue. In the future, international donors need to further align their engagement in the region and avoid duplication of efforts in order to maintain momentum. They are a key force to drive forward international standards of compliance, provide mutual assistance and share best practices.

ANNEX

Macroeconomic measurement of IFFs: A short but chequered history

The brief history of measuring IFFs using macroeconomics is a somewhat painful one. One goal has been to use macroeconomic data to estimate the significance of IFFs as a proportion of total economic activity, or total trade activity. This is easier said than done.

A leading example is the trade-based IFF measurement which was championed by Global Financial Integrity (GFI). As noted in our previous report, the GFI methodology has been critiqued for its leaps of logic.[248]

GFI's methodology is an attempt to use widely published macroeconomic data (the UN Comtrade database of official trade imports and exports) to assess illicit flows. A key element of this methodology is trade discrepancies. GFI takes the total exports for a specific product from a certain country and compares them with the total inflows (for that product and country) to the customer countries. The aggregate of the latter should equal the former, but often does not. These discrepancies are labelled IFFs by GFI and this is where the problems begin.

The assumption of illicit activity ignores the fact that trade statistics often have significant reporting errors. Products and commodities are often categorized differently on import than on export and their value is often recorded with different transport or overhead costs. These statistical and recording discrepancies are all attributed, in GFI's analysis, to illicit or illegal activities.[249] GFI then prorates each difference as 3% corruption, 60–65% commerce or trade mis-invoicing and 31–34% crime, with little – or at best out of date – evidential backing.

This trade mis-invoicing analysis is both wrongly derived (a discrepancy does not equate automatically to a crime) and wrongly apportioned (the fixed percentages are not reflected in real-world examples of splits between crime, corruption and illicit trade). In some high-profile examples, the GFI statistics have been debunked. GFI's South African gold IFF was found to be 75% explicable as recording errors made by an economic consultancy,[250] while cocoa flows out of Côte d'Ivoire were found to have been misreported as illicit, when they were actually passing through an intermediary in the Netherlands.[251]

Balance of payments methods, such as the World Bank's Residual Model, look at mismatches in national accounts and infer that any 'leftovers' represent IFFs. While these methods have a stronger reputation than the trade mis-invoicing work, they are still attributing illegality to a discrepancy, which can sometimes be a genuine statistical or reporting error.

Beyond these misinterpreted mismatches, trade and balance of payment methods also suffer from having no way to capture illicit flows that do not affect the official trade or balance of payment figures. Sadly, we know many transactions are conducted as far away from the legitimate trade system as possible – either through cash couriers, fake invoices or hawala systems.

Given all of the above, it is unsurprising that the most recent UNODC methodology tellingly comments that 'some quantitative studies equate IFFs with trade mis-invoicing only; while trade-based money laundering is not the only method to move money illicitly and the proposed statistical measures suffer from simplifying assumptions on data sources and methods.'[252]

An alternative macroeconomic approach is the econometric profiling of states vulnerability to IFFs. Econometric models such as MIMIC and the Gravity Model have been used to estimate money laundering and IFFs. In effect, these models take economic indicators and scale them according to a variety of socio-economic indicators. The models then apply an assumed proportion of illegality to trade volumes and other macro statistics. This style of econometric model has often been criticized as an art rather than a science, given its reliance on inferences from a variety of unrelated sources.

But in their defence, these macro models do seek to assess the totality of IFFs, not just those covered in trade or balance of payment data. In one case, the Tax Justice Network has pioneered the use of a model which calculates IFF vulnerability based on a range of governance and economic data.[253] The Network's model combines a measure of the secrecy of each country's cross-border investment and trade and the intensity of the channel – i.e., what proportion of GDP is accounted for by each type of transaction. The outputs are indicative only – they cannot give a fixed monetary estimate of IFFs – but have an analytical value in comparing jurisdictions with each other.

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ABOUT THE GLOBAL INITIATIVE

The Global Initiative Against Transnational Organized Crime is a global network with over 500 Network Experts around the world. The Global Initiative provides a platform to promote greater debate and innovative approaches as the building blocks to an inclusive global strategy against organized crime.

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