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Under the Radar: How Russia Outmanoeuvres Western Sanctions with Help from its Neighbours¹

Alexander Kupatadze² and Erica Marat³

Summary

This briefing note summarises research that examines how Russia evades sanctions imposed by the West after its full-scale invasion of Ukraine in 2022, focusing on the import-export operations of Russia, Georgia, and Kazakhstan. The research finds that sanctions have not cut supplies to Russia but have instead empowered trade networks and intermediaries with neighbouring states. Georgia and Kazakhstan have indirectly benefited from the increased transiting trade; however, the impact on the shadow economy and traditional organised crime appears to have been minimal so far because sanctions-busting is not illegal in these countries. Instead, we observe a conspicuous surge in trade anomalies and import- and export-related red flags. In many instances, these irregularities can be attributed to strategies employed to circumvent sanctions. While the Western focus has been on restricting the re-exports of sanctioned goods to undermine Russia's military apparatus, third-party states, such as Georgia and Kazakhstan, play a significant role in enabling Russia to sustain its international trade activities, thus yielding substantial financial gains that could be used for the country's military expenditure.

1 For the full research paper see Kupatadze, A. and Marat, E. (2023). *Under the Radar: How Russia Outmanoeuvres Western Sanctions with Help from its Neighbours*. Research Paper No. 18. University of Birmingham.

2 Dr Alexander Kupatadze is Associate Professor at King's College London. Prior to joining King's College, Dr Kupatadze taught at the School of International Relations, St Andrews University. His research specialisation is organised crime, corruption, public sector reform, informal politics and the crime-terror nexus. His work has appeared in the *Journal of Democracy*, *Theoretical Criminology*, *Nonproliferation Review*, *British Journal of Political Science*, among others. All correspondence to alexander.kupatadze@kcl.ac.uk.

3 Dr Erica Marat is a Professor at the College of Security Affairs of the National Defense University. Her research focuses on violence, mobilisation and security institutions in Eurasia, India and Mexico. Before joining NDU, Dr Marat was a visiting scholar at the Kennan Institute of the Woodrow Wilson Center. She is an author of *The Politics of Police Reform: Society against the State in Post-Soviet Countries* (OUP, 2018) and other books. Her articles have appeared in *Foreign Affairs*, *Foreign Policy*, *Washington Post*, *Just Security* and *Open Democracy*. All correspondence to erica.marat.civ@ndu.edu.

Background

In the aftermath of Russia's invasion of Ukraine in February 2022, Western sanctions have changed how neighbouring states trade with Russia. While Russia's economic ties with EU countries have declined, countries in Central Asia and the South Caucasus probably participate in sanctions evasion through both legal and informal routes. In addition, Russia continues to export oil and grain via the two regions, and Western brands continue to enter the Russian market, along with counterfeit goods.

This research examines how states adapted to new sanction regimes and explores the types of shadow economic activities that emerged as a result. The project analyses data for 2021-22 in Russia, Georgia and Kazakhstan including media reports on criminal activity and sanctions evasion written in Russian and languages native to those respective regions. It also examines import-export data through trade mirror analysis focusing on Western-sanctioned commodities to identify irregularities.

Findings show that trade between neighbouring countries and Russia increased in 2022, and these expose states' participation in shadow economic networks that help Russia evade sanctions. However, data suggests that countries in the two regions often conceal their real trade flows to avoid perceptions of supporting Russia.

In addition to leveraging both its membership of the Eurasian Economic Union (EEU) and the willingness of neighbouring countries to continue trade, Russia has softened the impact of Western sanctions through parallel imports of sanctioned brands. Decree No. 506, adopted a month after the invasion of Ukraine, allowed businesses to import original, non-counterfeit Western goods without manufacturer consent (Vasilenko, 2022; Yakubov, 2022). The list of goods permitted for parallel imports includes every Western brand that exited or reduced its presence on the Russian market,⁴

opening avenues for Western producers to sneak their products into Russia. Sanctioned brands thus became available on the Russian market soon after the legalisation of parallel imports, and Western-based companies continue to supply the Russian market with goods – from technologies to food products – via regional neighbours, including Georgia and Kazakhstan.

While Western focus has been on restricting the re-exports of sanctioned goods to undermine Russia's military apparatus, third-party states – such as Georgia and Kazakhstan – play a significant role in enabling Russia to sustain its international trade activities, yielding substantial financial gains for the country's military expenditure. Both Georgia and Kazakhstan, along with other countries in Central Asia and the South Caucasus, witnessed a sharp increase in trade rates with the EU (Kudrenok, 2023), with both countries reporting that their imports from the EU increased by 20% in 2022 (European Bank for Reconstruction and Development (EBRD), 2023). While Georgia and Kazakhstan have indirectly benefited from the increased transiting trade, the impact on the shadow economy and traditional organised crime appears so far to be minimal because sanctions-busting is not illegal in these countries.

Georgia and Kazakhstan have been selected as case studies⁵ in this analysis because both countries have strong economic and trade relations with Russia, but are also different in the depth of their political ties with Russia and the composition of their national political economy. Comparison between both countries highlights how different degrees of political closeness prior to Russia's full-scale invasion of Ukraine were poor predictors of either country's willingness to help Russia evade sanctions. Both countries have experienced a significant influx of migrants from Russia who engage in business activities that the research suggests are high risk for sanctions evasion. This phenomenon has created new networks for importing goods from the EU and other countries into Russia, confirming existing evidence that

4 The list of all permitted products and brands can be found here: https://consultant.ru/document/cons_doc_LAW_416496/343227a0f7231f293415124c9c5b7237496b9008/#dst100011

5 The time available for the research required restricting analysis to two countries; however, the data collected indicates similar impacts in several countries in the region. As such, research should not be interpreted as suggesting issues unique to Georgia and Kazakhstan.

businesses adapt to sanctions over time. Another group benefiting from this adaptation consists of occasional travellers who cross borders to go shopping. Finally, roughly 50 international companies relocated from Russia to Kazakhstan in 2022, while the number of companies that moved to Georgia remains unclear (RFE/RL, 2022).

This research seeks to contribute to growing literature on the connection between international sanctions and shadow economies, showing Russia softened the impact of international sanctions through its domestic legislature and willingness of neighbouring countries to maintain trade relations (Gaur et al., 2023; Early & Peksen, 2020; Blanton & Peksen, 2021; Petrescu, 2016; Li & Li, 2022). The research examines four main categories of trade, between Russia and neighbouring states, that operate in the realm of legal ambiguities: (1) re-exports of legal but sanctioned commodities (for example, luxury consumer goods), (2) re-exports of dual-use sanctioned commodities (such as semiconductors and cameras for civilian use that can be also used for military purposes), (3) financial services (financial transactions related to Russia, including the financing of trade with Russia), and (4) re-exports of Russian-produced goods to the rest of the world.⁶ The next section summarises key research findings before setting out some implications for consideration.

Key findings

Parallel imports

Parallel imports quickly created schemes involving new businesses and intermediaries in both Russia and neighbouring countries. Distributors of popular brands operating in Central Asia and the South Caucasus also took advantage of the legalisation of parallel imports and profited from higher prices on the Russian market. One of the most common schemes involved distributors of Western brands in neighbouring countries redirecting or increasing their supplies to Russia (Ivanova & Seddon, 2022). In a notable example, the Samsung corporation reopened its plant in Russia in June 2022 and claimed that its entire output would be shipped to Central Asia. This created an opportunity for the same goods to be re-exported back to Russia through shadowy schemes (Inozemtsev, 2022).

Contrary to our expectations at the beginning of the research, we have not found evidence of increased complicity with traditional organised crime. Instead, our research suggests that legitimate businesses are participating in shadow economic activities in two main ways:

- First, new types of networks of trade intermediaries who may or may not evade taxes and customs tariffs, consisting of formal businesses based in Georgia and Kazakhstan that trade in sanctioned goods with Russia and that represent a particularly high risk of sanctions evasion. Consequently, these intermediaries often have an affiliation with formal businesses or consist of informal groups with links to formal businesses. Some of these networks also facilitate the re-exportation of Russian commodities to the rest of the world.

⁶ The distinction between the first and second category is sometimes unclear. The re-export of certain consumer goods may appear harmless in principle, but specific spare parts can be used for military purposes even if these are not formally designated as dual-use technology. For example, Rostec (State Corporation for Assistance to Development, Production and Export of Advanced Technology Industrial Product Rostec), a Russian defence conglomerate based in Moscow, is known to have used spare parts from toys and vaping products to assemble Lancet loitering munitions. (See: *The Moscow Times*. (2023, January 26). *Rossiiskij byudzhet poterjal 40% tamozhennyh sborov ot vvoza jelektroniki*. (The Russian budget lost 40% of customs duties from the import of electronics). *The Moscow Times*. <https://www.moscowtimes.ru/2023/01/26/rossiiskii-byudzhet-poteryal-40-tamozhennyh-sborov-ot-vvoza-elektroniki-a31898>). In some cases, the chips have been extracted from other household appliances like fridges (see: Sheftalovich, Z. and Cerulus, L. (2022, September 5). *The chips are down: Putin scrambles for high-tech parts as his arsenal goes up in smoke*. *Politico*. <https://www.politico.eu/article/the-chips-are-down-russia-hunts-western-parts-to-run-its-war-machines/>). Nevertheless, we assess the risk of military utilisation to be higher for dual-use goods.

- Second, we have noted value discrepancies, unidentified countries of origin and destination, and other import- and export-related red flags that indicate illegality – including the evasion of customs tariffs and taxes – but that do not always link to the war and sanctions. In some cases, however, we find evidence that trade fluctuations and other irregularities arose after Russia’s full-scale invasion, and there is a high likelihood that these changes can be attributed to sanctions-evasion techniques. For example, the misreporting of countries of origin and destination increased dramatically after February 2022, and the only valid explanation for this change at this point is the sanctions.

Comparing impact

In the process of the analysis, we noticed significant differences in how Georgia and Kazakhstan reported their import-export data and in their formal and informal approaches to sanctions evasion. Georgia has been successfully policing re-exports to Russia after having returned several suspicious cargoes, not permitting them to transit from Türkiye and Armenia towards Russia. Kazakhstan has not demonstrated the same willingness. Georgia’s trade data is more transparent in documenting countries of origin and destination, even though some commodities like oil products and cars have been recorded as Georgia-to-Georgia trade. Kazakhstan’s rate of reporting ‘unknown’ countries of origin for imports is much higher than Georgia’s. Neither Georgia nor Kazakhstan have demonstrated enough commitment to monitor the re-exports of goods produced in Russia, and these have been on the rise since March 2022. As we have not observed any fluctuations in other intervening variables (such as corruption in customs), we can attribute this variation to a greater prevalence of sanctions-busting in Kazakhstan and Belarus compared with Georgia.

South Caucasus – Georgia

Sanctions have yielded both positive and negative consequences for Georgia’s economy. Here, we draw four key findings, noting that a more comprehensive list can be found in the research paper:

- ***Sanctions have indirectly resulted in a surge in demand for the transportation corridor through Georgia.*** With the northern route (via Russia and Ukraine) for transiting goods no longer available, demand for a transport corridor through Georgia (the ‘Middle Corridor’) has also grown significantly, with some logistical companies reporting an increase in workload of 30-40% (Business Media Georgia, 2022). Furthermore, the entire region is at risk of becoming a highway for illicit trade given the attempts by Türkiye and Iran to establish sanctions-proof trade corridors with Russia.
- ***Sanctions have contributed to an upsurge in remittances from Russia and an overall surge in trade.*** There was a fivefold increase in remittances to Georgia from Russia, amounting to US\$2.1 billion (Transparency International Georgia, 2023); and in 2022, Georgian exports to Russia increased by 6.8% and amounted to US\$652 million (Transparency International Georgia, 2023). The role of Georgia in re-exporting commodities produced in Russia is particularly noteworthy. Research shows a consistent increase in exports and re-exports of oil products from Georgia. This most likely relates to tremendous hikes in oil imports from Russia. No other oil-producing country, including the Central Asian countries, has reported an increase in oil product shipments to Georgia over the same period, and so the hike in Georgia’s exports can only be explained in terms of re-exports of products produced in Russia. There is more evidence that Georgian territory is used for re-exporting goods produced in Russia to third countries, including to EU member states.

- ***Sanctions have raised the potential for sanctions evasion and illegal trade practices.*** For example, the presence of sanctioned businesspeople in the Georgian market does not automatically imply the presence of illicit practices, but it does potentially increase the risk of sanctions-busting because of these individuals' links with businesses and trade networks in Russia.
- ***Sanctions have contributed to the emergence of a thriving financial and legal services industry that caters to Russian nationals.*** According to Tabula (2023), there is another notable example of a Georgian businessman with shady business links to Russia co-owning a Moscow-based company along with former high-ranking government officials; this company has helped wealthy Russians to emigrate to Georgia and other countries.
- ***The Georgian government has demonstrated a willingness on the part of authorities to counteract sanctions-busting, albeit efforts are modest.*** According to a statement made by Lasha Khutsishvili, the Minister of Finances, as of March 2023, the number of decisions made by Georgian customs to turn back shipments amounts to 1,020 (Fortuna, 2023), a modest number considering the colossal scale of transit trade passing through Georgia. However, this is evidence of policing re-exports to Russia more than re-exports from Russia. Conversations in a Telegram channel for truck drivers transporting goods via countries in the South Caucasus emphasise that incoming cargoes are systematically checked by Georgia and long investigations follow if there is some suspicion of sanctioned goods being transported. Some even suggested that to avoid getting 'stuck in Georgia', drivers transporting similar cargo considered reaching Russia from Türkiye by sea or circumventing Georgian territory by driving from Türkiye to Iran, onwards to Azerbaijan, and then on to Russia.

Central Asia and Kazakhstan

All Central Asian countries are believed to have helped Russia evade sanctions and have reaped benefits from their newfound role, serving as a transit zone for sanctioned goods from the EU to transit to Russia (Marlow, 2023; Atkins, 2023; Burna-Asefi, 2023). They also sell dollars and other currencies in exchange for rubles, and export Russian products to third countries. Kazakhstan's businesses exported sanctioned brands to Russia, while Russian firms have used Kazakhstan to camouflage exports. Several Western companies relocated to Kazakhstan and contributed to the nation's economy. By September 2022, Kazakhstan's exports had reached US\$65.8 billion, increasing by 47.5% from the previous year, but imports from Russia grew by only 3% suggesting that some imports remain underreported (Mami & Kenzheali, 2022).

Kazakhstan's shadow economy expanded in four main ways:

- ***The export of everyday goods to Russia by retailers.*** According to media reports, Russian parallel imports incentivised the smuggling of everyday goods such as car parts, phones, and clothes. Old and new entrepreneurs can follow shifting market demand for goods and find partners in Russia through Telegram channels. Mostly small businesses and individual entrepreneurs leverage the new shadow market. Large distributors of Western brands avoid violating sanctions (Stogney & Platonova, 2023). Large companies trading in non-Western brands are involved in sanctions evasion (Cerniauskas et al., 2022). An investigation by the Organized Crime and Corruption Reporting Project (OCCRP) showed how entrepreneurs from Russia facilitate supplies of drones and microelectronics through Kazakhstan, Kyrgyzstan, and Armenia (Zholobova et al., 2023). Members of the same families often participate in transnational networks supplying goods from EU countries to Russia via Kazakhstan.

- ***The camouflage of Russian transit goods such as wheat and oil.*** Intermediaries in Kazakhstan and Central Asia conceal sanctioned goods from Russia transiting to the EU and to various countries (Taran, 2022). For example, Russian exporters to the EU, especially of natural resources (iron, steel, crude oil, and coal) conceal the source of origin as Kazakhstan. Oil of Russian origin is blended with Kazakh oil then exported as of Kazakh origin (Aris, 2022). The volume of shadow exports of Russian grain to Kazakhstan is estimated at 1-1.5 million tonnes per year. After exporting Russian wheat illegally to Kazakhstan, however, Russian traders report it as Kazakh and transport it on to Uzbekistan. While in 2021, Russia was the leading exporter of grain, in 2022, Kazakhstan was the leading importer of grain from 'Kazakhstan'. Kazakhstan's producers and exporters of wheat called on the government to prevent shadow imports from Russia that unfairly disadvantage them on the domestic and international market (IDK Ekspert, 2022).
- ***Increased demand from Russian consumers travelling to Kazakhstan.*** Weeks after the start of the invasion, growing commodity prices boosted the Russian ruble against the Kazakh tenge. Russian consumers have therefore been able to enjoy greater purchasing power in Kazakhstan. Russian citizens have also opened Visa and Mastercard accounts in the Central Asian and South Caucasus republics. The Russian migrants have launched a series of enterprises in Kazakhstan servicing Russian consumers. According to the Agency of the Republic of Kazakhstan for Regulation and Development of Financial Market, Russians brought more than 40 billion rubles to the republic's banks over the last three months of 2022 (24 kg, 2023).
- ***An expanded informal labour market.*** For example, according to Arina Pirogova, the CEO of Quick Work, the share of informal labour has probably expanded to up to 40% of the working age population (Baigenews.kz, 2023). In January 2023, Kazakhstan's president, Kassym-Jomart Tokaev, announced a plan to establish an Agency against Economic Crime (Агентство по борьбе с экономическими преступлениями) to reduce the size of the shadow economy to 15%. This intention follows the logic of decision-making in Kazakhstan: numerical indicators are set out as benchmarks without specific paths outlined for achieving the goals.

Implications

In our research, we found evidence that Western sanctions have not cut supplies to Russia but have instead empowered shadow trade networks and intermediaries of various kinds by creating additional sources of income. In some cases, transiting goods can be re-exported to Russia with implicit yet unspoken approval from Western producers that have formally committed to new trade restrictions.

Moreover, the authorities of Georgia and Kazakhstan have formally committed to abiding by the new trade rules, but analysis suggests that they have indirectly benefited from transiting trade that has increased exponentially. On paper, and according to the information available in the official sources, there appears to be little to no increase in trade flows with Russia, particularly regarding restricted goods. Yet a substantial portion of the inflated traffic has been surreptitiously concealed through a myriad of obfuscating techniques, such as the intentional misrepresentation of origin and destination points, the deliberate underestimation of trade volumes and valuations, and the omission of critical details pertaining to the suppliers and importers involved. Nevertheless, a discernible disparity has emerged among the relevant states: Georgia has demonstrated more concerted efforts to combating the circumvention of sanctions, while Belarus and Kazakhstan have proven inadequate in their efforts to mitigate such activities.

Western states have prioritised their focus on the re-exporting of restricted goods to Russia, with the primary objective being to undermine the operational capacity of Russia's military apparatus and diminish the influx of goods that can be leveraged in armed conflict (U.S. Department of State, 2023). Despite such concerted efforts, the role of third-party states, such as Georgia and Kazakhstan, in enabling Russia to sustain its international trade activities cannot be understated, as these activities yield substantial financial gains that are allocated for the country's military expenditure. The identification of evidentiary support compounds this issue – it indicates that both Georgia and Kazakhstan are actively facilitating the transit and re-export of Russian oil products and wheat to markets located further afield.

Given the sheer volume of international trade, fully monitoring every conceivable incident of sanctions circumvention is a formidable challenge. We recognise that there are currently few incentives for these potential measures to be explored, but by making sanctions circumvention more visible we hope our research will provide further support to reformers. Western governments, states that share a border with Russia, and commercial entities could adopt more proactive measures to combat the ubiquitous phenomenon of sanctions violation. Likewise, suppliers in EU countries should be more diligent about increased demand and trade levels from countries neighbouring Russia because of sanction-dodging practices.

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