

ILLICIT FINANCIAL FLOWS AND STRATEGIC CORRUPTION

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Estimates suggest that global IFFs¹ range from USD 125 billion to USD 15 trillion.² **These flows undermine economic development by corrupting institutions, eroding state legitimacy, enabling state capture, and discouraging investment.** What is often overlooked is how IFFs related to circumventing sanctions contribute to fueling geopolitical divisions, wars and strategic corruption by providing funding for military and paramilitary operations, and state-sponsored organized crime.

The countries from the Western Balkans and the Black Sea region are particularly vulnerable to the corrosive effects of IFFs. **IFFs reached USD 31 billion in 2023 for the ten non-EU countries from the region – Albania, Armenia, Bosnia and Herzegovina, Georgia, Kosovo, Moldova, Montenegro, North Macedonia, Serbia, and Ukraine.** They have surged significantly after the Russian invasion of Ukraine in 2022, reaching in some cases 10% of the country's GDP.³ Russian economic and political influence in these countries seems to have reinforced the rise of IFFs.

For example, in Armenia, over 50% of the country's economy and more than 80% of its agricultural sector depend on Russia.⁴ Since 2010 Armenia has experienced a 425% increase in imports from Russia, rising to USD 4 billion in 2023. The

KEY POINTS

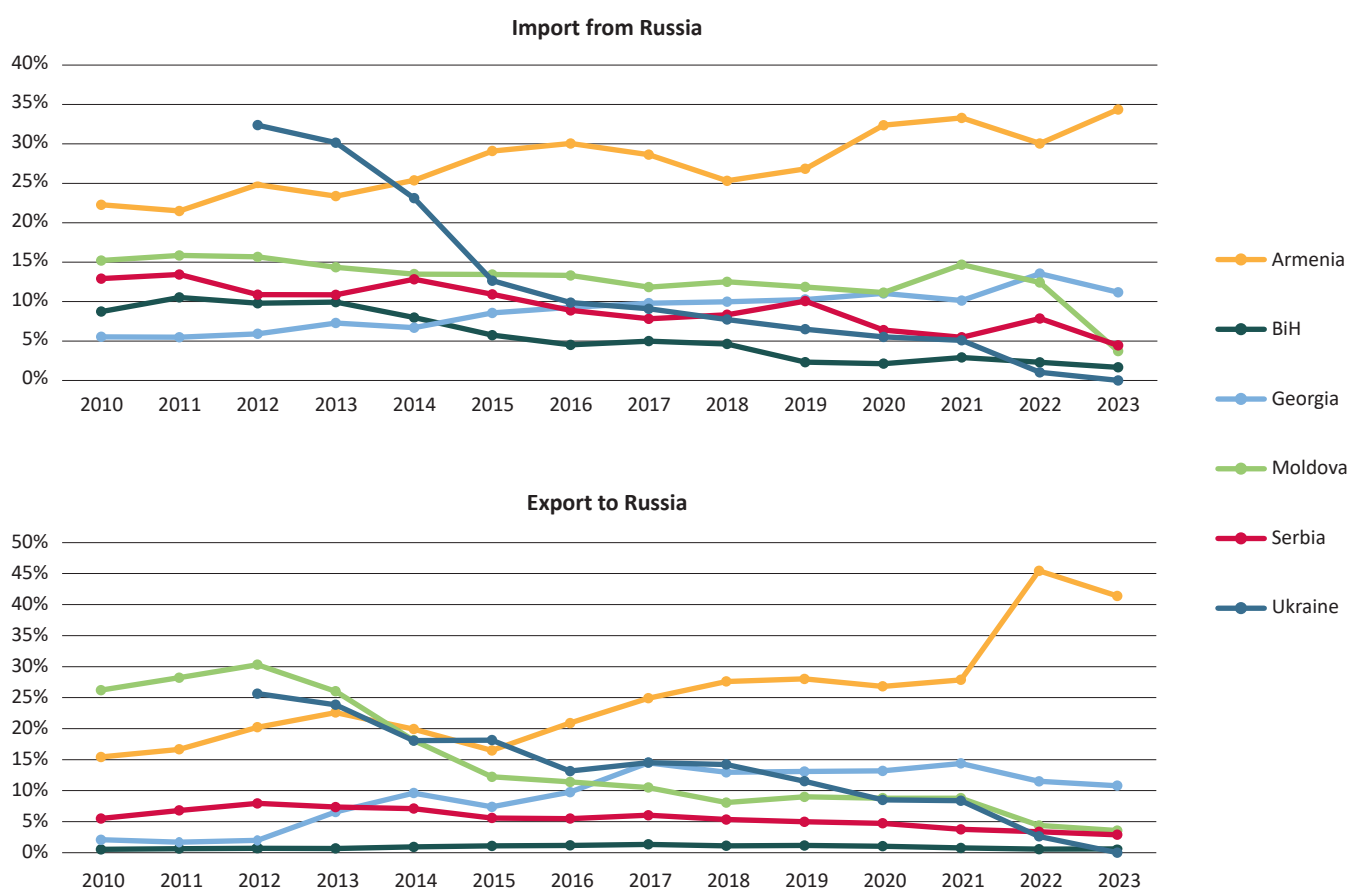
- **Illicit financial flows (IFFs)** in the Western Balkans and the Black Sea region **swelled** to USD 31 billion in 2023, displacing productive investments, corrupting institutions, enabling state capture, and eroding trust in democracy.
- The expansion of IFFs can be traced directly to the **surge of imports of dual-use goods from the EU and their reexport to Russia** through established networks, smuggling routes, and misinvoicing techniques.
- **Armenia** has become the major hub for re-exporting dual-use goods and the related IFFs, followed by **Serbia, Georgia, Bosnia and Herzegovina, and Moldova.** IFFs thus reinforce geopolitical fault-lines opened by Russia after the invasion of Ukraine.
- Other faultline regions face similar governance challenges that facilitate IFFs, like the ones in the Western Balkans and Black Sea, but with a **higher presence of state capture** and offshore financial hubs.
- The EU should act quickly to adapt its accession and development assistance to close IFF loopholes, e.g. by establishing dedicated **regional sanctions evasion monitoring groups.** The EU, UK, Norway and Switzerland need to adapt their **global development aid programs** accordingly, acknowledging also the rapidly shifting geopolitical environment.
- The countries from the Western Balkans and the Black Sea region should align their national regulations with **EU standards on dual-use goods and apply for membership in Multilateral Export Control Regimes (MECRs).**

¹ International Monetary Fund, [What are illicit financial flows?](#).

² Ferwerda, J., Unger, B., "How Big Are Illicit Financial Flows? The Hot Phase of IFF Estimations", – In: *Combating Fiscal Fraud and Empowering Regulators: Bringing tax money back into the COFFERS*, Oxford Academic, 2021.

³ Center for the Study of Democracy, *Breaking the Code: Russian and Chinese Disinformation and Illicit Financial Flows in Southeast Europe*, Sofia: CSD, 2023.

⁴ Karabashian, S., "De-Russification: Understanding the trajectory and reversibility of Armenia's Western pivot", *Middle East Institute*, 9 September 2024.

Figure 1. Bilateral Trade with Russia, % of the Total per Country

Note: Albania (0% import and 1.87% export), Kosovo (0% import and 0.58% export), Montenegro (1.38% import and 0.32% export), and North Macedonia (0.77% import and 3.02% export) are excluded from the figure due to their low average share of trade with Russia as a percentage of their total trade.

Source: CSD, based on data from the Eurostat International Trade Database (Comext).

country's exports to Russia have skyrocketed by an extraordinary 2,106%, to USD 3 billion in 2023. **Armenia, Georgia, and Serbia** had the highest trade deficits with Russia relative to their GDP in 2023, a trend also seen in Moldova and Bosnia and Herzegovina. These deficits are driven by these countries' dependence on Russian energy and raw materials.

The surge in IFFs has most probably been additionally fueled by the reactivation of established and the emergence of new criminal networks in many of the countries in the region, seeking to leverage rising demand from Russia (for military technology and dual-use goods of any kind) and lax or in some cases non-existent sanctions enforcement. **The routes, historically used for smuggling weapons, oil products, drugs and contraband from Soviet and Yugoslav times, are being repurposed to channel dual-use items and launder illicit funds.**

Among the exploited IFFs channels are Armenia's transit role for Southwest Asian drugs⁵, Georgia's opiate routes from the 'Golden Crescent' (Iran, Afghanistan, Pakistan), Moldova's heroin trans-shipments and Transnistrian arms trafficking, facilitated by Moldovan e-money providers,⁶ and Ukraine's drug, tobacco, and alcohol transit routes, complicated by the influx of weapons.⁷ All the countries in the Western Balkans have similar key transit routes for drugs, chemicals, arms, and human beings, as well as illicit tobacco products. Serbia and Bosnia and Herzegovina host

⁵ United States Department of State, "2020 INCSR—Volume I: Drug and Chemical Control", – In: *International Narcotics Control Strategy Report*, Bureau for International Narcotics and Law Enforcement Affairs, 2020.

⁶ United National Interregional Crimes and Justice Research Institute, *Illicit Financial Flows and Assets Recovery in the Republic of Moldova*, 2021.

⁷ Global Initiative Against Transnational Organized Crime, *Global Organized Crime Index*, 2023.

vulnerable free trade zones, which have been exploited for money laundering.⁸

In addition to criminal operations, bilateral trade is further used to create a legal “grey zone” for illicit financial practices, such as tax evasion and VAT fraud. With the increase of global geopolitical rivalry, **authoritarian states have sought to leverage these trade dependencies** to exert political and economic influence and circumvent sanctions. Nevertheless, bilateral trade flows with Russia in most countries except for Armenia have declined, following the full-scale invasion of Ukraine. Yet, Russia has remained very active and successful in taking advantage of its key role of an energy supplier and commercial partner to reroute the trade of sanctioned goods through the region.⁹

Box 1. Financial and Legal Services for Russian Citizens in Georgia

In 2022, remittances from Russia to Georgia surged fivefold to USD 2.1 billion. Nearly 15,000 Russian companies registered in the country, opening together with immigrating Russian citizens over 60,000 bank accounts.¹⁰ By the end of 2022, many Georgian banks began closing Russian citizens’ accounts due to suspicious cryptocurrency transactions.¹¹ Yet, a new industry of financial and legal services emerged, targeting Russian citizens and helping them register businesses, often in remote villages. Shadowy entrepreneurs exploited regulatory loopholes, hiring unemployed Georgians to receive and transfer funds from Russia for a fee.¹²

Box 2. What is Trade Misinvoicing and How are IFFs Measured?

Trade misinvoicing is the primary tactic of IFFs, with a share of over 50% of total trade-based financial transactions in many developing and emerging economies.¹³ There are **two main approaches to estimating the size of IFFs** – the *Partner Country Method Plus (PCM+)* and the *Gross Excluding Reversals (GER) method*, resulting from trade misinvoicing, in line with the UNCTAD methodology.¹⁴

- The *PCM+ method* compares import and export values reported by one country with the corresponding export and import values reported by its partner country, making it effective for detecting tax evasion and customs fraud. It highlights misreporting of goods’ value, quantity, or classification to evade taxes, launder money, or shift profits.
- The *GER method* treats total illicit inflows and outflows separately. It also assumes that all trade discrepancies are illicit, which may not always be accurate due to factors like statistical/reporting issues, exchange rate differences, or regular trade fluctuations. This method is preferred for detecting both import over-invoicing (which facilitates illicit outflows) and import under-invoicing (which brings illicit funds into a country).

While both methods are effective in detecting IFFs, *PCM+* primarily identifies trade mismatches between countries and may miss some forms of trade-based money laundering.

⁸ Global Initiative against Transnational Organised Crime, *Illicit financial flows in Bosnia and Herzegovina, Montenegro and Serbia: Key drivers and current trends*, 2022.

⁹ Observatory of Economic Complexity (OEC) data.

¹⁰ Transparency International Georgia, “Georgia’s Economic Dependence on Russia: Impact of the Russia-Ukraine war”, 22 February 2023.

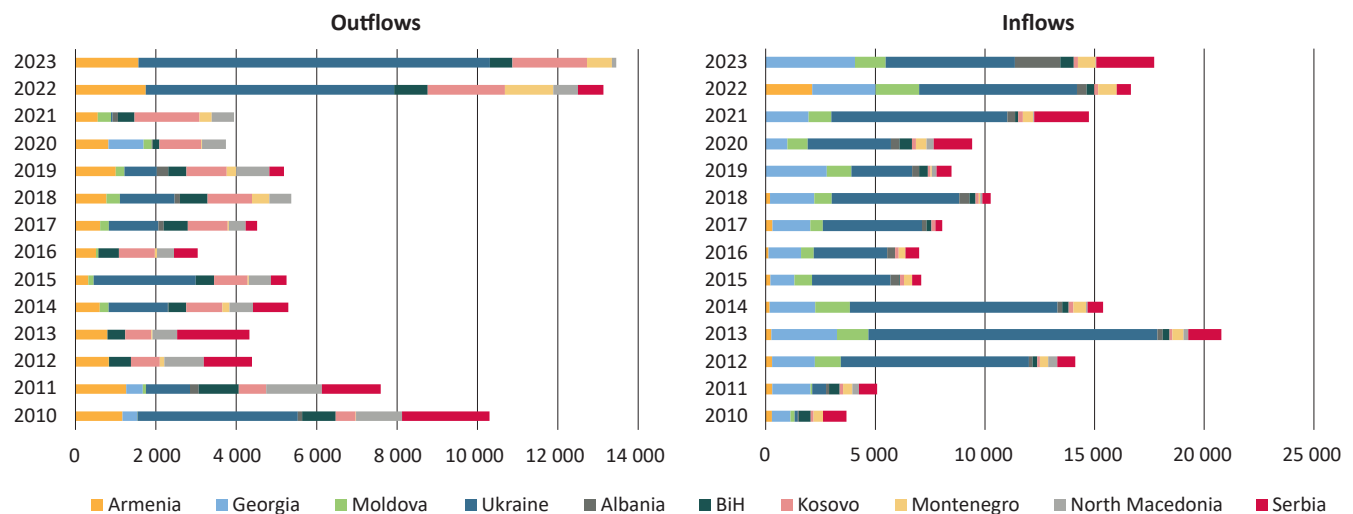
¹¹ Darchiashvili, E., “Bank of Georgia” closes the accounts of Russian citizens”, *Business Press News*, 28 December 2022.

¹² Marad, E., and Kupatadze, A., *Under the Radar: How Russia Outmanoeuvres Western Sanctions with Help from its Neighbours*, Serious Organised Crime and Anti-Corruption Evidence, Research Paper 18, August 2023.

¹³ Global Financial Integrity, “Report Finds Trade Misinvoicing Continues to be a Massive and Persistent Problem”, 16 December 2021.

¹⁴ UNCTAD, *Methodological Guidelines to Measure Tax and Commercial Illicit Financial Flows. Methods for Pilot Testing*, July 2021.

Figure 2. Evolving Trends in Illicit Financial Outflows and Inflows in the Western Balkans and the Black Sea Region, 2010-2023, USD Million



Sources: CSD calculations based on IMF (trade statistical database) and estimated via the PCM+ method (UNCTAD).

The largest **illicit financial outflows** from the Western Balkans and the Black Sea region since 2010 have been recorded in 2022 and 2023.¹⁵ **Ukraine, Kosovo*,¹⁶ and Armenia** saw the highest levels of IFF outflows in this period, which has coincided with the ramping up of sanctions against Russia. On the other hand, the largest rise in **illicit financial inflows** after 2022 has been observed in **Georgia, Moldova, Albania, Bosnia and Herzegovina, Montenegro, and Serbia**. The largest inflows occurred in two periods: 2012–2014 and 2021–2023, which suggests a strong link between sanctions evasion and IFFs. Ukraine, Georgia, Moldova, and Serbia have consistently recorded the highest inflows.

Weaponizing Trade for Sanctions Evasion

Despite the strong EU financial and military support for Ukraine and the significant drop in direct trade between the EU and Russia, the Kremlin has successfully continued to **circumvent sanctions using informal trade networks and generating illicit financial flows**. IFFs have then been weaponised by existing and emerging strong Russia-related oligarchic and **state capture networks** in the region to further corrupt and evade sanctions. European businesses, whether knowingly or

unknowingly, have played a role in these operations. Their subsidiaries located in non-sanctioning countries have become key intermediaries, reselling goods to Russia through complex, often opaque structures.

The trade in **dual-use goods** – items with both civilian and military applications – have exploded in 2022 and 2023 although export controls were introduced to weaken Russia's war capabilities. Among the products that have been reexported through the region to Russia include electronic integrated circuits, converters, and microchips. The dual-use goods trade has helped Russia to remain exceptionally resilient to sanctions.¹⁷ CSD's calculations based on UN COMTRADE data reveal a steady decline in global dual-use goods exports to Russia post-2021. Specifically, exports dropped by 37.23% in 2022, by 28.81% in 2023, and by 96.35% in 2024, compared to pre-sanctions levels.

Dual-use goods from Europe reach Russia through three primary channels:

- **Direct re-export:** A European entity sells goods to a company in a third country, which then re-exports them to Russia. This is the most common strategy for sanctions evasion.
- **Indirect re-export:** A European entity sells goods to a proxy buyer, who resells them in foreign markets, from where they ultimately reach Russia.

¹⁵ According to CSD estimates using Partner Country Method Plus (PCM+) and the Gross Excluding Reversals (GER) method.

¹⁶ * The designation "Kosovo" is without prejudice to positions on status and is in line with UNSCR 1244/1999 and the ICJ Opinion on the Kosovo declaration of independence.

¹⁷ Caspian Policy Center, "Central Asia's Gateway of Dual-Use Technology and Materials to Russia", 28 March 2024.

- **Fictitious transit:** Goods are declared as *en route* to a third country via Russia. However, once inside Russian territory, the buyer changes, and the goods remain in Russia. This method often involves shipments crossing the EU-Belarus border, frequently labelled as Chinese, only for their designation to change once inside Russia.¹⁸

Box 3. Limited Effectiveness of EU and G7's Sanctions

Since Russia's annexation of Crimea in 2014, the EU and G7 have been implementing various measures to **cut Russia's access to sensitive goods and technologies**. The EU imposed restrictions on dual-use goods¹⁹ and froze assets²⁰ of individuals responsible for supporting the Russian invasion. The G7 provided guidance²¹ to industries on how they should prevent the diversion of controlled goods to Russia.

The EU placed a **ban on Russian crude oil** on 5 December 2022, followed by a ban on refined petroleum products on 5 February 2023. The ban affects around 90% of EU oil imports from Russia that arrive by sea. The EU, alongside the G7, has also **enforced a price cap** on Russian oil to limit Moscow's earnings. In addition to these measures, the EU has banned all forms of Russian coal imports, prohibited new investments in Russia's energy sector, and stopped the temporary storage or placement of Russian crude oil and petroleum products in EU ports. Germany and Poland were cut off from importing Russian oil via pipeline.²² The EU **sanctioned over 2 400 individuals and entities** and froze over EUR 28 billion of private assets.²³ Moreover, the EU excluded Russian banks from the SWIFT messaging system in 2022, aimed to further isolate Russia from global financial systems.

Still, the measures have **had limited effectiveness**. In 2023, Turkey became the world's biggest buyer of Russian oil products and imported 18% of Russia's total exports of oil products.²⁴ **New methods of evading sanctions**, such as cryptocurrencies and cyber-enabled trade-based money laundering, have emerged, complicating enforcement.²⁵ Moreover, the responsibility for due diligence falls on various actors, including suppliers, buyers, shipping companies and financial service providers, creating additional administrative burdens for them.

Armenia stands out for its significant role in re-exporting EU goods to Russia.²⁶ Statistical analysis of monthly trade flows from 2022 to 2024 shows that for every U.S. dollar increase in EU exports to Armenia, Armenian exports to Russia increase by USD 2.58, suggesting a highly responsive and structured supply chain. **The timing of these trade spikes is also revealing.** For example, in late 2022, EU exports of television and digital cameras to Armenia saw unusual spikes in September, October, and December – followed closely by corresponding rises in Armenian sales to Russia in November, December, and early 2023. Total Armenian exports of dual-use goods to Russia soared by more than 3500% in 2022.

In addition to its direct trade with Russia, Armenia also facilitates the indirect re-export of goods by expanding its 2024 shipments to Belarus and Kyrgyzstan to bypass Western sanctions. Armenia's jewelry industry, as another example, is stamping official marks on Russian-made gold for re-export, mainly to the UAE and Hong Kong.²⁷ Many major gold buyers are connected to Armenian politicians and business elites.²⁸ All this mislabelling creates considerable IFFs, compared to the size of the transit (enabling) economies, fueling local oligarchic, state capture and organized crime groups.

¹⁸ Helmer, M., "Trotz strenger Sanktionen: Wie deutsche Waren Russland erreichen", ZDF heute, 13 July 2024.

¹⁹ European Commission, Council Regulation (EU) No 833/2014 of 31 July 2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine.

²⁰ EUR-Lex, Council Regulation (EU) No 269/2014 of 17 March 2014 concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine.

²¹ European Commission, Preventing Russian Export Control and Sanctions Evasion: Updated Guidance for Industry, September 2024.

²² European Commission, Sanctions on energy, 24 February 2025.

²³ European Commission, Sanctions against individuals, companies and organisations, 24 February 2024.

²⁴ Vladimirov, M., et al., *Kremlin Pitstop: Financing Putin's War*, Sofia: Center for the Study of Democracy, 2024.

²⁵ Europol, *The changing DNA of serious and organised crime (EU-SOCTA 2025)*, 2025.

²⁶ Interfax, "Armenia sees economic risks due to possible intensification of sanctions against Russia, Iran in 2025", 23 January 2025.

²⁷ After the 2022 embargo on Russian gold, Armenia imported 89 tons of Russian gold worth USD 5.2 billion in 2022, rising to 111 tons valued at USD 6.2 billion by early 2023.

²⁸ Akhundov, K., "Re-export deadlock: Armenia's speculative economy", *Caliber*, 26 November 2024.

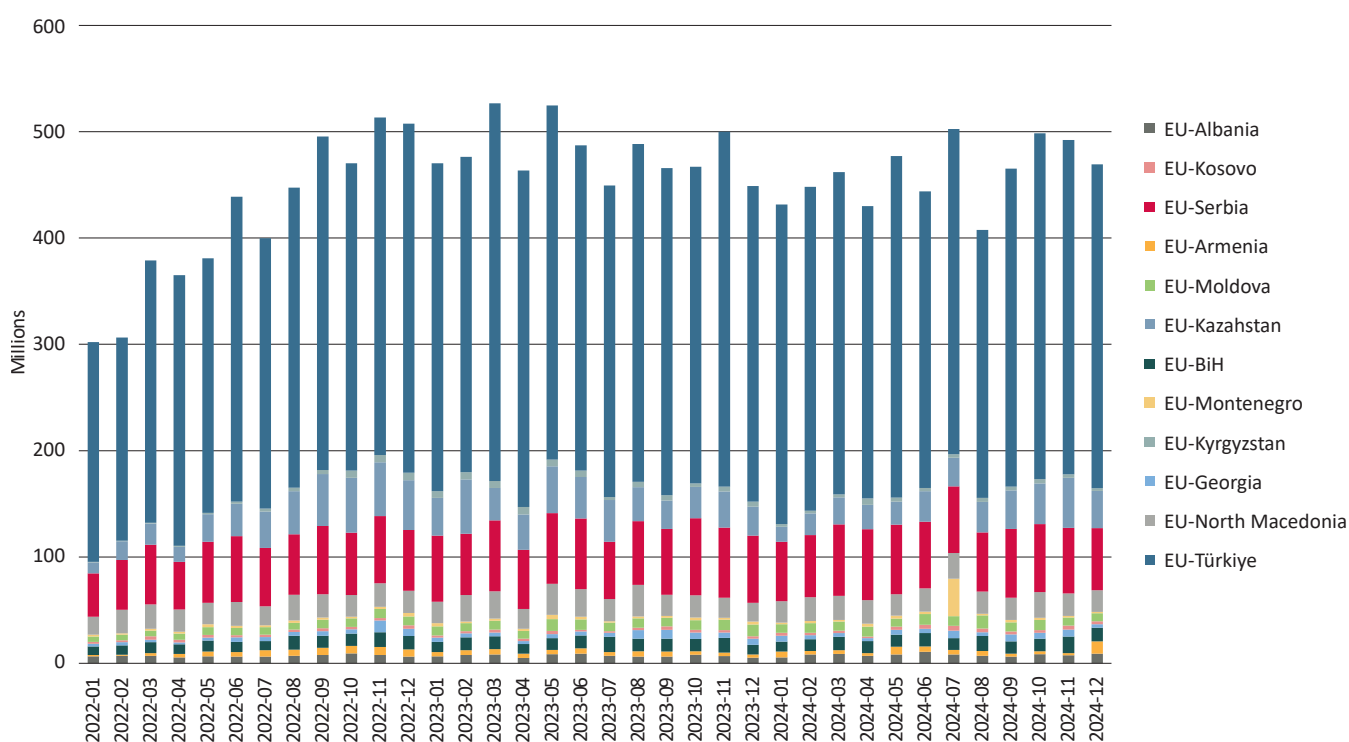
Box 4. Armenian Intermediaries Facilitating Sanction Evasion

TAKO LLC, a company trading in electronic and telecommunications equipment, registered in Yerevan and owned by a Russian national, has been under U.S. sanctions since 2023.²⁹ It collaborated with Radioavtomatika, a Russian company under U.S. sanctions, to channel restricted goods into Russia. The U.S. Office of Foreign Assets Control (OFAC) reported that TAKO LLC changed its name to TACO LLC in an attempt to circumvent trade restrictions.³⁰ In a separate case, Milur Electronics LLC, the Armenia-based affiliate of Milandr (a Russian microelectronics company linked to the military) ordered microchips, produced them, and facilitated their sales to Russia.³¹

For the remaining countries, there is no statistically significant correlation between EU imports and their exports to Russia. However, this **does not exclude the possibility of** re-export – as this might happen also through third countries, such as Turkey and the Gulf states. For example, bilateral trade data shows rising export of **dual-use goods** from **Serbia, Bosnia and Herzegovina**, and **Moldova**, although not at the same scale as in **Armenia**.

Serbian companies have exported at least USD 71.1 million worth of sanctioned dual-use goods to Russia since February 2022.³² These shipments have included high-priority electronics identified by the United States and the EU as components found in Russian weapons systems recovered in Ukraine. There are several cases that reveal how Serbian firms have benefitted from the export of dual-use goods to Russia.

Figure 3. Exports of Dual-Use Goods from the EU to Selected Third Countries, in USD Millions



Source: Eurostat EASY COMEXT and UN COMTRADE (United Nations Statistics Division).

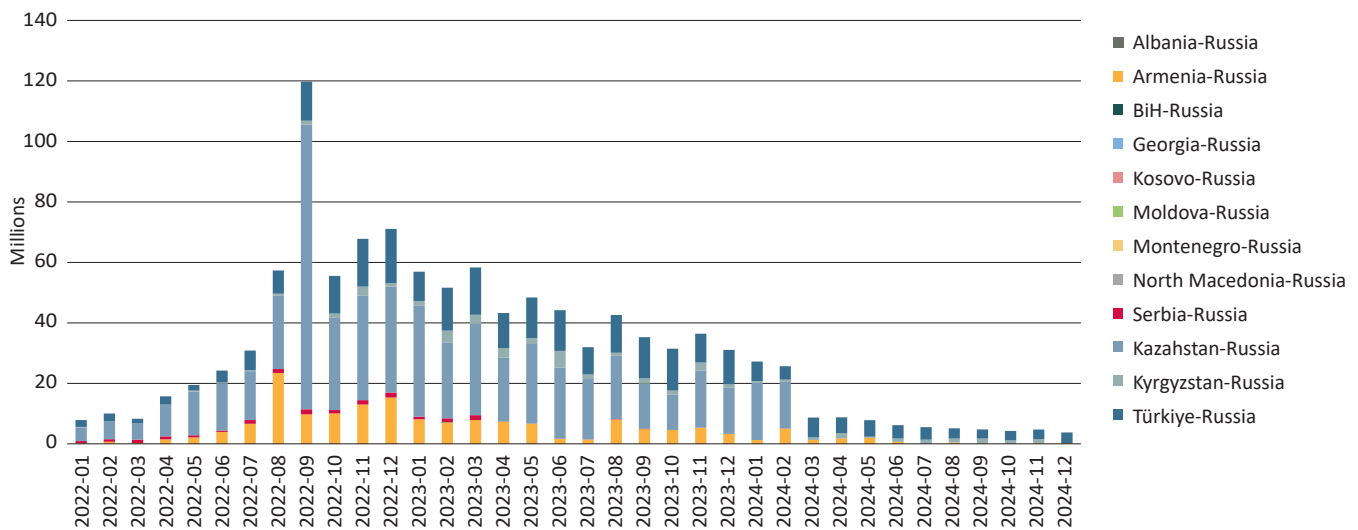
²⁹ News.am, "Which Armenia company is put on US sanctions list?", 13 April 2023.

³⁰ Ashirov, Q., "USA puts sanctions on several Armenian companies," AzerNEWS, 14 April 2023.

³¹ Pope, H., "U.S. Treasury Sanctions Kremlin Microelectronics Supplier", Organised Crime and Corruption Reporting Project, 17 November 2022.

³² Katić, M., and Jevtović, M., "Milionske zarade srpskih firmi kroz šemu zaobilazjenja sankcija Rusiji", RFE/RL's Balkan Service, 8 November 2023.

Figure 4. Exports of Dual-Use Goods from Third Countries to Russia, in USD Millions



Note: There is no available data for Kazakhstan's exports to Russia after February 2024.

Source: Eurostat EASY COMEXT and UN COMTRADE (United Nations Statistics Division).

Box 5. Serbian Firms' Export of Dual-Use Goods to Russia

Kominvex, a Serbian company founded in 2005, shifted from wholesale motor vehicle parts to shipping dual-use goods (microchips, processors, disk-storage devices, digital cable communication systems) to Russia. It exported USD 143.9 million worth of goods, including USD 54.3 million in high-priority electronics from March 2022 to July 2023.³³ Soha Info, another Serbian firm, exported goods worth USD 18 million to Russia between October 2022 and July 2023, including USD 6.3 million in dual-use electronics, which are tightly controlled for military use.³⁴ Ventrade DOO, founded in April 2022, just two months after Russia's full-scale invasion of Ukraine, has been **sanctioned by the U.S. for supplying military-grade radio equipment** to Russia's defense sector. The company, originally established with EUR 1,000 in capital, exported equipment to Promsvyazradio, a Russian firm importing dual-use technology.³⁵

Box 6. Moldova's Role in the Supply of Aircraft Parts to Russia

Before aligning with EU sanctions, three Moldovan companies were involved in **selling aircraft parts** worth USD 15 million to Russia between 2022 and 2023. These spare parts, sourced from Western countries, were supplied to major Russian airlines such as Pobeda and S7 Engineering, months after Russia's invasion of Ukraine. The companies – Airrock Solutions (founded in November 2021), Aerostage Services (founded in April 2022), and Maxjet Service (established in 2011) – acted as intermediaries, placing orders for the parts and facilitating their transportation to Russia, often directly to Russian airports.³⁶

Bosnia and Herzegovina and **Moldova**, which had minimal-to-no-prior history of exporting dual-use goods to Russia, **recorded a significant rise in the export of dual-use goods** to Russia in 2023 – a year after the conflict commenced and sanctions intensified.³⁷ Moldova, for example, still does not have a national strategy for Small Arms and Light Weapons (SALW). In

³³ Business and Human Rights Centre, "Serbian companies export sanctioned dual-use technology to Russia, new investigation shows", 8 November 2023.

³⁴ Ibid.

³⁵ Visnjic, B., "US Sanctions Companies from Serbia, Montenegro for Military Exports to Russia", *BalkanInsight*, 31 October 2024.

³⁶ Ukrainska Pravda, "Three Moldovan companies sold US\$15 million worth of aircraft parts to Russia", 31 January 2024.

³⁷ Moller-Nielsen, T., "EU sanctions on Russia 'massively circumvented' via third countries, study finds", EURACTIV, 26 February 2024.

2024, the national Parliament suspended the country's participation in the Conventional Armed Forces in Europe Treaty, highlighting shifting defense priorities.³⁸ Moreover, the effective enforcement of dual-use export controls demands specialised expertise, advanced monitoring systems, and coordination with EU institutions, which Moldova still lacks.³⁹

Georgia, Montenegro, and North Macedonia recorded their highest export values of dual-use goods to Russia in 2021, marking a **significant surge** compared to previous years.

Both the US and the European Union have criticised **Georgia's** role in sustaining Russia's military operations through the supply of banned items, such as drones, computer processors, GPS devices, and memory cards.⁴⁰ Ongoing tensions in the **breakaway regions of Abkhazia, South Ossetia, and Nagorno-Karabakh**, along with broader conflicts in the Caucasus and Russia's invasion of Ukraine, have made the country increasingly **vulnerable to arms trafficking**. For example, Georgia's export of Radio Navigation Equipment surged by 213% in 2023. These devices, which can be used for GPS navigation, have been found in downed Russian aircraft in Ukraine. Armenia received USD 3 million worth of Digital Data Processing Blocks from Georgia in 2023, a dramatic increase compared to 2022. These blocks are essential for modern **digital electronics used in military applications**. Moreover, Georgia's export of Sound/Image Receiving and Transmitting Equipment to countries like Kazakhstan and Azerbaijan increased by 34%, with these nations acting as intermediaries to Russia.⁴¹ Georgia has also intensified its export of dual-use items to neighbouring and Central Asia countries.

Box 7. Arms and Dual-Use Goods Continue to Reach Russia through Georgia

"Kairo Logistics", operating under the legal entity "Service-Multi" LLC, has openly admitted to falsifying trade origin documents to evade sanctions. Registered in Moscow in 2018, the company has extensive experience in **transporting restricted goods by rerouting shipments**. In May 2024, "Ai, Faktsi" investigative team contacted Kairo Logistics via WhatsApp, posing as customers seeking to transport 30 drones from Tbilisi to Samara, Russia. The company representative informed the team that the cargo was supposed to be taken through Azerbaijan or Iran, at a **price 20 times higher than the standard rate**. The company made the process alarmingly easy. No physical documentation was required beyond an invoice and an electronic signature on a contract. Once sufficient information was obtained, the investigative team ceased the operation without sending any cargo. Later, the manager of Kairo Logistics openly admitted that, despite sanctions, prohibited goods were still reaching Russia with the key difference that transportation routes have shifted through Turkey or Azerbaijan.⁴²

In a separate case, **Cargo Rapido**, a Georgian transportation company registered in 2020 and owned by a Russian citizen from North Ossetia, agreed to **ship prohibited goods** such as Intel processors and memory cards to Russia without official paperwork. The cost included a "10% insurance fee" – a euphemism for bypassing customs regulations.⁴³

³⁸ Interfax, "Moldovan govt approves withdrawal from CFE Treaty", 6 March 2024.

³⁹ European Commission, *Republic of Moldova 2024 Report*, 2024.

⁴⁰ Rakhimbekov, N., et al., *Russia's Sanctions Evasion Report 2023 – 2024 Focus: Central Asian Countries, Caucasus, and China*, Center for Global Civic and Political Strategies and Civil Society Coalition "Dongelek Ystel", 2024.

⁴¹ Business and Human Right Resource Centre, "Georgia: New investigation unveils country's role in facilitation of military tech exports to Russia despite international sanctions", 1 August 2024.

⁴² Yusif, A., and Mikhelidze, N., "Sanction Evasion: How Georgia Facilitates Russia's Military Supply Chain", *Association of Investigative Journalists "Ai, Faktsi"*, 1 August 2024.

⁴³ Yusif and Mikhelidze, "Sanction Evasion", *Association of Investigative Journalists "Ai, Faktsi"*, 1 August 2024.

What's Next?

Illicit financial flows have surged in the Western Balkans and the Black Sea region following Russia's full-scale invasion of Ukraine. This increase is **closely linked to the re-export of dual-use goods** from the EU to Russia through established smuggling routes and trade misinvoicing practices. **Armenia has emerged as a major transit hub**, followed by Serbia, Georgia, Bosnia and Herzegovina, and Moldova, all countries also well-known for their special links and vulnerabilities to Russia.

Long-standing governance and enforcement capacity issues in the region, the existence of well-established **state capture and oligarchic networks** interlinked with Russian state-owned monopolies and their state-backed contracts, as well as the spike in geopolitical rivalry and sanctions have contributed to the increase in IFFs. Through **offshore channels and informal financial networks**, Russian-linked firms invest in strategic sectors, such as energy, banking, construction, and transportation, while shielding their ownership and evading Western sanctions. This process not only facilitates the reinvestment of illicit funds into domestic economies but also ensures that strategic assets remain under Russian control, allowing Moscow the **leverage to shape policy decisions and influence electoral processes**. In that way, by manipulating financial networks and engaging in **investments, which involve elements of strategic corruption**, the Kremlin is further eroding financial transparency and undermining regulatory oversight.⁴⁴ The complicity of both state and non-state actors contributes to this growing challenge, further eroding EU accession, rule of law and anti-corruption, capacity-building efforts.

Geopolitics Begins at Home: Address the IFFs, State Capture, Foreign Interference Nexus

For the EU to **become a geopolitical player**, it should step up its engagement with the region of the Western Balkans and the Black Sea, providing a **robust political timeline for accession, without giving up on conditionalities**, first and foremost based on the core democratic values of rule of law and human rights. Candidate countries must **align their foreign policies**

with those of the EU, including on economic security and sanctions. No European country has a fundamental geoeconomic interest in being associated with an aggressive, non-democratic Russia. However, individual leaders and networks involved in state capture have vested interests and have **exploited the US and NATO security guarantee and European economic solidarity** to water down and circumvent sanctions on Moscow, thereby reinforcing IFFs, corruption, and state capture.

Geopolitical rivalries culminating thus far in Russia's war in Ukraine and the imposition of unprecedented economic security measures and sanctions, have considerably widened the opportunities for IFFs, even changing their very definition and needed policy responses. With the introduction of sanctions, **IFFs have transcended from the realm of strictly illegal into unwanted or undesirable transactions**, enormously expanding the discretionary powers of national enforcement authorities to define IFFs, and respectively the scope for **leverage through strategic corruption and state capture**. Addressing these new challenges has pushed the EU into considering policies for **strategic autonomy and economic security**, and in reinforcing its core democratic values.

Deploy an Effective and Coherent Economic Security Strategy Based on Trade and Investment Flows Diversification

In the new geoeconomic reality of rapidly increasing security threats, economic coercion and trade wars, the EU should **leave behind its reactive attitude** and assert itself as an independent player that protects the security and competitiveness of its members, candidate and potential candidate countries, and **projects it globally**. In terms of **economic security**, the EU, Western Balkans, and the Black Sea countries should **modernise their trade policies** to embed diversification and resource security priorities. They should **limit the use of opaque state-to-state bilateral trade and investment agreements** negotiated behind closed doors and strengthen the regulation and oversight of free trade zones (FTZs). All countries should implement **investment screening** (linked to EU regulations and best practice, as exercised in France and Germany⁴⁵) to prevent illicit capital from entering critical infrastructure and key sectors.

⁴⁴ Shentov, O., Stefanov, R., and Vladimirov, M. (eds.), *The Kremlin Playbook in Europe*, Sofia: Center for the Study of Democracy, 2020; Stefanov, R., et al., *The Kremlin Playbook in Southeast Europe: Economic Influence and Sharp Power*, Sofia: Center for the Study of Democracy, 2020.

⁴⁵ Markov, D., and McLaren, R., *Forging the Shield: National Economic Security Policies in an Era of Global Uncertainty*, Sofia: Center for the Study of Democracy, 2024.

The EU has rightly focused on developing a viable **positive economic statecraft** by increasing its public investment resources for the Western Balkans and the Black Sea, yet demanding quick and sustained pace of reforms, and including them in the *Rule of Law Report* mechanism applied to the member states. In particular, the *Growth Plan for the Western Balkans* and the funding provided under the *Reform and Growth Facility* and the *Ukraine Facility* present an excellent opportunity for the countries to **decouple economically from Russia**, develop their own, decarbonised energy markets, and create new industrial supply chains.

However, there is a need for an **EU management and oversight mechanism** in place to guarantee corruption and state capture – free implementation and local buy-in. This mechanism should work in parallel to civil society's watchdog function, as well as the procedures for holding wide public consultations on the countries' Reform Agendas.

Developing Early Warning Mechanisms at EU Level

In addition to upholding the rule of law, the EU should also employ a **centralised early warning system** to detect in real time spikes in IFFs linked to sanctions evasion and broader national security concerns. Vulnerable industries should be monitored to flag high-risk deals. EU-level efforts should be supported by **regional monitoring groups**, focused on trade, with active participation from civil society organisations across Europe, including in the Western Balkans and the Black Sea regions. Available risk assessment mechanisms should be duly utilised. For example, CSD's *State Capture Assessment Diagnostics (SCAD) methodology*⁴⁶ is capable of detecting institutional enablers, legal gaps and monopolization trends in key sectors, while the *Monitoring Anticorruption Policy Implementation (MACPI) tool* could be applied in high-risks sectors to evaluate the effectiveness of anti-corruption measures in critical enforcement institutions.⁴⁷ And last, but not least – national governments should continuously educate **state and non-state actors** (tech companies, shipping services and intermediaries) of the risks of **evading sanctions and of law enforcement consequences**.

⁴⁶ Stoyanov, A., Gerganov, A., and Yalamov, T., *State Capture Assessment Diagnostics*, Sofia: Center for the Study of Democracy, 2019.

⁴⁷ Gerganov, A., *Monitoring Anti-Corruption Policy Implementation in High-Risk Sectors*, Sofia: Center for the Study of Democracy, 2021.

Implications for the Global South

The **Global South** faces similar challenges related to the spread of IFFs due to governance gaps and could draw valuable lessons from the experiences of the Western Balkan and Black Sea countries. However, the Global South does not benefit from the EU's rule of law frameworks and associated enlargement conditionalities, while suffering from a higher prevalence of **authoritarian and hybrid regimes and state capture**. The **BRICS countries**⁴⁸ claim to propose an alternative model of global governance, distinct from that of the West, yet its main features, policy implications, and enforcement mechanisms remain vague at best, and in any case lack the depth and detail of the EU conditionality and human rights-based development model. BRICS' model often supports state capitalism and state capture, raising concerns about its potential to normalise the flow of politically motivated, state-driven capital into vulnerable economies, and displace Western businesses and aid.⁴⁹ Moreover, **offshore destinations and tax havens**, such as the British Virgin Islands (BVI), Panama, Curaçao, and the Cayman Islands, serve as major repositories for the financial assets of kleptocratic regimes and sanction evasion.⁵⁰

Development assistance, when effectively implemented, can serve as a powerful tool against the global IFFs and state capture threat.⁵¹ Key initiatives such as *EU's Global Gateway (EUR 300 billion)*, *World Bank's Program on Anticorruption for Development*, *the Alliance for Security, Justice and Development (USD 1 billion)*, and *the African Development Bank's partnership combatting illicit finance*, could play a crucial role in this effort. However, for these initiatives to achieve lasting impact, the development community must also:

- Lead the establishment of a **regular IFFs and state capture monitoring procedures**.

⁴⁸ Brazil, Russia, India, China, South Africa, along with Egypt, Iran, the United Arab Emirates, Saudi Arabia, and Ethiopia.

⁴⁹ Stefanov, R., Tsabala, K., and Trifonova, G., "The BRICS Conundrum in a World in Flames: Time for the EU to Rise to the Challenge?", *CSD Blog Post*, 13 October 2023.

⁵⁰ Vladimirov, M., and Osipova, D., *Global Reach: The Kremlin Playbook in Latin America*, Sofia: Center for the Study of Democracy, 2024.

⁵¹ Stefanov, Tsabala, and Trifonova, "The BRICS Conundrum in a World in Flames", *CSD Blog Post*, 13 October 2023..

- Build capacities among financial regulators, central banks, anti-trust authorities, and national security agencies for **assessing opaque investments, flagging high-risk deals and related security threats**. This could include the adoption of the Financial Action Task Force (FATF) standards for performing background checks and reporting suspicious transactions.
- Propose **guidelines for ensuring free competition and business transparency**, as well as rules for signing bilateral trade agreements based on cost-benefit analysis.
- **Boost foreign investments from democratic market economies**, including through the development of strategic economic partnerships based on mutual preferential treatment of trade flows and cooperation on large-scale projects.
- **Pressure offshore financial hubs to block financial transfers** linked to sanctioned entities, oligarchic networks in authoritarian states and organised criminal networks.⁵²

⁵² Vladimirov, and Osipova, *Global Reach: The Kremlin Playbook in Latin America*, Sofia: CSD, 2024.