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Shadow Economies

The Rise of Illicit Networks and Alternative Markets in Sanctions Circumvention

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DEMOCRACY

This working paper examines illicit financial flows (IFFs) in the Western Balkans and Black Sea regions, shedding light on their scale, drivers, and consequences. Covering ten countries – Albania, Montenegro, Serbia, North Mace-donia, Bosnia and Herzegovina, Kosovo, Georgia, Moldova, Ukraine, and Armenia – the analysis combines trade data with econometric methods to estimate the magnitude, correlations, and impacts of IFFs. The paper explores in particular the dynamics of IFFs in trade with a focus on sanction evasion, strategic corruption, conflict financing, economic stability and implications for development assistance to the Global South.

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ILLICIT FINANCIAL FLOWS IN FRAGILE GEOECONOMIC REGIONS

Illicit Financial Flows (IFFs) refer to the movement of money across borders that is illegal or unreported, typically through mechanisms like trade misinvoicing, money laundering, tax evasion, and corruption.[1] So far, the focus of research in IFFs has been closely related to its illegality (e.g. money laundering) as opposed to its illicit aspects, such as policy undesirability or unacceptability.[2,3] With renewed global power competition, exemplified most starkly by large-scale wars in Europe, Asia and Africa, the creation of new antagonistic geopolitical structures such as BRICS, the imposition of massive economic sanctions, and the use of economic coercion for achieving foreign policy aims, the global rule of law framework has unraveled, widening the gap between illegal and illicit. When illegal, these flows undermine economic development by eroding trust in and legitimacy of institutions and discouraging investment. Yet their size and negative impact is significantly amplified when considering potential illicit aspects, such as circumventing sanctions on goods necessary to sustain military operations as has been the case of Russia's war in Ukraine. Such IFFs are potentially considerably more damaging to global development assistance, by rendering investment and aid flows from sanctioned countries unwanted or corrosive, while diminishing trust in the established global development system around the UN, the World Bank and IMF, which Russia and China, for example seek to actively disrupt or challenge.

Estimates suggest that global IFFs can range from USD 125 billion to USD 15 trillion[4], highlighting their significant share of the world economy, but also uncertainty and complexity in accurately measuring the scale of illicit activities that underpin them.[5] Trade misinvoicing is a key channel of IFFs making up over 50% of total IFFs in many developing and emerging economies. Given increasing trade volumes in the global economy, rates of detection are low, despite being a critical target in efforts to combat IFFs at national and global level.[6]

Trade misinvoicing, through mislabeling or misclassifying goods, third-party invoicing, over- or under-valuation of shipments, false end-user certifications, or splitting shipments, enables illicit financial flows to bypass sanctions and regulations. Misinvoicing is often used to disguise the true nature of trade

1 International Monetary Fund (IMF), The IMF and the Fight against Illicit Financial Flows.

2 Institutional Review Board, Illegal and Illicit Behavior.

3 Legal Information Institute, Cornell Law School, Illicit.

4 Ferwerda, J., Unger, B., "How Big Are Illicit Financial Flows? The Hot Phase of IFF Estimations", - In: Unger, B. (ed.) et al., *Combating Fiscal Fraud and Empowering Regulators: Bringing tax money back into the COFFERS*, 2021, pp. 75–88.

5 Ibid (selected estimations of illicit financial flows).

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

transactions, particularly when involving critical and sensitive (so-called "dual-use goods") technologies with military applications. Sanctions evasion and illicit trade has become a much higher risk area of IFFs with the explosion of sanctions following Russia's invasion of Ukraine in 2014 and in 2022.[7]

This working paper analyses IFFs across ten countries – Albania, Montenegro, Serbia, North Macedonia, Bosnia and Herzegovina and Kosovo (hereafter Western Balkans), and Georgia, Moldova, Ukraine, and Armenia (hereafter Black Sea countries), using quantitative and qualitative methods. This includes the use of trade data and econometric techniques to estimate the scale, correlations and impact of illicit flows. The paper explores in particular the dynamics of IFFs in trade with a focus on sanction evasion, strategic corruption, conflict financing, economic stability and implications for development assistance to the Global South.

Methodology

To estimate the IFFs from trade misinvoicing, the analysis applies the Partner Country Method (PCM+) and the Gross Excluding Reversals (GER) methods – part of the six UNCTAD approaches for measuring IFFs.[8] The PCM+ method is used to detect illicit financial flows based on traders deliberately misreporting the value, quantity, or classification of goods in cross-border transactions to evade taxes, launder money, or shift profits. By fraudulently manipulating the price, quantity, or quality of a good on an invoice submitted to customs, substantial sums of money can be shifted across international borders.

This statistical approach compares import and export values reported by one country with the corresponding export and import values reported by its partner country. The trade gap is focused on the discrepancy in trade transaction values. The largest assumption guiding this method is that trade statistics are sufficiently accurate and comparable to treat differences in mirror statistics as misinvoicing, which makes it directly applicable to measuring tax and commercial IFFs as such.

The PCM+ method was applied in all target countries by using the International Monetary Fund Trade Database[9] (IMF DOTS), which provides detailed information on the value (volume) of merchandise trade between countries. The data focuses on the direction of trade showing exports and imports of goods between the 10 countries and the world and vice versa.

The CIF-to-FOB ratio[10] is a key concept in the PCM+ method. It helps correct discrepancies between different trade reporting systems, ensuring that trade data is comparable and accurate. The application of the method requires estimating the CIF-to-FOB ratio while considering the trade orientation of each

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7 Lewis, D., Prelec, T., *New Dynamics in Illicit Finance and Russian Foreign Policy*, T., SOC-ACE Research Programme.

8 UNCTAD, *Methodological guidelines to measure tax and commercial illicit financial flows - Methods for pilot testing*, 2021.

9 IMF, Direction of Trade Statistics.

10 Cost, insurance, and freight (CIF) and free on board (FOB) are international shipping agreements used in the transportation of goods between buyers and sellers.

of the 10 target countries - whether export- or import-driven in a given year. Additionally, it must reflect commodity-specific ratios, accounting not only for the monetary trade value but also for the physical quantity of each commodity.

Although the PCM+ could be applied in most cases, the CIF-to-FOB ratio could not be directly derived from the available IMF DOTS or even UNCTADstat data[11], as both databases provide information only on trade volume (value) and not on exact quantity. The COMEXT database by Eurostat[12] is the only source offering both value and volume data, but it covers only 9 out of the 10 target countries, excluding Armenia, and does not provide "world-to-country" data, which is required to apply the PCM+ method.[13]

Therefore, the paper uses the **standardized 1.1 CIF-to-FOB ratio to overcome some of the limitations** in the data and ensure a more consistent and accurate data on trade flows across the 10 countries. The 1.1 CIF-to-FOB ratio is a practical method for adjusting the differences in reporting standards between exporting countries (FOB) and importing countries (CIF). This adjustment simplifies the comparison of trade data, making it easier to identify anomalies that may indicate misinvoicing.[14,15]

The PCM+ method was combined with the Gross Excluding Reversals **(GER) method**. While both methods are effective for detecting IFFs, GER is often preferred for its ability to explicitly identify import over-invoicing (which facilitates illicit outflows) and import under-invoicing (which brings illicit funds into a country). In contrast, PCM+ primarily focuses on trade mismatches between partners, potentially missing certain instances of trade-based money laundering.

GER treats total illicit inflows and outflows separately, without offsetting them, while PCM+ calculates net trade discrepancies, which means that in-

11 UNCTAD, UNCTADstat Data centre.

12 Eurostat, Database.

13 Several other challenges arise when using Eurostat's Comext database: PCM+ method equation to calculate CIF to FOB ratio cannot be directly applied despite having the quantity from the Comext Database since the formula itself asks for: CIF price declared by importer, FOB price declared by exporter, declared quantity by importer, and declared quantity by exporter. The quantity comparison cannot be extracted from the Easy Comext database; hence, it is not possible to complete the formula. It is also specified that the ratio is to be calculated for specific goods, commodities, and trading partners, which again brings us to the limitation of downloading and organizing the data.

14 There are CIF–FOB differences because export value is mostly reported on an FOB basis, while import value is on a CIF basis. The CIF–FOB differences result in a higher import value than export value. The International Monetary Fund estimates that, on average, the CIF price is greater than the FOB price by 10 per cent. Similarly, research about CIF–FOB ratios of CEPII covering more than 200 countries and 5000 products between 1994 and 2007 reveals that there is a stable gap of 10 per cent in terms of value of trade for exports, and of 5 per cent for imports. Normally, the means that the CIF–FOB ratios are in the range of 1.05 to 1.1.

15 In their Illicit Financial Flows to and from Developing Countries: 2005-2014, GFI discusses how the CIF/FOB ratio is used to adjust trade data for comparability between export and import values. They also assume a constant 10% markup on the FOB value for imports to make them comparable to export data, which is equivalent to applying a 1.1 multiplier to convert CIF values to FOB values. In simpler terms, GFI adjusts the import data by multiplying by 1.1 (representing a 10% markup) to align the CIF values with the FOB export values. This 1.1 factor reflects the assumption that transport costs account for 10% of the value of the goods.

flows and outflows can balance each other out, potentially underestimating the total scale of IFFs. PCM+ depends on high-quality, matched trade data from both trading partners, which is often not available. On the other hand, GER 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 working paper applies PCM+ to compare trade data flows between the 10 countries and the world, examining import CIF versus export FOB values. Meanwhile, GER is used to calculate illicit inflows and outflows for each country. Total IFFs are the sum of the estimated illicit outflows and illicit inflows.

According to the GER method, illicit outflows are calculated by summing positive trade discrepancies across partners, while illicit inflows are based on negative discrepancies.[16] These are derived from differences between (i) a country's reported exports and the world's recorded imports from that country, and (ii) the country's reported imports and the world's recorded exports to that country.

Links between IFFs and Sanctions Evasion

The paper estimates the changes in IFFs in the Western Balkans and the Black Sea region resulting from sanctions evasion related to Russia's war in Ukraine. It seeks to analyze how the scope of IFFs has expanded with the introduction of sanctions and what are the steps the EU, UK, and other Western development agencies can undertake to better adapt their strategies to the dual challenge of IFFs growth in capacity and resource poor regions that lie on geopolitical fault lines. The paper tests the following hypotheses:

- *First, the increase in the EU's exports of dual-use goods to the ten target countries is linked to the evasion of the G7+ trade sanctions against Russia.*
- *Second, there is a positive relation between the increase in dual-use goods (re-) exports to Russia and the rise in IFFs (estimated via PCM+ method) after 2021.*

The testing of the **first part** of the hypothesis relies on the **error correction model (ECM)** for cointegrated variables.[17] It was applied to all ten target

[16] Lépissier, A., Davis, W., and Ibrahim, G., P., *Presenting a new atlas of illicit financial flows from trade misinvoicing*, Brown University, 2022.

[17] Cointegration refers to a statistical relationship where two or more non-stationary time series move together in the long run, meaning their linear combination remains stable despite short-term fluctuations. This indicates a long-run equilibrium between the variables. When time series are cointegrated, standard regression models may produce misleading results due to spurious correlations, requiring the use of an error correction model (ECM). The ECM, implemented using STATA, separates long-run equilibrium (LR) effects from short-run dynamics (SR) and includes an adjustment term (ADJ), which measures how quickly deviations from equilibrium are corrected. A significant negative coefficient for the ADJ term indicates a stable adjustment process, ensuring that short-term fluctuations do not stray from the long-run equilibrium.

countries, as well as to three additional economies – Kazakhstan, Kyrgyzstan and Türkiye -- that are used as benchmarks due to their well-documented role as trade hubs for dual-used goods shipped (re-exported) to Russia.

Standard regression models can give misleading results when used with data that changes too much over time. As expected, trade flows showed strong fluctuations after February 2022, and tests confirmed that some of the variables were not stable. Because of this, the next step was to check for cointegration – basically, to see if the variables still move together in the long run, even if they drift apart in the short term. In our model:

- The **dependent variable** is the **respective country's exports to Russia**.
- The **independent variable** is the **EU's exports to that country**.

The presence of cointegration justified the use of an ECM, which captures both the long-term equilibrium relationship and short-term dynamics. Based on the statistical properties of the variables, we selected the Autoregressive Distributed Lag Error Correction Model (ARDL-ECM) as the appropriate type of ECM.

To test the **second** hypothesis, we conducted a simple correlation analysis to assess the potential validity of the assumption and began identifying independent and control variables that could support a more robust regression analysis, contingent on data availability.

TRADE DEPENDENCE AND EXPOSURE TO RUSSIA

To understand the patterns of IFFs from trade, it is crucial to assess the broader economic and trade dynamics of the countries of the Western Balkans and the Black Sea region. This includes the analysis of their economic exposure and ties to Russia, and how this dependence impacts the scale and nature of IFFs.

Trade Structure

Russia's full-scale invasion of Ukraine in February 2022 has intensified the economic and political insecurity in all countries in the Western Balkans and Black Sea region. While all of them have gradually strengthened their ties with the EU, they remain heavily influenced by pro-Russian political and business interests.

Russia has consistently run trade deficits with all ten countries over the past 14 years, depleting their scarce financial resources often with practices of monopolistic pricing or state capture-related rent extraction. One major exception is **Ukraine**, which has sharply reduced its trade with Russia after the annexation of Crimea in 2014. In 2023, **Armenia, Georgia**, and **Serbia** recorded the highest trade deficits with Russia as a share of national GDP, followed by **Moldova** and **Bosnia and Herzegovina**. These have been driven not only by fluctuations in oil and gas prices and the region's heavy reliance on Russian energy and raw materials, but also by the broader economic impact of Russia's 2022 invasion of Ukraine. The war has increased market volatility and inflationary pressure, disrupted supply chains, and triggered shifts in trade routes due to sanctions. These developments have further strained national economies and deepened structural vulnerabilities across the region.

Since 2023, Armenia's trade deficit with Russia (4% of its GDP) has grown due to its persistent energy dependence at high energy import prices and its role as a key trade (re-export) hub for Russia amid tightening international sanctions on Moscow, as shown in Figure 1. The re-export of goods to and from Russia has fuelled Armenia's economic growth. Before Russia's full-scale invasion of Ukraine, trade between Armenia and Russia was valued at around USD 2.5 billion annually, a figure that skyrocketed to USD 12 billion in 2024.[18] This growing economic dependence has further locked the country into geopolitical dependence on Moscow even in times when many other post-Soviet countries have made bold attempts to pull away from Russia's sphere of influence.

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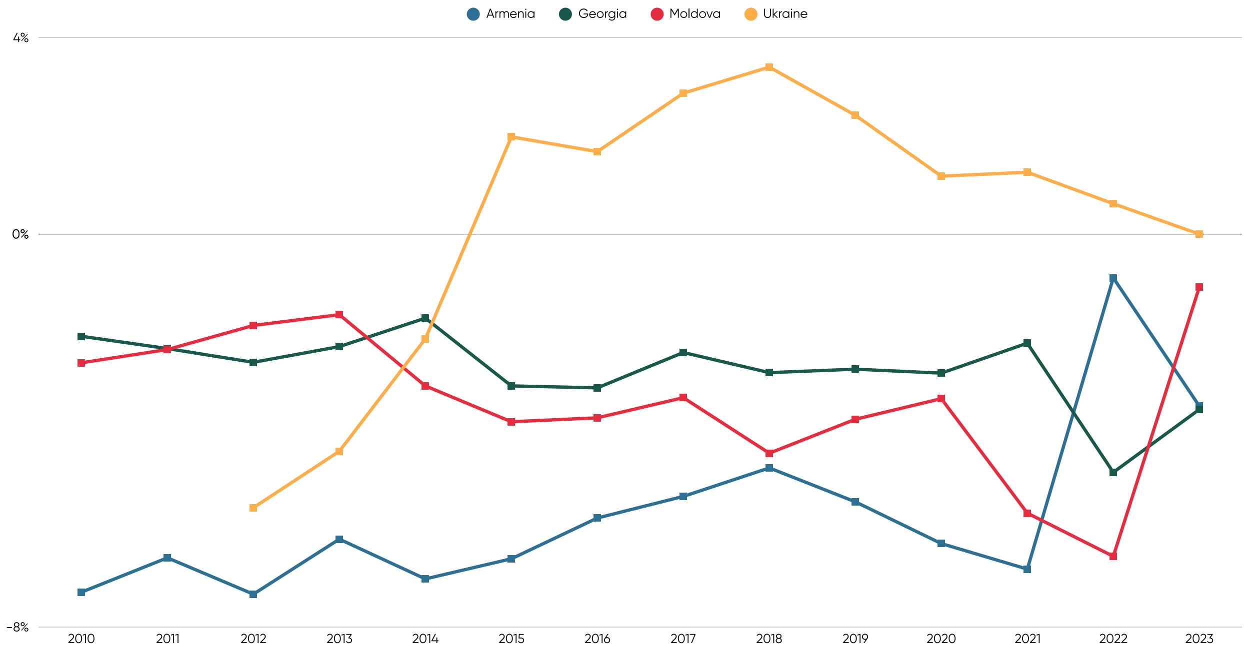
[18] Mgdesyan, A., "Trade Turnover Between Russia and Armenia Reaches $12 Billion – Lavrov", *Business Media*, 21 January 2025.

Figure 1. Bilateral Trade Deficit (-) of Armenia, Georgia, Moldova and Ukraine with Russia as a Share of GDP (%), 2010-2023

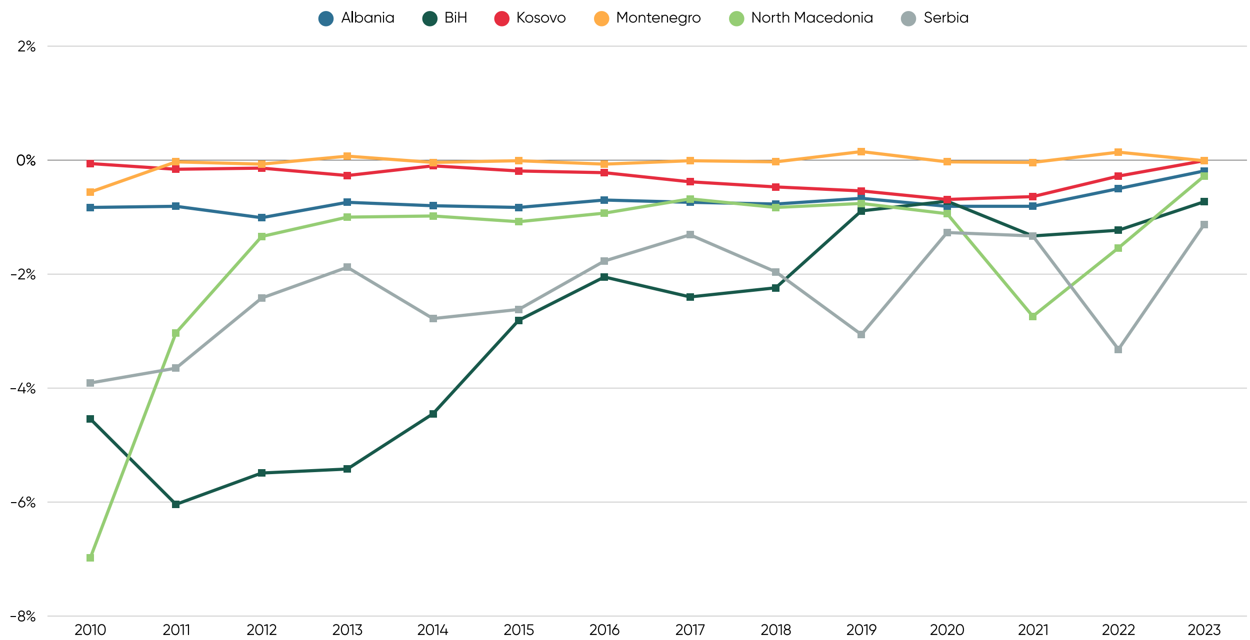


Source: CSD, based on data from Eurostat International Trade Database (Comext).

Albania, Kosovo, Montenegro and **North Macedonia** have maintained a negative but marginal trade deficit with Russia and an overall small bilateral trade turnover (Figure 2). The four countries imported Russian goods worth only USD 142 million in 2023, down from USD 874 million in 2010.[19] Albania's imports from Russia have fallen to below USD 50 million, mostly in petroleum products. North Macedonia, which used to import more than USD 300 million in oil derivatives from Russia, has now diversified its supply to the refineries in Greece. The only major Russian import remains small volumes of natural gas. Still, Russia remains a key energy supplier, especially to Serbia and Bosnia, which rely on Russian gas for almost 100% of their needs.

[19] In fact, Kosovo has almost no trade with Russia.

Figure 2. Bilateral Trade Deficit of Western Balkan Countries with Russia as Share of GDP (%), 2010-2023



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

Although imports from Russia into the **Western Balkans** have decreased by approximately one-third in 2023 (from USD 3 billion in 2010-2014 to USD 2 billion) (Figure 4), exports to Russia from the region have increased by 67% (from USD 571 million in 2010 to USD 957 million in 2023) (Figure 3).

In the **Black Sea region**, Russian imports have dropped sharply by 92.8%, from USD 28 billion in 2012 to USD 2 billion in 2023. The majority of this decline is driven by **Ukraine, which has gradually decoupled its economy from Russia** since the annexation of Crimea in 2014. The decline is also significant in Georgia and Moldova, even though exports to Russia there constitute a large portion of GDP. In a similar dynamic, Russian exports to the region have decreased from USD 18 billion in 2012 to just USD 805 million in 2023.

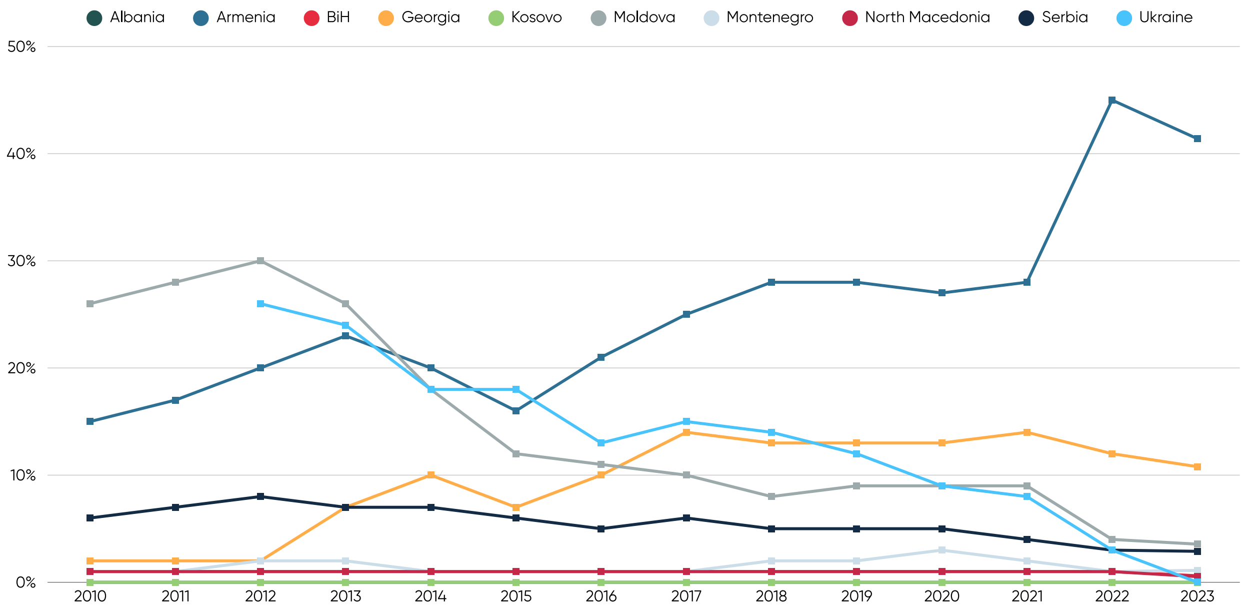
Armenia stands out as an exception to the broader regional trend. Between 2010 and 2023, the country saw a 425% increase in imports from Russia (Figure 4), reaching USD 4 billion - equivalent to 18% of Armenia's GDP in 2023. Additionally, Armenia's exports to Russia skyrocketed by over 2000%, totalling USD 3 billion in 2023 -accounting for 34% of Armenia's total exports. Russia has become Armenia's largest and fastest-growing trading partner since 2022.[20]

While **Armenia's economy has shown resilience, it remains small and highly vulnerable**. Its trade dependency on Russia, combined with a limited industrial base and the impact of sanctions, leaves Armenia at risk of an econom-

[20] Observatory of Economic Complexity (OEC) data, Armenia.

ic downturn and a rise in illicit finance and money laundering if sanctions enforcement tightens. Such a shift could lead to rising inflation, increasing national debt, a growing budget deficit, and sharp devaluation of the national currency. [21]

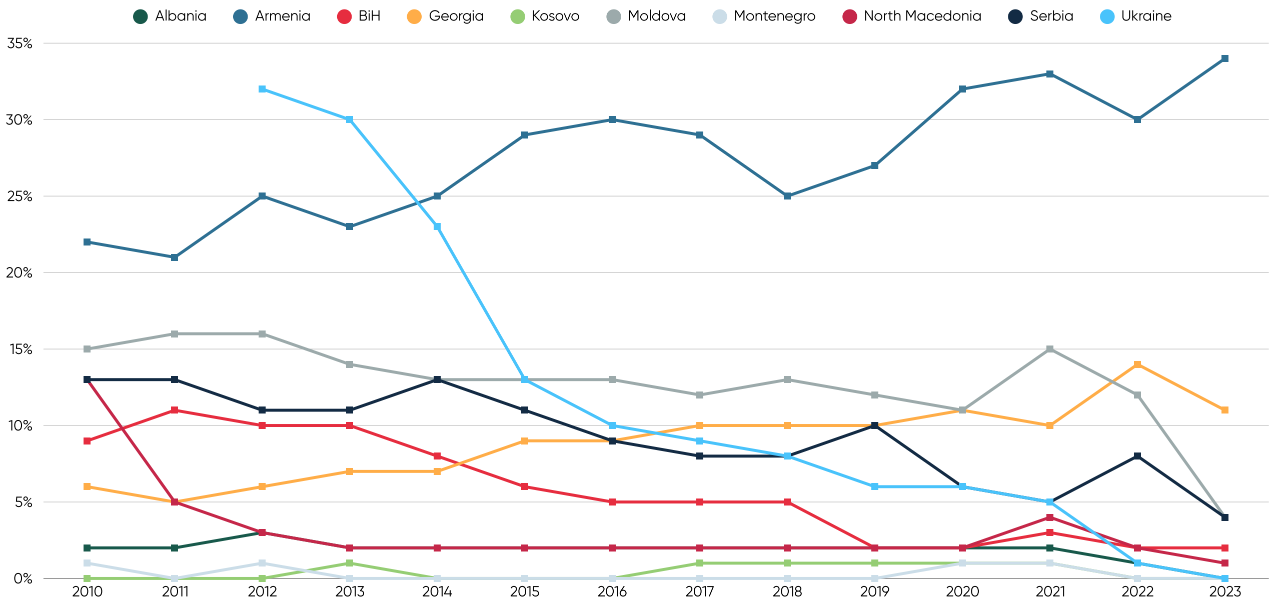
Figure 3. Exports to Russia as Percentage (%) of Total Export per Year



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

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

Figure 4. Imports from Russia as Percentage (%) of Total Export per Year



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

Russia Weaponising Energy and Import Bans

Over the past two decades, Russia has solidified its economic influence in the Black Sea region by using a wide range of tools of political and economic coercion, most notably weaponising energy dependencies. The Kremlin has continuously aimed to slow down and hinder the region's Euro-Atlantic integration. Georgia, Ukraine and Moldova have had to contend with the de facto Russian occupation of parts of their territories and have faced the full spectrum of Russian influence operations.

Georgia's proximity to Russia and the presence of Russian troops in the breakaway territories of Abkhazia and South Ossetia, territories recognized by Moscow as independent in 2008, leave it vulnerable to a potential Kremlin aggression against the country's sovereignty, which likely explains the government's more conciliatory stance toward Russia on several issues since 2022.

Moldova has been among the most vulnerable and worst affected states of the Russian war in Ukraine and its **weaponisation of energy supplies**. Similar to Armenia, Moldova has been heavily exposed to Russian energy imports. The threat of **discounting gas supplies has long** been an instrument Russia has used to wield influence over the country's foreign and strategic direction, such as EU membership. This dependency is compounded by the energy relationship with the **Russia-controlled separatist region of Transnistria**, which supplies around 60% of Moldova's electricity through the MGRES power plant. In return, Moldova provides Transnistria with gas, creating a strong energy interdependence. To diversify its energy supplies, since 2022 Moldova started importing small volumes from Romania and Southeast Europe.[22]

Following the results from a national referendum, Moldova amended its Constitution in 2024 to prioritize EU membership, aiming to alleviate its energy dependence on Russia with the help of the EU. In response, in January 2025, Russia's **Gazprom suspended gas deliveries to Moldova**, **including Transnistria, despite a valid contract until 2026, triggering a humanitarian crisis** with rolling blackouts. In response, the EU provided Moldova with a support package to ease rising energy costs, aiming to reduce Moldova's dependence on Russian energy. **This was not the first time Russia has weaponised energy supply against Moldova**.

On the other side, Armenia is far from the EU and shares borders with three assertive regional powers all with close ties to Moscow - Iran, Türkiye and Azerbaijan - which have all emerged as hubs for circumventing Western sanctions against Russia. Small and poor, both Armenia and Moldova have had successive pro-European governments but also strong pro-Russian domestic political forces and economic agents, making the **countries vulnerable to the full array of coercion from the Kremlin's Playbook**.[23]

Russia is still Armenia's **main security** and **energy provider,** particularly in gas and nuclear. Around 85% of Armenia's gas is imported from Russia, with gas also fueling thermal plants that generate nearly 70% of the country's electricity.[24] **In 2023, Russia reportedly halted the gas pipeline running through Georgia to Armenia for two months**, a move not publicly disclosed by the Armenian government.[25] This was not the first time Russia stopped gas supplies to Armenia in response to disagreements over its foreign and security policy, revealing how Russia is able to exert pressure on the Armenian government when its actions or stance are not aligned with Moscow's interests. Most notably, Russia let Azerbaijan take over the Nagorno Karabakh region in September 2023, following a single day offensive by the Azeri forces. Many believe Russia's passive attitude has been related not only to its ongoing war in Ukraine but also as a way of punishing Armenia for its efforts at reducing its dependence on Moscow.

Prior to 2014, Ukraine and Russia have had strong trade relations, with Russia being Ukraine's largest trading partner. Ukraine exported agricultural products, coal, and industrial goods to Russia, while importing energy, machinery, and technology. Ukraine's dependence on Russian natural gas, often at discounted prices, and its role as a key transit country for Russian gas exports to Europe, created a deep economic interdependence. **Russia exploited its enormous economic influence to exert political pressure**, including by trying

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[22] Center for the Study of Democracy, *Energy (IN) Security and Good Governance in Moldova: Making the Energy Transition Possible*, Policy Brief No. 143, January 2024.

[23] Conley, H. A. et al., *The Kremlin Playbook: Understanding Russian Influence in Central and Eastern Europe*, Lanham: Rowman & Littlefield, October 2016.

[24] International Energy Agency, Armenia 2022: Energy Policy Review, March 2022.

[25] Waal, T., "Armenia Navigates a Path Away from Russia", *Carnegie Russia Eurasia Center*, 11 July 2024.

to block Ukraine's aspirations to join the EU and NATO, through a series of gas supply cuts in 2006, 2009, and 2014.[26,27,28]

Russia uses the structural trade imbalances as a point of leverage over countries, particularly those of the former Soviet Union. **The Kremlin has systematically imposed targeted import bans to exert economic and political pressure on neighbors.** Over 50% of Armenia's economy and more than 80% of its agricultural sectors depend on Russia.[29] Similar structural trade dependencies exist in all post-Soviet countries from the region even if not to the same degree as in the case of Armenia. Whenever countries such as Moldova, Armenia, Georgia and Ukraine have tried to diversify their political relations, in particular considering deeper Euro-Atlantic integration, Russia has introduced economic coercion measures to pressure them to abandon their plans. While these actions have often forced local producers to modernize and shift their export markets to the EU, the diversification efforts have been only marginally successful as the Russian market remains the most important one for agricultural exporters from the region.[30]

In response to the international sanctions after the annexation of Crimea in 2014, Russia has banned the import of agricultural products from countries that sanctioned Moscow, including **Albania** and **Montenegro**.[31] Russia embargoed fruit imports and ended duty-free exemptions from Moldova that same year after it signed a free-trade deal and association agreement with the EU. Russia employed similar tactics against North Macedonia. Russia had been one of the largest markets for North Macedonian agricultural exports, and North Macedonia's economy is still heavily dependent upon its agricultural sector. After the invasion, North Macedonia has aligned with the U.S. and EU sanctions against Russia and even expelled 11 Russian diplomats for violating diplomatic norms in 2022.[32] Widely seen as a retaliatory move, Russia temporarily banned all plant imports from North Macedonia, citing the discovery of a "highly dangerous" stink bug on a Macedonian apple.[33]

Similarly, just days after Armenia moved to ratify the International Criminal Court's founding Rome Statute, Russia banned Armenian dairy imports. Soon after, it extended the ban to agricultural products from both Armenia and Moldova, citing "sanitary concerns." With both economies heavily reliant

26 Russia's Economic Influence and Corrosive Capital in Eastern Europe: Ukraine, Moldova and Armenia, Center for the Study of Democracy (Unpublished report).

27 Center for the Study of Democracy, *EU and NATO's Role in Tackling Energy Security and State Capture Risks in Europe*, Policy Brief No. 47, February 2015.

28 Ibid.

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

30 Deisadze, S., Gelashvili, S., and Seturidze, E., *An Overview of the Georgian Wine Sector*, Free Network, 21 November 2022.

31 Tomovic, D., "Russia Extends Sanctions to Include Montenegro", *BalkanInsight*, 14 August 2015.

32 Aljazeera, North Macedonia orders expulsion of five Russian diplomats, 28 March 2022.

33 Lomsadze, G., "Russia Bans Armenian Dairy as Relations Continue to Sour", *Eurasianet*, 3 April 2023.

on the Russian market, these restrictions placed significant pressure on local farmers.[34]

Taking advantage of the EU sanctions imposed on Moscow in 2014, **Bosnia and Herzegovina** significantly increased its exports of fruits and vegetables to the Russian market. However, this surge turned problematic when in 2016, Russia imposed a temporary import ban on Bosnian fruits and vegetables, citing safety concerns.[35] Although the ban lasted just over 10 weeks, it significantly impacted the viability of Bosnian fruit and vegetable producers.

All these sanctions and countersanctions impact the flow of trade and related finances leading to potential increases in IFFs, complicating their analysis and counteraction.

Russia's Economic Footprint in the Western Balkans

Russia has increasingly sought to leverage its economic footprint in the Western Balkans, on the back of diplomatic support for political leaders seeking to bank on nationalistic feelings opposing their country's officially stated EU-integration efforts, capitalising on widespread state capture practices among local elites, and exploiting the region's ethnic and social rifts.[36] The Kremlin has amplified its influence by wielding the whole range of soft and sharp power instruments, such as supporting mainstream and fringe political parties, employing media disinformation, cultural and religious ties, sponsoring civil society activities, and activating former and current security services' networks.[37]

Kremlin-linked capital has been invested in strategic sectors and enterprises in the region, such as energy, infrastructure, communications, finance, and retail. Russian state-owned companies and financial institutions have acquired some of the region's largest enterprises. Russian oil and gas companies have played a significant role in blocking energy diversification and hindering the liberalization of energy markets in the region, **guaranteeing monopolistic profits and rents, readily available for re-investment in state capture**. They have secured control over major refineries, fuel distribution networks, and gas transmission and storage facilities throughout the Balkans.[38] Dependence on Russian oil and gas became the core element of the Kremlin Playbook as it has become a financial and political vehicle for entrenching further the **informal networks of influence, relying on illicit finance** to further their state capture tactics.

Under pressure from U.S. sanctions, **Serbia** has since the end of 2024 taken steps to reduce its energy dependence on Russia, halting Russian crude oil

34 Ibid.

35 Toè, R., "News Russian Ban Alarms Bosnia Fruit Producers", *BalkanInsight*, 5 August 2016.

36 Shentov, O., Stefanov, R., Todorov, B. (eds.), *Shadow Power: Assessment of Corruption and Hidden Economy in Southeast Europe*, SELDI and Center for the Study of Democracy, 2016.

37 Conley, H. A. et al., *The Kremlin Playbook: Understanding Russian Influence in Central and Eastern Europe*, Lanham: Rowman & Littlefield, October 2016.

38 Center for the Study of Democracy, *Russia's Economic Influence in the Balkans: Tackling Kremlin's Sharp Power*, Policy Brief No. 89, November 2019.

deliveries via Croatia and forcing Gazpromneft to divest from NIS. However, Serbia remains a key transit hub for Russian gas through **TurkStream - the largest remaining route for Russian gas exports to Europe** - while continuing to attract further investments from Gazprom other gas-related projects. At the same time, **Serbia established itself as a gateway for Russian citizens barred from direct travel to the EU**, and has refused to enforce international restrictions on dual-use goods trade with Russia – becoming a critical backdoor for circumventing Western sanctions. Serbia's continuing breaking of ranks with EU's foreign, trade and sanctions policies has made the country a prime regional hub for Russia-related IFFs.[39]

Russia also wields disproportionate economic and political influence in Bosnia and Herzegovina through Republika Srpska (RS), where it maintains strong ties with the entity's leadership. **RS imports Russian natural gas via TurkStream and previously hosted a Russian-owned refinery closely linked to the power structure of the Pro-Russian Bosnian Serb leader** - Milorad Dodik. Russia is one of the largest foreign direct investors in the entity, with Kremlin-owned banks VTB and Sberbank still operating freely in the country. Although Sberbank sold its controlling stake in Agrokor - formerly the region's largest retail giant - in 2021, its ownership was transferred to a Serbian oligarch with deep connections to Russian investments in Montenegro, preserving Moscow's foothold in the region.[40] Given RS's history of defying the formal rules of Bosnia and Herzegovina and the country's Western orientation, seeking to benefit from grand deals with Serbia and Russia, it is very likely that the country faces continuous flows of IFFs.

Russia remains **Montenegro's largest foreign direct investor** and **exerts significant influence through economic and political channels**. The country's service sector is heavily reliant on Russian tourists, making it financially susceptible to Moscow's leverage.

Russian investments have had the biggest impact on the economy of Montenegro where they constitute roughly a third of the country's GDP. They have been largely concentrated in just two sectors of the Montenegrin economy – real estate and tourism, which make up a quarter of the added value in the country.[41] For example, between 2017-2018 Russian investment in real estate reached EUR 80.8 million, or over 60% of Russia's total investments in Montenegro.

Meanwhile, Russian tourists used to be the largest group of visitors to Montenegro, amounting to almost 25% of the total. Since 2006, they have jumped five-fold, to 350,468 in 2017, spending a total of 3.06 million nights. At an average price per night of around EUR 70,one could estimate that in 2017 alone,

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[39] Center for the Study of Democracy, Illicit Financial Flows and Disinformation in Southeast Europe, Interactive Visualization.

[40] Stefanov, R. et al, *The Kremlin Playbook in Southeast Europe: Economic Influence and Sharp Power*, Sofia: Center for the Study of Democracy, 2020.

[41] Stefanov et al., *The Kremlin Playbook in Southeast Europe*, Sofia: CSD, 2020.

Russian tourists spent over EUR 200 million on accommodation, which was around 5% of GDP back then.[42]

In 2018, the United States imposed sanctions on Russian oligarch Oleg Deripaska, as well as his companies Rusal, En+ and others in which he held stakes, citing Russia's "malign activities".[43] In 2005, Oleg Deripaska's En+ Group, through its subsidiary Salomon Enterprises (later renamed the Central European Aluminium Company, CEAC), acquired the Podgorica Aluminium Plant (KAP) in Montenegro. This positioned KAP as part of Deripaska's broader industrial network under En+ Group's control, indirectly tying it to the broader Kremlin strategy to expand influence in the Mediterranean. KAP was Montenegro's largest industrial enterprise, which once made up around 50% of the country's exports. Following KAP's bankruptcy in 2013, Deripaska withdrew.

Beyond economic ties, Russia influences Montenegrin politics through pro-Serbian parties, the Serbian Orthodox Church, and various sharp power tactics[44], including media manipulation and disinformation campaigns. Despite Montenegro's NATO membership, these entrenched networks continue to serve Russian strategic interests. Montenegro has long maintained close ties to Russia, dating back to the reign of Tsar Peter the Great, often relying on 'beyond the book' agreements that straddle the state and private business domains, giving rise to sizable IFFs.

Russia has also secured **long-term energy leverage** in **North Macedonia** through a natural gas import contract via TurkStream passing through Bulgaria. Russian-linked businesses also control the largest district-heating plant in Skopje, reinforcing Moscow's energy leverage. Additionally, Russian oligarchs have made strategic investments in the country, for example in the control of FK Vardar - the nation's most lauded soccer club – while seeking to build preferential relations with political parties. Russian influence also extends through GRU operations, the Russian Orthodox Church, and informal networks fuelling ethnic tensions with Bulgaria, all serving to destabilize the country and obstruct its Euro-Atlantic integration.

There is limited to no Russian influence in **Kosovo** and **Albania**. However, there is some evidence for Albania laundering Russian petroleum products entering the Western Balkans, which might have resulted in IFFs, though the volumes were very small.[45]

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42 Stefanov et al., The Kremlin Playbook in Southeast Europe, Sofia: CSD, 2020.

43 U.S. Department of the Treasury, "Treasury Designates Russian Oligarchs, Officials, and Entities in Response to Worldwide Malign Activity", 6 April 2018.

44 Ibid.

45 Stefanov et al., The Kremlin Playbook in Southeast Europe, Sofia: CSD, 2020.

ILLICIT FINANCIAL FLOW DYNAMICS IN THE WESTERN BALKANS AND THE BLACK SEA REGION

This section analyses IFFs over a 14-year period across the Western Balkans and the Black Sea countries. Using UNCTAD's PCM+ and the GER techniques, it estimates IFFs linked to trade misinvoicing. It also examines broader IFF patterns, including illicit trade networks, smuggling, and vulnerabilities in key sectors, within the context of regional economic dependencies, geopolitical dynamics, and sanction evasion.

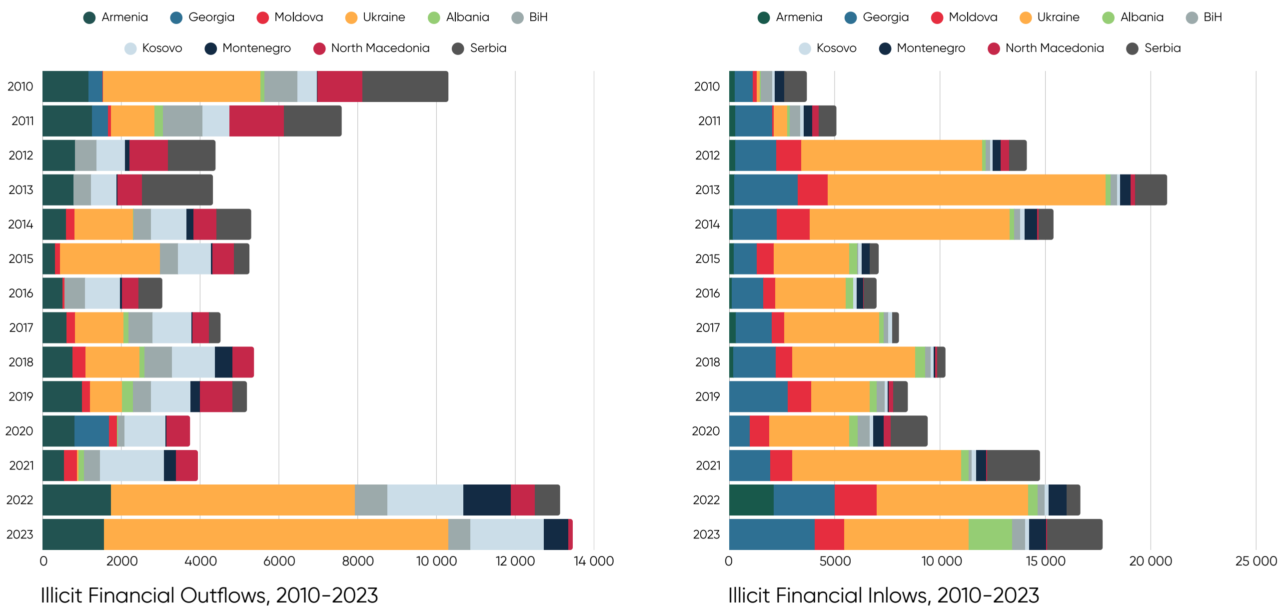
The **Western Balkans and Black Sea region are particularly vulnerable to IFFs.** However, none of the countries in these regions have a clear definition of IFFs in their legal frameworks.[46]

Following Russia's 2022 invasion of Ukraine, **IFFs surged in countries from both regions, in some cases exceeding 10% of GDP**. In 2023, IFFs in Western Balkans and Black Sea region countries from trade misinvoicing **reached USD 31 billion, doubling pre-war levels**. Trade misinvoicing is a major channel of IFFs in all target countries, alongside tax evasion and financial crimes facilitated through shell and front companies, and powerful informal business networks.

The largest illicit financial **outflow**s have been recorded in 2022 and 2023 in Ukraine, Kosovo and Armenia, coinciding with the ramping up of sanctions against Russia (Figure 5). 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, again coinciding with periods of introduction of sanctions against Russia.

[46] United Nations Interregional Crime and Justice Research Institute (UNICRI), Illicit Financial Flows and Assets Recovery in the Republic of Armenia, Georgia, Moldova, Ukraine, Research Papers, 2021; Global Initiative against Transnational Organised Crime (GI-TOC), Illicit Financial Flows in Albania, Serbia, Bosnia and Herzegovina, Montenegro, 2024.

Figure 5. Evolving Trends in Illicit Financial Outflows and Inflows, 10 countries, 2010-2023 (USD millions)



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

All countries are **exposed to the illicit energy trade**, particularly in coal, gas, fuels, and electricity. Ukraine was highly vulnerable in 2010–2011, with large-scale gas theft and the shifting of the profits to offshore hubs.[47]

The following country-level insights help explain the key factors driving IFF trends across both regions. In Albania IFFs remain largely overlooked, with tax evasion and VAT fraud as primary contributors. High-level politicians, public officials, and private entities have been implicated in fraud and trade misinvoicing schemes.[48] In **Bosnia and Herzegovina and Montenegro** illicit trade in legal goods, particularly tobacco, is a major source of IFFs. Over 20% of the tobacco market operates illicitly, with both countries serving as key smuggling transit hubs to the EU. Trade misinvoicing in Bosnia and Herzegovina accounts for an estimated EUR 10.2 billion in imports, while tax evasion and customs fraud caused over EUR 2 million in state revenue losses in 2022.[49] Tax evasion remains widespread in **Montenegro**, where Russian financial inflows have surged as individuals and businesses seek to relocate assets to evade sanctions.[50] Large volumes of undeclared cash have entered the country, often channeled through tax havens with weak corporate ownership transparency.

47 Our statistical analysis of key energy commodities showed weak correlations between the price fluctuations of the energy commodities and the increase in IFFs across the ten countries. This suggests that commodity prices alone do not sufficiently account for the increase in IFFs.

48 GI-TOC, Illicit Financial Flows in Albania, Serbia, Bosnia and Herzegovina, Montenegro, 2024.

49 Ibid.

50 Ibid.

Trade-based money laundering is prevalent in **Kosovo**, especially in construction and real estate. Trade misinvoicing is common, with an estimated EUR 8 million in customs duties evaded between 2020 and 2022. The shadow economy[51] represents 31% of GDP, closely linked to tax evasion.[52] In **North Macedonia** trade-linked money laundering and VAT fraud are major concerns. VAT return scams and offshore tax havens are frequently used for laundering illicit proceeds. Trade misinvoicing is also a persistent issue in **Serbia**, exemplified by an organized crime group that evaded EUR 18 million in taxes through car import under-invoicing. New tax evasion methods involve cash withdrawals by entrepreneurs in the secondary raw materials market.

Large-scale financial crimes, such as the 2014 Global Laundromat and Bank Fraud cases, both linked to laundering IFFs originating from Russia, exposed systemic vulnerabilities in **Moldova**. Moldovan authorities failed to investigate both cases. The Global Laundromat alone contributed to the embezzlement of USD 1 billion from three of the country's largest banks. The case demonstrated how Moldovan political elites enabled the laundering of at least USD 20 billion in Russian funds to Western Europe via Moldovan banks, using fraudulent court rulings on fake debt defaults. These events revealed the extent to which Moldova's supervisory institutions and judiciary had been captured by oligarchic networks of Russian and domestic actors, turning the country into a key transit point for evading international oversight.[53]

After the 2018 Velvet Revolution and despite all efforts to improve its governance, **Armenia** also remains vulnerable to corrosive capital, with a long-standing fusion of political and business interests enabling the exploitation of public resources. From 2008 to 2017, over USD 10 billion in illicit cash is estimated to have left Armenia, much of it later re-entering the economy as opaque foreign investment in strategic sectors.[54]

A large shadow economy fuels IFFs in **Ukraine,** mainly through smuggling, VAT fraud, offshore profit shifting, and counterfeit goods trade. An estimated USD 3 billion in corporate profits are shifted offshore annually, while tax evasion costs the budget USD 600 million. Discrepancies in trade data, such as Polish exports being 30% higher than recorded Ukrainian imports, suggest sophisticated smuggling networks. [55,56,57]

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51 A broader term that includes both the grey economy and illegal activities (like drug trafficking, smuggling, or counterfeit goods). It covers all economic activity that is hidden from the government to avoid taxation, regulation, or law enforcement. The grey economy is a subset of the shadow economy, as it involves legal but unregulated activities, while the shadow economy also includes illegal activities.

52 GI-TOC, Illicit Financial Flows in Kosovo, North Macedonia, Serbia, 2024.

53 Center for the Study of Democracy, *Russia's Economic Influence and Corrosive Capital in Eastern Europe: Ukraine, Moldova and Armenia* (Unpublished report).

54 Russia's Economic Influence and Corrosive Capital in Eastern Europe: Ukraine, Moldova and Armenia, Center for the Study of Democracy (Unpublished report).

55 UNICRI, Illicit Financial Flows and Assets Recovery in Ukraine, *Research Papers*, 2021.

56 The State Financial Monitoring Service of Ukraine, Report on the National Risk Assessment in the Field of the Prevention and Counteraction of the Legalisation (Laundering) of Criminal Proceeds and the Financial Terrorism, OSCE, 2019.

57 The Vienna Institute for International Economic Studies (WIIW), Fighting Systemic Smuggling: Customs Reform in Ukraine, 2018.

Georgia has also become a transit hub for illicit flows due to its direct border with Russia. Following Russia's invasion of Ukraine, financial inflows from Russia surged, with remittances reaching USD 2.1 billion in 2022. Regulatory loopholes allowed intermediaries to facilitate money transfers and company registrations for Russian clients, mimicking offshore practices. [58,59,60] A new industry of financial and legal services catering to Russian citizens relocating to Georgia has emerged. They act as intermediaries for Russian clients seeking business addresses for sale, which they can use to register companies. Some abandoned villages in southern Georgia have become home to hundreds of businesses registered by Russian citizens, resembling practices typically seen in offshore jurisdictions and tax havens.[61] Corporate service providers tapped into a regulatory loophole by hiring unemployed Georgian men to serve as Russian financial intermediaries. They would withdraw the funds in cash and hand the money over to the real beneficiaries (citizens of Russia) in exchange for a fee.[62]

The Western Balkans and Black Sea countries serve as key transit hubs for illicit trade, with deeply entrenched networks and established routes for arms and drug trafficking, which have more recently been also employed in sanctions circumvention. These regions have become a target destination for smuggling sanctioned goods to Russia. The war in Ukraine has significantly increased the demand for both weapons and civilian items that can be repurposed for military use. Informal trade routes, once used for smuggling weapons, oil products, drugs, and contraband during the Soviet and Yugoslav eras, are now being exploited to channel dual-use items and launder illicit funds, exposing the countries more to Russia.

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[58] GI-TOC, Global Organised Crime Index: Georgia, 2023.

[59] Transparency International Georgia, Georgia's Economic Dependence on Russia: Impact of the Russia-Ukraine war, 2023.

[60] Ibid.

[61] Lomsadze, G., "Georgia's "Russian" villages", *Eurasianet*, 2 December 2022.

[62] Marat, E., and Kupatadze, A., Under the Radar: How Russia Outmanoeuvres Western Sanctions with Help from its Neighbours, Serious Organised Crime and Anti-Corruption Evidence, August 2023.

Box 1. Illicit Trade Routes Fueling IFFs

Western Balkans:

- **Bosnia and Herzegovina** remains a hub for arms trafficking, with a large stockpile of weapons from the civil wars of the 1990s still in circulation and positioned along key smuggling route between Serbia and Montenegro.[63] The latter provides access to the black market of automatic weapons, explosives, and small arms.[64] Albania faces rising risks from converted weapons and 3D-printed firearms.[65]

Black Sea:

- **Moldova** plays a key role in illicit arms trade, with Transnistria's Soviet-era stockpiles fuelling the smuggling. Despite a government crackdown, arms transfer to Belarus and Russia, evading EU sanctions, has persisted. Evidence suggests that Moldova has been also serving as a transit country for nuclear materials.[66]

- The tensions in the breakaway regions of Abkhazia and South Ossetia, as well as in Nagorno-Karabakh have also left **Georgia** vulnerable to arms trafficking. The illegal and unaccounted movement of arms and ammunition within the region has increased concerns over the proliferation of such weapons.

- **Ukraine** has received massive arms shipments since 2014, raising fears of weapons diversion into criminal networks. Before the war, Ukraine played a crucial role in organized crime networks, based on three smuggling routes: The Northern Route (Afghan heroin and arms via Central Asia and Russia), the Balkan Route (via Iran and Türkiye), and the Black Sea Route.[67,68]

- Arms trafficking in **Armenia** remains a concern, though on a smaller scale compared to neighbouring countries. Weapons from the First Nagorno-Karabakh War in the 1990s are still in circulation, while ongoing hostilities in the region contribute to the continued illegal flow of arms.

Russia's formal and informal business and financial networks are constantly adapting their strategies to circumvent Western sanctions. Sanctioned Russian entities and individuals, but not only, have rapidly **shifted assets to secretive offshore jurisdictions**. There is "strong evidence" that sanction targets are increasing their funds in offshore tax havens, using financial secrecy to

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[63] GI-TOC, Global Organised Crime Index: Bosnia and Herzegovina, 2023.

[64] Maraš, V., Illicit Financial Flows in Montenegro, GI-TOC, March 2024.

[65] GI-TOC, Global Organised Crime Index: Albania, Moldova, Georgia, 2023.

[66] Zaitseva, L., and Steinhäusler, F., "Nuclear Trafficking Issues in the Black Sea Region", EU Non-Proliferation Consortium, *Non-Proliferation Papers*, No. 39, April 2014.

[67] UNICRI, "Illicit Financial Flows and Assets Recovery in Ukraine", *Research Papers*, 2021.

[68] UNODC, World Drug Report 2010, New York: United Nations, 2010.

hide assets.[69] Russian oligarchs have moved assets to places such as Cyprus, the British Virgin Islands and Swiss banks, mirroring earlier massive outflows that included Black Sea and Baltic countries. An example of the latter is the publicly exposed 'Global Laundromat' scheme, which is estimated to have moved nearly USD 21 billion out of Russia via banks in Moldova and Latvia between 2010 and 2014, illustrating the scale of illicit outflows by corrupt insiders even before the latest sanctions.[70] Some of these funds, originating in offshore jurisdictions, have been subsequently transferred to other countries through both **legitimate and illegitimate transactions**. Some of these deals, such as the construction of the Serbian part of the Turk Stream gas pipeline project, have been marked by alleged **cases of strategic corruption**, allowing Srbijagas, Serbia's state-owned gas company, to operate without transparent public tenders and to conclude deals without the legally required public oversight. [71]

Similarly, China's state-owned and state-linked enterprises have allegedly engaged in strategic corruption fuelling IFFs to advance their overseas investments. Over the past decade, **Chinese SOEs have been implicated in high-profile corruption cases abroad**, generating illicit financial flows. The Belt and Road Initiative infrastructure projects in Africa and Southeast Asia have been characterised by "rampant bribery" - with an estimated 60-80% of Chinese companies paying bribes to politically exposed persons to speed up projects.[72] The lack of competition and opaque negotiation process in BRI projects in the Western Balkans has created risks of inflated costs and strategic corruption, too. In May 2018, in North Macedonia, the then prime minister Nikola Gruevski and three ministers were charged with corruption in the awarding of the Kichevo-Ohrid and Miladinovci-Stip motorway contracts, with the cost of some materials in the latter contract inflated by almost 300%.[73]

The **rise in IFFs is being driven by gaps in sanctions enforcement in all Western Balkan and Black Sea countries**, which is further enabling the trade in sanctioned goods.

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[69] Kavakli, K. C., Marcolongo, G. and Zambiasi, D., "Sanction Evasion Through Tax Havens", Baffi Carefin Centre, *Research Paper No 212*, November 2023.

[70] OCCRP, "The Russian Laundromat Exposed", 20 March 2017.

[71] Galev, T. et al., Impact of Sanctions on Infiltration of Russia in Europe, BridgeGap project, 2025.

[72] AML RightSource, "Why China's Belt & Road initiative faces overwhelming odds in its fight against corruption", 6 May 2021.

[73] Crawford, N., "Growing public debt isn't the only problem with Chinese lending to the Balkans", IISS, 2020.

Box 2. Preventing Illicit Trade in Sensitive Technologies

Multilateral Export Control Regimes (MECRs), such as the Wassenaar Arrangement, the Australia Group, the Missile Technology Control Regime (MTCR), and the Nuclear Suppliers Group (NSG) are non-binding agreements and have a crucial role in preventing the illicit trade of military and sensitive dual-use items.[74] Members of MECRs are required to implement strict export licensing systems, conducting thorough screenings of end-users to prevent controlled items from reaching sanctioned entities. They must also enforce robust due diligence measures to verify the legitimacy of recipients and block diversion through front companies or third countries facilitating sanctions evasion. **However, loopholes in export control systems are often exploited.**[75]

Apart from Armenia, all other countries are candidate or potential candidate countries (Kosovo) for EU membership. Harmonising their legal systems with EU dual-use regulations[76] is a key requirement in their EU accession process. While encouraged to gradually adopt these measures, strict export controls are not mandatory until full membership in the EU. The **lack of full alignment with, and poor enforcement of, EU** restrictive measures in international export control regimes, in combination with the historically **weak governance structures and regulatory oversight** in these countries, has heightened the risk of sanction evasion through illicit trade (Table 1). These critical vulnerabilities are exacerbated by the countries' geographical proximity to Russia and the Kremlin's political and economic influence.[77]

74 Drishti IAS, Multilateral Export Control Regimes.

75 Koeppen, M., Vladimirov, M., and Osipova, D., Networks of Power: Russia's Shadow Influence in Germany, Sofia: Center for the Study of Democracy, 2024.

76 EC, Regulation (EU) 2021/821 of the European Parliament and of the Council of 20 May 2021 setting up a Union regime for the control of exports, brokering, technical assistance, transit and transfer of dual-use items (recast).

77 Ministry of Foreign Affairs in Armenia, Non-Proliferation, Strategic Export Control and Nuclear Security; Global Organised Crime Index, Georgia, 2023; EC, DG ENEST, 2024 Communication on EU enlargement policy, EC, DG ENEST: Moldova Report 2024, Bosnia and Herzegovina Report 2024, Kosovo* Report 2024, Serbia Report 2024, North Macedonia Report 2024, Albania Report 2024.

Table 1. Country-Specific Trends in Alignment with MECRs and EU Sanctions

Countries	MECR Membership	Sanctions alignment	Enforcement risks
Albania	Not a member	Fully aligned with EU sanctions	Still lacks full implementation of EU dual-use regulations, making it vulnerable to illicit diversions.[78]
Serbia	Not a member	Did not align with EU sanctions against Russia	Long-standing ties with Russia and non-alignment with EU measures make Serbia a high-risk country for sanctions evasion and illicit trade.[79]
BiH	Not a member	Formally aligned with EU sanctions, but political divisions hinder enforcement.	The political crisis in pro-Russian Republika Srpska (March 2025) weakens national enforcement, increasing risks of illicit flows and trade with dual-use items.[80,81]
North Macedonia	Not a member	Fully aligned with EU sanctions	Has aligned its framework with the EU acquis, but enforcement capacity remains limited, making it also a potential transit hub for illicit trade.
Kosovo	Not a member	Partially aligned with EU sanctions but needs stronger legal frameworks for enforcement.	Lack of fully developed institutional mechanisms increases its vulnerability to illicit trade, especially through cash-based transactions.[82]
Ukraine	Member of both the Wassenaar Arrangement and the Australia Group.	Fully aligned with EU sanctions against Russia.	While Ukraine has the strongest legal framework, its large shadow economy and ongoing war make it a hub for illicit arms flows.[83]
Montenegro	Applied for Australia Group membership; Wassenaar Arrangement accession ongoing.	Generally aligned with EU sanctions; Drafting a new law to improve implementation.	Weak enforcement mechanisms and proximity to key smuggling routes increase vulnerabilities.[84]
Moldova	Not a member	Partial alignment with EU sanctions; adopted a new export control law (effective 2025), but still not fully harmonized.	Weak oversight and institutional capacity make it a transit point for illicit arms trade, exacerbated by its historical role in laundering illicit financial flows from Russia. [85,86]

78 Ibid.

79 Ibid.

80 Ibid.

81 Daily Sabah, "Bosnia's Serb entity pushes for own border police in new escalation", 17 May 2025.

82 Ibid.

83 EC, DG ENEST, Ukraine Report 2024, 2024 Communication on EU enlargement policy.

84 EC, DG ENEST, Montenegro Report 2024, 2024 Communication on EU enlargement policy.

85 Republic of Moldova, Parliament, LAW No. LP213/2024 of 31.07.2024.

86 EC, DG ENEST, Moldova Report 2024, 2024 Communication on EU enlargement policy.

Countries	MECR Membership	Sanctions alignment	Enforcement risks
Georgia	Not a member	Did not impose sanctions on Russia.	Postponed EU accession talks until 2028, despite implementing some export control measures on battlefield goods. Breakaway regions (Abkhazia and South Ossetia) and proximity to conflict zones increase risks of arms proliferation.[87,88]
Armenia	Not a member	Did not align with EU restrictive measures.	Very close political and economic ties with Russia increase the likelihood of Armenia serving as a transit hub for sanctioned goods.

[87] EC, DG ENEST, Georgia Report 2024, 2024 Communication on EU enlargement policy.

[88] Global Organised Crime Index, Georgia, 2023.

ILLICIT FINANCE AND THE EVASION OF SANCTIONS ON DUAL-USE GOODS

Russia's Illicit Trade in Dual-Use Items

The trade in sanctioned dual-use goods is a major form of evasion, fuelling IFFs while directly sustaining Russia's war in Ukraine. In response to international sanctions, Russia has intensified its search for advanced machinery, electronic components, and other critical technologies originally intended for civilian use but adaptable for military applications - such as drones and missile systems. For instance, Russia's drone production has been significantly hampered by supply chain disruptions.[89] To secure critical war components, the Kremlin has turned to alternative markets, most notably China, Türkiye, the UAE, and India.[90] Yet, transhipment countries along the way, such as the countries of the Western Balkans and the Black Sea, have also added to the rise of IFFs related to dual use goods sanctions evasion.

In February 2025, Russia saw a sharp decline in imports, which fell to USD 19.9 billion - 13% lower than the same month in 2024 and over 30% below the average monthly volume recorded in the fourth quarter of 2024. This decline followed tightened U.S. banking sanctions targeting Gazprombank and over fifty other institutions, as well as China's new export controls on dual-use goods. Chinese operators halted shipments, leaving many metal and industrial products stuck at the border. At the same time, Russia's railway system struggled to reroute freight, hitting its lowest transport volumes in 16 years.[91] Notably, global exports of dual-use goods to Russia had already declined by 96% in 2024 compared to 2021, underscoring the broader impact of sanctions and trade restrictions.

Although facing significant obstacles in circumventing G7 sanctions to obtain Western high-tech parts,[92] **Russia has proven exceptionally resilient to the restrictive measures.** However, the presence of sanctions means that this resilience has come at a steep cost to official finances, giving rise to considerable IFFs which are going to circulate in the system for years to come, fuelling other forms of illicit behaviour. Further, this resilience has been driven by three key factors.[93]

Russia started powering its weapons systems by procuring off-the-shelf computer chips and electronic components – often from US manufacturers – that are rarely subject to export restrictions. In addition, Russia has demonstrat-

89 The New Voice of Ukraine, "Russia may face supply issues in Shahed drone manufacturing – ISW", 13 February 2025.

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

91 The Odessa Journal, The Central Bank has recorded a dramatic decline in the import of goods to Russia, 14 March 2025.

92 Ibid.

93 Feldstein, S., and Brauer, F., "Why Russia Has Been So Resilient to Western Export Controls", *Carnegie Endowment for International Peace*, 11 March 2024.

ed a remarkable ability to leverage **networks of third-country traders** to secure dual-use components critical for its tanks, missiles, and drones. Very often these networks have been reinforced through Russian nationals on the ground[94], integrating them better with Moscow's internal sanction's evasion institutional infrastructure.

Russia obtains 98 percent[95] of its components via third countries, relying on **a web of intermediaries who hide their transactions through shell companies** and use neutral third-country ports to receive and ship goods. Dual-use items **from European states** such as the most sensitive and critical weapons' components - integrated circuits, wireless communication systems, satellite navigation, connectors, cameras, bearings, and CNC machine tools, have continued to make their way to 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.
- **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.[96]

As these goods are under sanctions in the G7+ countries, financing their trade gives rise to IFFs, irrespective of whether Western traders are aware or unaware of the illegality of the transaction.

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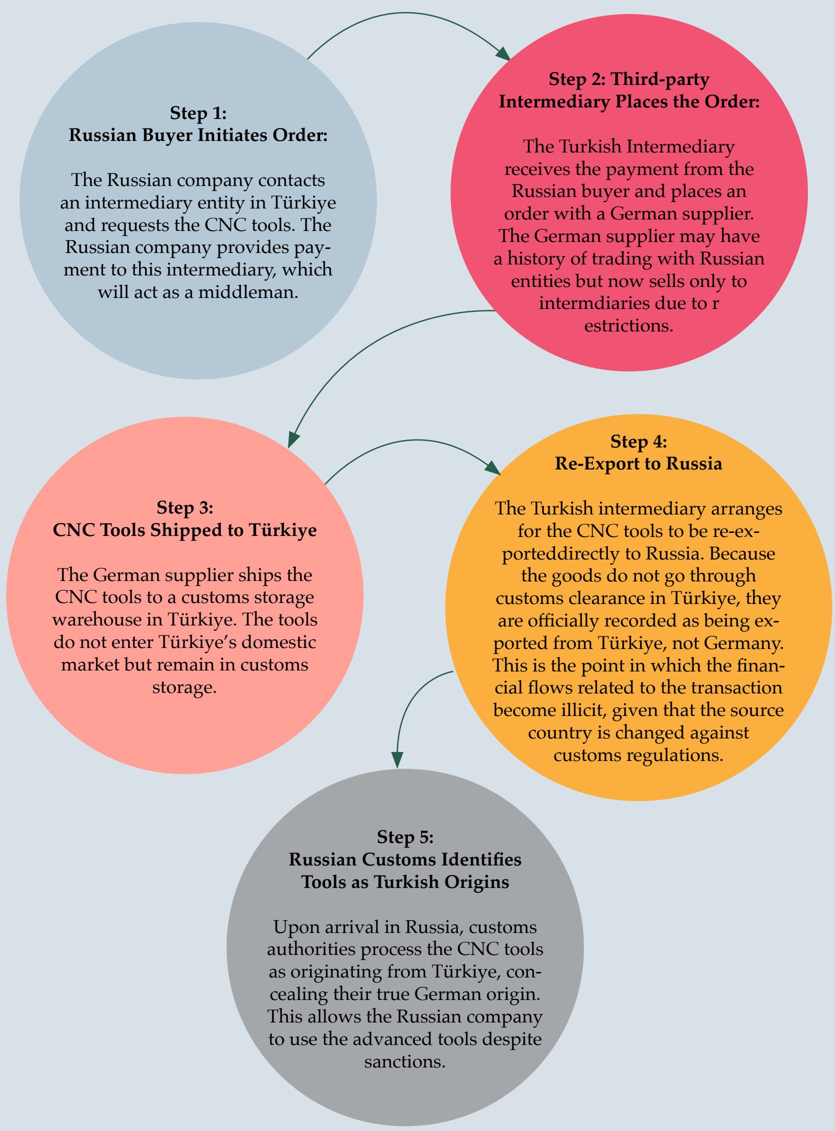
[94] Vladimirov, M. et al.,The Kremlin Playbook in Türkiye, Geoeconomics Unfolded, Sofia: Center for the Study of Democracy, 2025.

[95] Sonnenfeld, J. A., and Wyrebkowski, M., "The Dangerous Loophole in Western Sanctions on Russia", *Foreign Policy*, 7 September 2023.

[96] Helmer, M., "Trotz strenger Sanktionen: Wie deutsche Waren Russland erreichen", *ZDF heute*, 13 July 2024.

Box 3. Case Study of Sanctions Evasion Mechanism: Indirect Export of Computer Numerical Control (CNC) Tools from Germany to Russia[97]

A Russian company seeks to acquire advanced manufacturing tools equipped with computer numerical control (CNC) technology, which is capable of precisely cutting and finishing metal parts. Since direct purchases are prohibited, the company uses an intermediary in a third country, such as Türkiye, to facilitate the transaction indirectly:



Russia is leveraging formal and informal networks to sustain trade flows uninterrupted with the West. The **Kremlin relies on networks built on formal or informal partnerships between Russian and domestic business groups across Europe**. The tighter the control over a good's trade, the more likely it is that more criminal elements would be called upon, including **transnational organised crime**. Given that Moscow exerts state capture control over Russia's economy through its security services, and that it officially

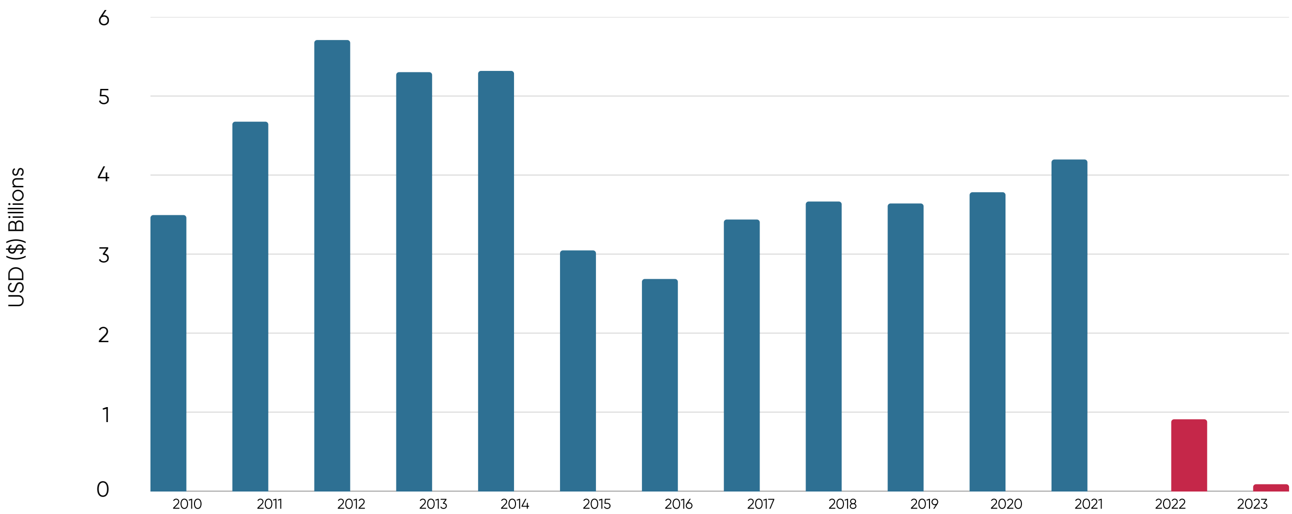
[97] Smith, H., Kozlov, O., and Abdullaev, N., "Managing sanctions risks from Russia's trade partners", *Control Risks*, 16 March 2023.

denounces the sanctions as illegitimate, members of its administration and institutions do not shy away from engaging with any alternative trading partners. These networks collaborate to secure the continuation of trade ties in key markets, with local power brokers benefiting from Russian political and financial backing to orchestrate these deals. As a result of the sanctions many of the financial operations of these networks create IFFs, which Western banks cannot accept for business, pushing such networks to engage in money laundering. While Russia's deep ties with European energy companies, including in the Western Balkans and the Black Sea region are well-known, Moscow's indirect economic footprint in key industrial sectors has remained less visible, and an important source of illicit finance to continue the trade in dual-use goods. **These informal networks ensure that domestic firms remain entrenched in the Russian market, where they hold dominant positions in key industries**.[98] Thus, the rerouting of dual-use goods has basically entirely replaced the volume of EU direct exports to Russia from before the war, theoretically making all financial transactions related to the re-routing - illicit.

Dual-use Goods Trade with Russia: Trends Before and After the Ukraine Invasion

Before Russia's full-scale invasion of Ukraine in 2022, EU exports volume of dual-use goods have been relatively consistent, peaking around 2012-2014 at over USD 5 billion and stabilising around USD 3-4 billion annually in the years leading up to 2022 (Figure 6). However, after the invasion of Ukraine, this export dropped to USD 87 million in 2023, marking an almost complete halt in EU MS direct trade of dual-use goods.

Figure 6. EU's Export of Dual-Use Goods to Russia Before and After the Invasion of Ukraine (2010-2023) (USD)



Source: Eurostat, Easy COMEXT.

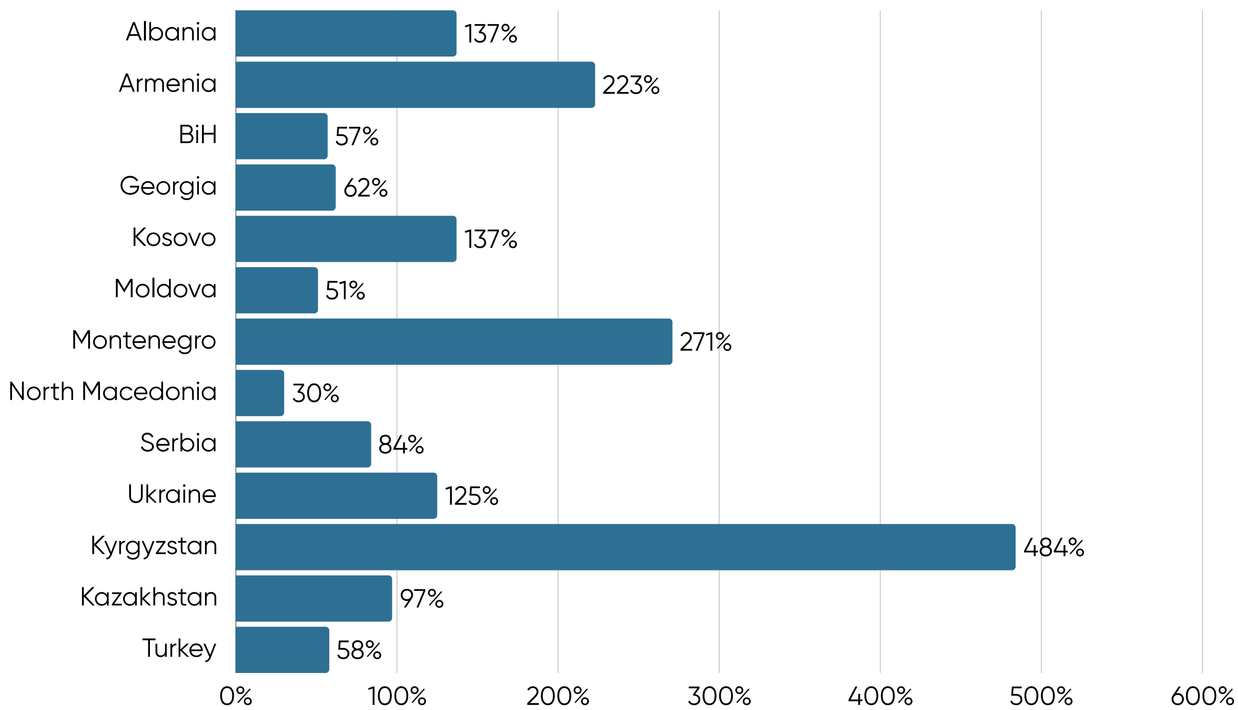
[98] For instance, many German companies continue operating in Russia after 2022.

Despite the sharp decline in direct export of dual-use goods, there is a **significant increase in the export of European dual-use items to third countries** from Central Asia, but also through the Western Balkans, the Black Sea region and Türkiye (Figure 8). The five Central Asian countries[99] **doubled their imports of dual-use goods from the EU in 2023 - from USD 300 million in 2021 to USD 636 million**. However, **in 2024, imports from EU dropped by 17%** compared to 2023. This decline likely reflects tighter EU export controls, strengthened enforcement, and increased pressure on third countries to curb sanctions evasion.

In 2024, the total value of dual-use goods imported by the Western Balkans, Black Sea countries, and the five Central Asian states amounted to **approximately 94% of the EU's pre-war exports of such goods to Russia in 2021**, which stood at USD 4.2 billion.

In 2024, all Western Balkans and Black Sea countries increased their imports of sensitive technologies from the EU by over 50% compared to the 12-year annual average before the war in Ukraine. Even when compared specifically to 2019 (Figure 7), there was a substantial rise, with Montenegro leading the increase in EU dual-use imports, followed by Armenia, Albania, and Kosovo. The surge in imports across these countries far exceeds their domestic demand, suggesting a growing trend of sanction evasion and illicit financial flows linked to the re-export of goods to Russia.

Figure 7. Percentage (%) Increase in EU's Dual-Use Export in Target and Benchmark Countries in 2024 vs. 2019 (in Value)

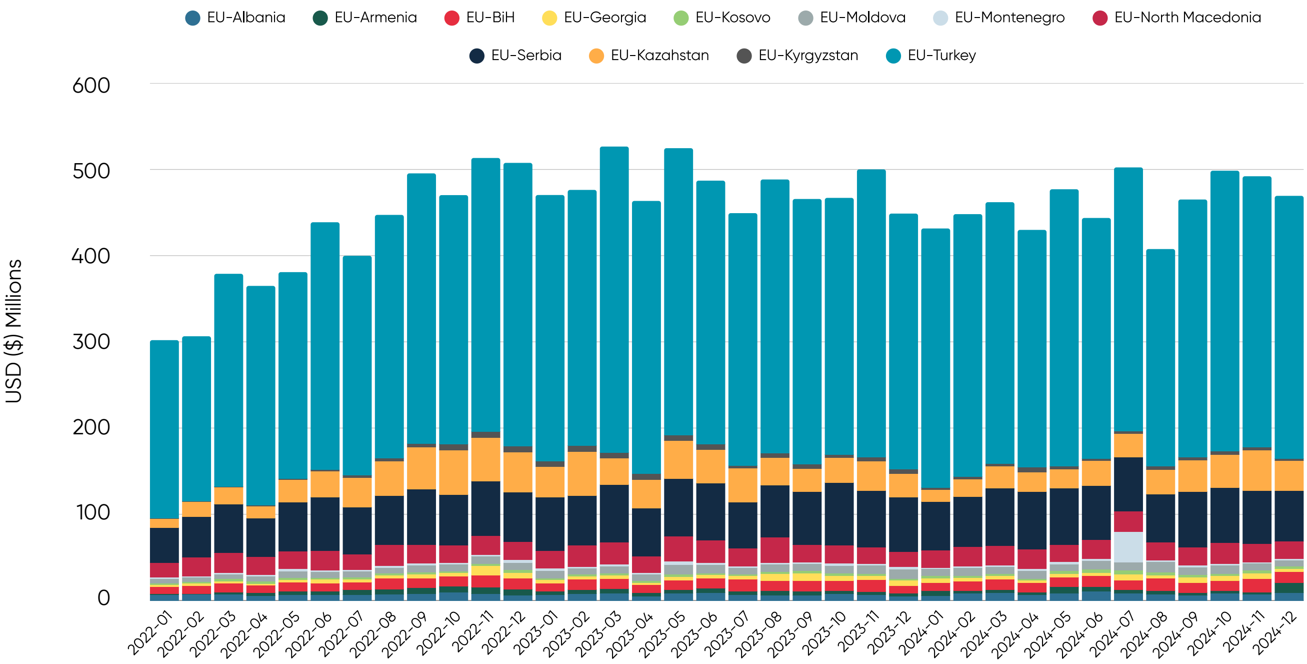


Source: Eurostat, Easy COMEXT; UN Comtrade Database.

[99] Kyrgyzstan, Kazakhstan, Tajikistan, Turkmenistan and Uzbekistan.

In this paper, we use Kazakhstan and Kyrgyzstan as benchmark cases, along with Türkiye, which all have played a key role as suppliers and re-exporters of dual-use goods to Russia.

Figure 8. EU Export of Dual-Use Goods to the Western Balkans, Black Sea Countries, Kazakhstan, Kyrgyzstan and Türkiye



Source: Eurostat, Easy COMEXT; UN Comtrade Database.

Kyrgyzstan has mainly imported from EU the following goods cateogrized as dual-use:

- **Ball, spherical and cylindrical roller bearings:** Essential for armoured vehicles, aircraft, and missile systems, rose from a minimal base in 2021, increasing by over 26,000% in 2022.[100]

- **Static converters:** Used for power systems in military vehicles, radar, missile guidance, and other defense technologies, grew by 516.29% from 2021 to 2022.

- **Communication equipment:** Machines for voice, image, and data transmission play a crucial role in military communications and electronic warfare systems, increased by 333.63% in 2021-2022.

[100] Ball bearings rose from 29,755 units in 2021 to 1,596,592 units in 2022. Similarly, spherical roller bearings increased from 7,034 units to 289,589 units, and cylindrical roller bearings grew from 1,927 units to 505,680 units over the same period.

- **Telescopic sights and periscopes:** crucial for precision targeting and situational awareness in weapons systems, especially for infantry and armored vehicles, surged by 1,925.64% from 2021 to 2022.
- **Semiconductors and cameras:** Newly exported in significant volumes after 2022 and vital for advanced military systems, such as drones, surveillance technologies, and electronic warfare

Armenia has exhibited a similar pattern in its import trends from the EU. However, while Armenia's imports of certain dual-use goods from the EU have surged in percentage terms, their absolute values remain relatively modest:

- **Precision Machinery:** Exports of machine centers for metalworking surged by 242%, reaching over USD 1.17 million.
- **Military Computing:** Processing units for data machines doubled from USD 3.79 million in 2021 to USD 7.72 million in 2022.
- **Bearings:** Ball bearing exports jumped from USD 119,153 in 2021 to over USD 2 million in 2023, while the purchase of cylindrical roller bearings rose by 358% in 2022 and 303% in 2023.
- **Electronics:** Exports of machines for data transmission surged 181%, reaching USD 14.48 million, while electrical apparatus for radar and missile guidance spiked by 802%.
- **Aircraft Parts:** Armenia's imports of aircraft parts rose from zero between 2010 and 2021 to USD 1.87 million in 2023.

Russia has continued to exploit sanction loopholes in countries within its sphere of influence, taking advantage of weak governance and regulatory oversight. There have been significant shifts not only in EU exports of dual-use goods to these countries but also in their export of the same goods to Russia (Table 2). These sudden surges are undoubtedly linked to the collapse of direct EU exports of dual-use items to Russia leading to their replacement by third-country firms.[101] It is important to note though that the changes for many of the countries are **rather small in absolute terms**. They might not show as IFFs using the standard calculation methods, as they are **booked as legitimate trade** in the respective countries' trade data. There could also be notable price valiations during the **rise of inflation** in 2021 – 2022, which could have impacted the value of imports and exports, unrelated to actual physical trade volumes. Yet, the **staggering relative increases** are indicative of abnormal activity, which given the many recorded cases of sanctions eva-

[101] Moller-Nielsen, T., "EU sanctions on Russia 'massively circumvented' via third countries", *Euractiv*, 30 September 2024.

sion indicate that it is fairly safe to assume there has also been a simultaneous increase in IFFs too.

Armenia and **Serbia** have seen the most notable exports of dual-use goods to Russia since 2022. Both countries began reducing their exports of dual-use goods to Russia in 2023 and 2024. Despite the decline, Armenia's export to Russia in 2023 represents a major surge (2,660%) compared to its 12-year annual average of USD 2 million. Armenia's economy has become increasingly dependent on re-exporting sanctioned goods to Russia and reselling Russian gold, driving substantial growth. Beyond the EU and Türkiye, Armenian intermediaries actively source dual-use items from the U.S., Southeast Asia, and the UAE.

Similarly, Serbia's exports to Russia rose by 220% in 2022 compared to pre-war levels. Serbia's decision not to impose sanctions on Russia, combined with its strategic partnership and free trade agreement, have placed the country in a unique position as a key trade hub for re-exporting Western goods to Russia. The drop in the export value can be linked to increasing pressure from U.S. sanctions authorities on Serbia, particularly after sanctions were imposed on Gazpromneft and Gazprombank - both critical to the functioning of Serbia's oil and gas sector. Customs records and analysis reveal that since the start of the war in Ukraine, Serbia has exported at least USD 71.1 million worth of sanctioned dual-use goods to Russia.[102] Despite the subsequent decrease, Serbia continues to export **machine tool parts, bearings, electrical apparatus, and other dual-use components**. While our monthly data analysis indicates occasional overlaps between increases in EU exports to Serbia and Serbia's shipments of dual-use goods to Russia, such instances are less frequent and less pronounced than in cases like Armenia, suggesting a more limited or inconsistent re-export pattern.

While the value of the dual-use goods export of some of the countries – both individually and combined – remain marginal compared to Armenia and Serbia, for example, it is notable that they recorded an increase in exports to Russia in 2021. Georgia, Montenegro, and North Macedonia recorded their highest export of dual-use goods to Russia in 2021. Combined, the export of the three countries might worth only EUR 598,908 but represent a 103% increase compared to their average annual export levels from 2010 to 2020. This trend reflects Russia's opportunistic approach to sourcing dual-use goods through any available channel, regardless of scale, and suggests that it may have been stockpiling critical military-grade components in preparation for the invasion of Ukraine.[103]

The **Moldovan** government found that three Transnistrian factories had been selling Western aircraft parts to Russian airlines just months after Russia's

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[102] Katić, M., and Jevtović, M., "Milionske zarade srpskih firmi kroz šemu zaobilaženja sankcija Rusiji", *RFE/RL's Balkan Service*, 8 November 2023.

[103] Kosovo's export of dual-use items to Russia was recorded as "0" for all years, while until 2014, Ukraine's export of dual-use items to Russia was substantial, surpassing even Armenia's current export levels. As expected, these exports declined sharply after Russia's annexation of Crimea. There is strong evidence that even countries with little or no direct trade history with Russia have been facilitating the export of sensitive goods to Russia since 2022.

invasion of Ukraine in February 2022.[104] **Georgia** has also been recognised as a key hub for sanctions evasion with a crucial role in sustaining Russia's military industrial complex.[105] Since 2022, the country has increased its exports of dual-use items to neighbouring and Central Asian countries, **raising concerns that it may be exploiting legal loopholes to channel critical goods to Russia:**

- Armenia received USD 3 million worth of Digital Data Processing Blocks from Georgia in 2023, a dramatic increase compared to 2022.
- In 2023, 80% of Georgia's radio navigation system exports went to Azerbaijan, with 11% directed to Turkmenistan - marking the first such exports to Turkmenistan since 2022.[106]
- In 2023, Georgia's export of sound/image receiving and transmitting equipment to Kazakhstan and Azerbaijan rose 34%, with these countries serving as intermediaries to Russia.[107]
- In 2023, Georgia's exports of radio navigation equipment to Russia rose 213% to over USD 0.3 million, while exports of integrated circuit components increased 36%, also totalling USD 0.3 million.[108]

Table 2. Western Balkans and Black Sea countries' Export of Dual-Use Items to Russia between 2010-2024 (in USD millions)

Country	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
BiH	0	0	0	0	0	0	0.01	0	0	0	0	0	0	0.04	0
Montenegro	0	0	0	0	0	0	0	0	0	0	0	0.01	0	0	0
North Macedonia	0	0.01	0	0	0.01	0	0	0.02	0.01	0.02	0.06	0.31	0.06	0	0
Albania	0	0	0	0	0	0	0.18	0.13	0.03	0	0	0	0	0	0
Serbia	0.68	1.61	1.13	1.7	2.82	2.65	3.02	5.46	6.71	6.51	7.6	12.15	13.88	4.69	0.02
Kosovo	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Moldova	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Georgia	0.01	0.05	0.03	0.03	0	0	0.04	0	0	0.05	0.01	0.28	0.01	0	0
Ukraine	0	0	120.35	117.69	82.96	0	0	7.39	15.63	11	10.36	15.43	1.7	0	0
Armenia	1.25	1.4	1.52	1.49	1.94	1.65	2.77	3.36	5.16	3.04	3.5	4.23	94.56	72.01	13.74
Benchmark Countries															
Kazakhstan	23.72	93.53	125.54	93.08	126.63	29.15	35.7	49.07	82.11	88.67	59.06	61.12	306.03	292.78	34.31
Kyrgyzstan	3.38	1.29	0.88	1.03	1.03	0.86	4.01	0.73	0.64	1.17	1.35	1.71	11.24	30.38	11.95
Türkiye	31.43	47.78	53.69	41.96	33.74	19.99	12.65	17.83	19.44	21.7	28.98	30.43	95.45	160.07	52.93

Note: The table displays the export of dual-use goods to Russia over a 14-year period, with the highest recorded values for some of the countries highlighted in red.
Source: Eurostat.

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104 Ibragimova, G., "Is Moldova Ready to Pay the Price of Reintegrating Transnistria?", *Carnegie*, 24 January 2024.

105 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.

106 Imerlishvili, M., "RFE/RL Report on Georgia Re-Exporting "Dual-Use" Products for Russia Stirs Controversy", Civil Georgia, 7 March 2024.

107 Yusif, A.,and Mikhelidze, N., "Georgia: New investigation unveils country's role in facilitation of military tech exports to Russia despite intl. sanctions", *Business and Human Right Resource Centre*, 1 August 2024.

108 Ibid.

SANCTIONS EVASION TACTICS OF ILLICIT TRADE NETWORKS

The cases analysed from the **Western Balkans and the Black Sea countries** reveal a set of recurring patterns in sanction evasion tactics. Key trends among companies include **rebranding** and **relocation** where firms change names, relocate operations, or register subsidiaries in third countries to maintain the trade flow despite restrictions.

- **"TAKO" LLC (Armenia)** – Previously known as **"TACO" LLC**, rebranded after being sanctioned in 2022.[109] Despite restrictions, it continued supplying electronic components to Russia's defence sector. Fully owned by a Russian national, the company collaborated with the Russian **"Radioavtomatika"**[110] – also under U.S. sanctions -- to channel electronic and telecommunications equipment into Russia.[111]

- **"Milur Electronics" LLC (Armenia)** – Acts as a front for **"Milandr"**, a sanctioned Russian microelectronics company linked to Russia's military industrial complex, allowing continued access to foreign suppliers.[112] Operating out of Armenia, Milur Electronics evaded export controls by placing orders from foreign factories, producing microchips, and facilitating overseas sales on behalf of Milandr to Russia.

- Serbian company **"Kominvex"** – Initially an automotive parts trader, it shifted its focus and market segment to exporting **microchips and dual-use electronics** after 2022.[113] From March 2022 to July 2023, Kominvex exported a total of USD 143.9 million worth of goods to Russia with a third of these shipments falling into the "high-priority" electronics and equipment categories.[114]

Using **shell companies** and **front entities** is another common strategy where new or little-known companies are established in third countries to avoid direct transactions to Russia by creating layers of intermediary companies and by masking the true end-user of restricted goods.

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109 Office of Foreign Assets Control (OFAC), Sanction List Search - TACO LLC.

110 OpenSanctions, Radioavtomatika LLC.

111 U.S Department of the Treasury, "Treasury Targets Russian Financial Facilitators and Sanctions Evaders Around the World", 12 April 2023.

112 Pope, H., "U.S. Treasury Sanctions Kremlin Microelectronics Supplier", OCCRP, 17 November 2022.

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

114 Katic, M., Jevtovic, M., and Zivanovic, M., "Investigation: Serbian Firms Ship Sanctioned Dual-Use Tech To Russia", *Business and Human Rights Centre*, 8 November 2023 ; OpenSanctions, Kominvex DOO.

- **Moldovan firms ("Airrock Solutions"** (founded in November 2021), **"Aerostage Services"** (founded in April 2022), **"Maxjet Service"**) – acted as intermediaries for approximately USD 15 million worth of **Western aircraft parts** and organised their delivery to major Russian airlines, including Pobeda and S7 Engineering, just months after Russia's invasion of Ukraine in February 2022.[115]

- **"International Business Corporation Bar" (Montenegro)** – used as a **front company** to transship European-origin industrial equipment and military supplies to Russia. Despite being registered in Montenegro, it was fully controlled by the Russian national Sergey Kokorev, who used IBC to export critical items for the aerospace, defence, and heavy industries including to AMS Tekhnika, a U.S.-designated Russian firm supplying Russia's military industrial complex.[116]

- Serbian firms - **"Ventrade" DOO**[117] and **"Soha Info"**[118] – facilitated the export of **high-priority electronics** to Russian military-linked companies. Founded in April 2022, Ventrade DOO was connected to Promsvyazradio, a Russian firm specialising in radio equipment and dual-use technology imports. Between October 2022 and July 2023, Soha Info exported USD 18 million in goods to Russia, including 30% in high-priority, dual-use electronics and USD 4.3 million in tightly controlled Intel components used in Russian weapons.[119]

Sanctioned goods are often **diverted via third countries** - first exported to non-sanctioning nations and then rerouted to Russia, taking advantage of weak enforcement controls in transit countries.

- **Luxury car smuggling (Georgia)** – cars are legally sold in Georgia but then immediately transported across the border to Russia, avoiding official export controls. Under Georgian law, if a car is driven across the border by an individual, it is not considered a commercial export. This allows new, high-value vehicles to be moved into Russia without triggering export restrictions. Since Georgia's National Statistics Bureau only records exports when a customs declaration is filled – though never filled in this case - luxury cars over EUR 50,000 are exported to Russia without any trace.

[115] Ukrainska Pravda, "Three Moldovan companies sold US$15 million worth of aircraft parts to Russia", 31 January 2024; Radio Free Europe/Radio Liberty (REF/RL), "Moldova Suspends Companies That Brokered Airplane-Parts Sales To Russia", 13 August 2024.

[116] Visnjic, B., "US Sanctions Companies from Serbia, Montenegro for Military Exports to Russia", *Balkan Insight*, 31 October 2024; OpenSanctions, International Business Corporation Bar.

[117] OpenSanctions, Ventrade DOO.

[118] OpenSanctions, Soha Info.

[119] Katic, M., Jevtovic, M., and Zivanovic, M., "Investigation: Serbian Firms Ship Sanctioned Dual-Use Tech To Russia", *Business and Human Rights Centre*, 8 November 2023.

Vehicles are transported from Tbilisi dealerships to a hidden lot near the Lars border, issued temporary plates, and driven into Russia as "private travel" to avoid export records. The "Lars" border parking lot operates with a high turnover - as soon as one car crosses into Russia, another arrives to take its place. Nearly all are brand new, unregistered, and still in their original protective packaging, confirming they were never driven in Georgia.

- The **Georgian "Kairo Logistics"** charged an inflated rate for transporting drones to Russia, likely to cover bribery expenses. During the investigation, the logistics operator candidly stated, "It's a sanctioned cargo… you need to communicate with positions using envelopes," implying the use of bribes. Similarly, another Georgian logistics company, "Cargo Rapido" directly imposed a "10% insurance fee," which was essentially a disguised bribe to customs officials.[120]

- **Bosnia's auto parts industry** – German automotive firm Mann + Hummel's Bosnian subsidiary sold parts to Turkish intermediaries, who then re-exported the same goods to Russia. This avoided direct violation of EU sanctions.[121] The **German factory in Bosnia has exported EUR 753,331 worth of products to Russia in 2023, including** deliveries to Russian automotive companies Yural (Favorit Parts) and F.A Logistik (Forum Auto), two of Russia's largest automotive parts traders. In February 2024, reports emerged that F.A Logistik had hired a veteran who had fought for the Russian army in Ukraine as a senior administrator.[122] In March 2022, Ukraine's Deputy Digital Minister Kostiantyn Koshelenko raised concerns that Mann + Hummel parts had been found in captured Russian military vehicles, including the 'Tigr' and 'Pantsir tanks.'[123]

  In many cases, Bosnian trade data lists **Turkish traders as the exporters rather than Mann + Hummel itself**. While a Turkish company ordering from the Bosnian subsidiary of a German firm and then shipping goods to Russia does not necessarily violate sanctions, it underscores how German subsidiaries in third-party countries can be exploited by intermediaries to circumvent restrictions.

Falsifying trade documents, through altered declarations, mislabeling of goods, and forged certificates of origin, is a common tactic for smuggling restricted goods across borders undetected. Common techniques observed include mislabelling goods (e.g. declaring a restricted semiconductor as a "household electronics component"), undervaluing invoices (to under-report the payment that will be made, with the balance settled illicitly via offshore

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120 Asatiani, I., "Russia's "Auto Heaven"", *Association of Investigative Journalists in Georgia*, 13 February 2024.

121 Aurora Media, "Participants in a Special Military Operation in Khabarovsk Krai are Being Helped to Master New Professions", 21 February 2024.

122 Ibid.

123 Automobil Industrie, "Bosch schränkt Russlandgeschäft massiv ein", 18 March 2022.

accounts or crypto), and split shipments (sending disassembled parts that only become militarily-useful when reassembled in Russia). These methods generate discrepancies in trade data that analysts use to infer illicit flows. The two cases from Georgia below clearly illustrate that evaders often rely on bribing customs officials to bypass sanctions.

- **"Kairo Logistics" (Georgia) –** explicitly admitted to falsifying origin documents, rerouting shipments through Türkiye and Azerbaijan and then shipping them to Russia. Registered in 2018 in Moscow, in Georgia, the company operated under the legal entity "Service-Multi" LLC.[124] To ship drones from Tbilisi to Samara (Russia), no physical documentation was required beyond an invoice and an electronic signature on a contract. The company explained that while the goods were technically not sent directly to Russia, the altered documentation allowed the shipment to pass through third countries like Türkiye or Azerbaijan before reaching Russia. For this service they provided a quote 20 times higher than usual, citing the cargo's sanctioned status, and mentioned the use of bribes at border crossings to ensure successful delivery.[125]

- **"Cargo Rapido" (Georgia) –** agreed to transport Intel processors and memory cards to Russia without official documentation. The service included an additional cost of a "10% insurance fee" to bypass customs regulations. The operator explained that the shipment would be conducted unofficially, without export declarations or proper documentation. The transportation route was Tbilisi-Vladikavkaz-Samara, with an estimated delivery time of four weeks. The operator explicitly stated that no documentation was required, except for a contract with an individual, ensuring that payments would not go through the company's account. Registered in 2020 and owned by the Russian citizen - Taimuraz Tokazov, the company is primarily handling parcel deliveries to and from Russia.[126, 127]

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124 Yusif, A. and Mikhelidze, N., "Sanction Evasion: How Georgia Facilitates Russia's Military Supply Chain", Experiment #1, *Ifact*, 1 August 2024.

125 Ibid.

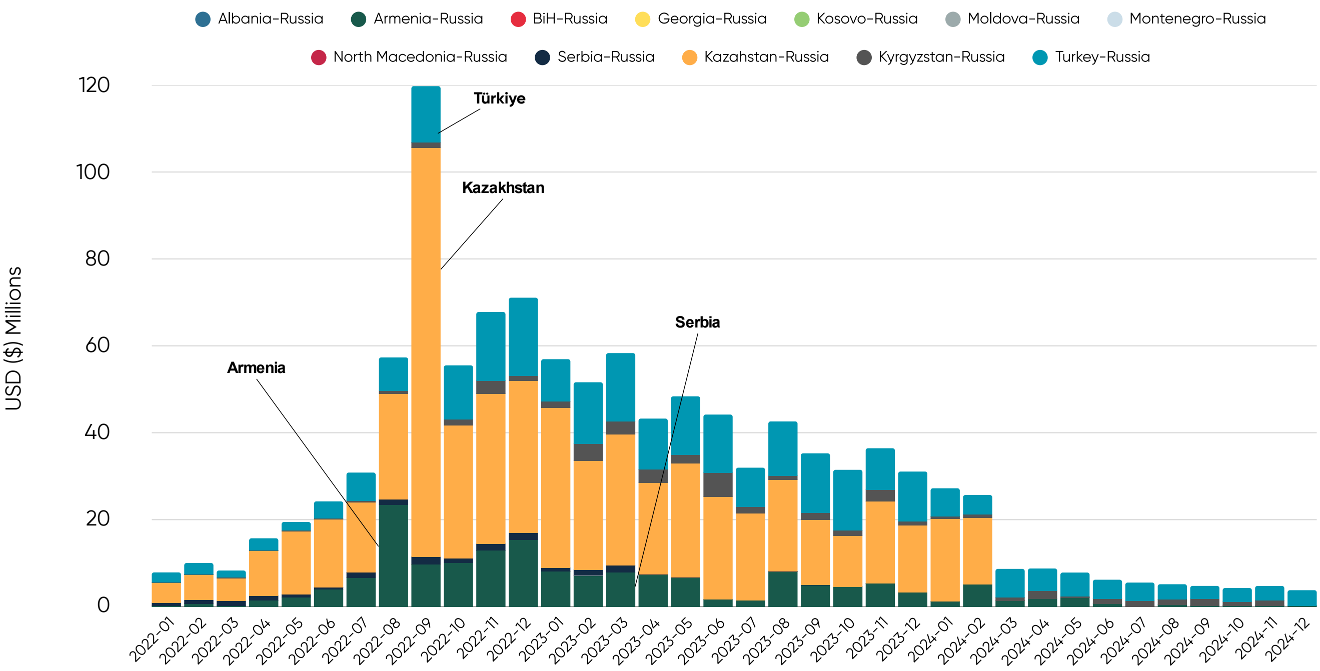
126 Yusif, A. and Mikhelidze, N., "Sanction Evasion: How Georgia Facilitates Russia's Military Supply Chain", Experiment #2, *Ifact*, 1 August 2024.

127 When approached by journalists and asked about the illegal transportation of sanctioned goods to Russia, Taimuraz Tokazov denied involvement. See: Iusif, A, and Mikhelidze, N., "Evading Sanctions: How Georgia Facilitates Russia's Military Supply Chain", New Iveria.

THE NEXUS BETWEEN ILLICIT FINANCIAL FLOWS AND SANCTIONS EVASION

While EU exports of dual-use goods have increased across all ten countries, **Armenia** together with **Kazakhstan** and **Kyrgyzstan** stand out as the biggest buyers of EU-manufactured dual-use goods. The EU exports to these three members of the Eurasian Economic Union **strongly influence their monthly exports to Russia, highlighting these countries as key re-export hubs for Russian trade aiding sanctions evasion practices** (Figure 9).

Figure 9. Exports of Dual-Use Goods from Western Balkans and Black Sea Countries, Kazakhstan, Kyrgyzstan and Türkiye to Russia Since 2022 on a Monthly Basis



Source: Eurostat, Easy COMEXT; UN Comtrade Database.

A closer examination of the monthly trade flows between 2022 and 2024 suggests that for every USD 1 increase in EU exports to Armenia, Armenian exports to Russia increased by USD 2.58. **This elasticity far exceeds that observed in Kazakhstan and Kyrgyzstan**. Moreover, the timing of these trade spikes is also revealing. Between 2021 and 2023, Armenia's re-exports to Russia closely mirrored its EU imports of dual-use items. The rapid redirection of EU technology into Russia's war machine during the same period is further seen in huge spikes in static converters and printed circuits – essential for defense electronics, electrical apparatus and data-processing machines – critical for military logistics and cyber operations. Notably, communication apparatus surged 28,002% (USD 116K in 2021 to USD 32.8M in 2022), while television camera exports - previously absent from the trade statistics - hit USD 5 million in exports in 2022.

In late 2022, **EU exports of television and digital cameras** to Armenia saw unusual increases in September, October, and December—followed closely by corresponding spikes in Armenian exports to Russia in November, December, and early 2023. The same pattern applies to **static converters and electrical apparatus** used in military circuits.

At the same time, Kazakhstan's exports to Russia closely mirror EU exports to Kazakhstan, with a USD 1 increase in EU exports linked to a USD 0.89 rise in Kazakh exports to Russia. Adjustments occur almost immediately, surpassing Armenia and Kyrgyzstan in speed, highlighting Kazakhstan's critical role in Russia's logistical network:

- EU exports of **machining centers (used for tank** and **aircraft components)** to Kazakhstan surged 137% in late 2022, followed by a sharp rise in Kazakhstan's exports to Russia in early 2023 - a pattern repeated in late 2023 and early 2024.
- Further, **automatic data-processing units (used for missile guidance** and **radar operations)** saw a 2,259.12% jump in Kazakh exports to Russia in September 2022, after a 61.54% rise in EU exports in July.
- **Machines for data transmission (used for drone control systems** and **encrypted data transfer)** followed a similar trajectory, with increases of 83.78% (Sept 2022), 189.99% (Feb 2023), and 106.15% (May 2023). These spikes pushed monthly Kazakh exports to Russia from under USD 1 million before 2022 to USD 2–9 million in 2023.

Kyrgyzstan follows the same pattern. On average, a USD 1 increase in EU exports results in a USD 0.47 rise in Kyrgyz exports to Russia, with 92% of trade adjustments occurring within 1-2 months.

Kazakhstan and Kyrgyzstan have become key re-export hubs for the following dual-use items to Russia:

Kazakhstan:
- **Bearings (ball, cylindrical, spherical, and tapered roller bearings)** saw massive spikes, especially tapered roller bearings, rising from USD 16,823 in 2021 to USD 14.8 million in 2023 - critical for military vehicles, tanks, and aircraft.
- **Communication apparatus** (for secure military communications) surged by 3,778%.
- **Static converters** (for military and aerospace power management) increased by 407% in 2022 and 125% in 2023.
- **Automatic data-processing machines skyrocketed** from USD 91,595 in 2021 to USD 71.1 million in 2022—a dramatic 77,807% rise.
- **Electronic integrated circuits, critical for missile systems**, grew by 33,247% from 2021 to 2022.

Kyrgyzstan:
- **Reception and transmission apparatus surged** from a negligible base in 2021, increasing by an astonishing 576,685% in 2023[128]
- **Electronic integrated circuits and amplifiers** (newly exported in 2021) increased from USD 18 in 2021 to USD 8.6 million in 2023.
- **Aircraft and spacecraft components** began in 2022, growing from USD 2 million in 2022 to USD 2.56 million in 2023.

After December 2023, the statistical link between EU exports to Türkiye and its exports to Russia has weakened. While Türkiye remains the largest importer of dual-use goods from the EU, from March 2022 to February 2024, Türkiye exported USD 242 million in dual-use goods to Russia - significant, but still less than Kazakhstan's USD 590 million.

The statistical correlation between the increase in EU exports to the Western Balkans and Black Sea countries and corresponding dual-use exports to Russia is relatively weak. However, this does not rule out the possibility of specific cases of re-exports, especially given the sharp rise in imports of Western dual-use goods after 2022, which deviates from the typical consumption patterns of these products in those countries over the previous decade.

While most of the Western Balkan countries reported minimal exports of dual-use goods to Russia between 2022 and 2024, **Serbia stands out as an exception**. It has maintained significant trade ties with Russia, exporting a range of dual-use items, needed for the production, maintenance, and operation of advanced industrial and military applications. The key exported items included parts and accessories for machine tools, various types of bearings (ball, tapered roller, spherical roller), static converters, telecommunication equipment (for voice, image, and data transmission), printed circuits, plugs, sockets, and switching apparatus for low-voltage electrical circuits.

More broadly, dual-use goods exports to Russia from most observed countries **dropped sharply after February 2024**, leaving Türkiye and Kyrgyzstan as the main suppliers, though at lower volumes. This decline could be explained with the growing pressure from Western countries and the threat of secondary sanctions.[129,130] The US pressure and **threat of SWIFT exclusion of Kyrgyzstan** led to new banking rules and tightened financial controls, closing this payment route for goods from Europe and disrupting Russia's imports.[131] Meanwhile, Armenia has managed to keep the delicate balance between Russia and the West by **shifting its export of dual-use items to Belarus** and Kyrgyzstan, guaranteeing a continued flow of goods to Russia.[132]

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[128] In 2021, Kyrgyzstan's export of reception and transmission apparatus to Russia amounted to USD 334, whereas by 2023, it had surged to USD 1,926,462.

[129] Shahbazov, F., "Türkiye-Russia trade declines amid Western sanctions", *Eurasia Daily Monitor Volume: 21 Issue: 151*, Jamestown Foundation, 18 October 2024.

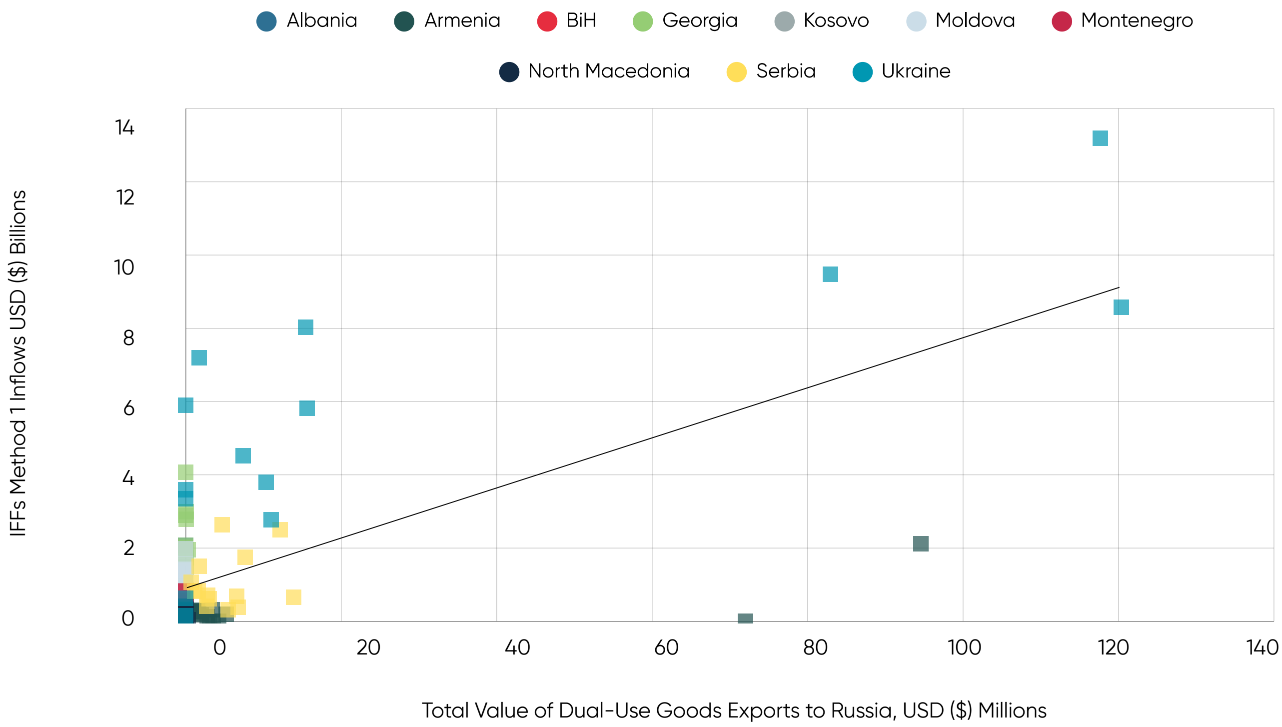
[130] Samson, A., Cook, C., and Seddon, M., "Türkiye quietly halts re-exports of US-made goods to Russia", *Financial Times*, 30 April 2024.

[131] EUToday Correspondents, "Kyrgyzstan Closes Payment Route for Goods from Europe and China, Disrupting Russian Imports", *EU Today*, 30 September 2024.

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

A **correlation analysis** showed there is a **positive correlation** between the rise in exports of dual-use goods from target countries to Russia and the increase in illicit financial inflows in the same countries after 2021 (Figure 10).

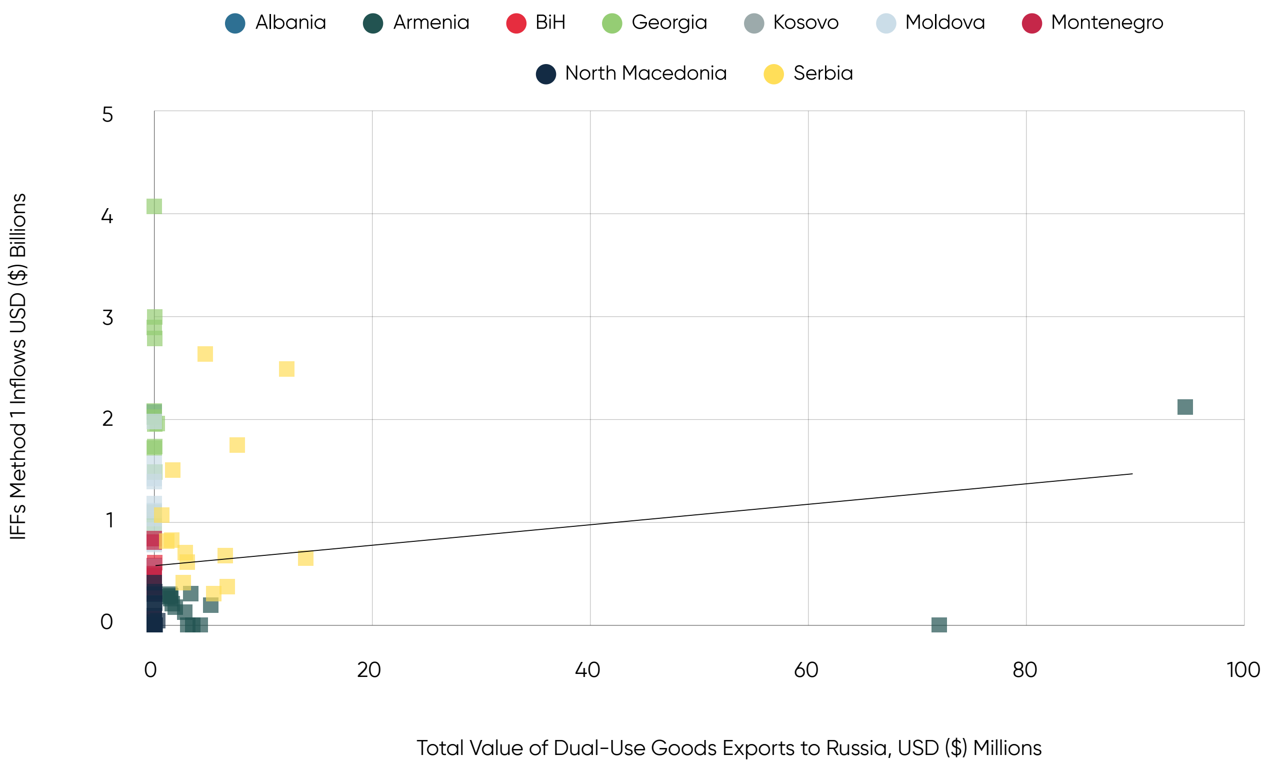
Figure 10. Correlation Between Dual-use Goods Exports to Russia and IFFs Inflows (All 10 Countries)



Source: Eurostat, Easy COMEXT and UN Comtrade Database. CSD Calculations Based on IMF (Trade Statistical Database) and Estimated via UNCTAD's Method 1 (PCM+).

When removing Ukraine from the list of countries, however, the correlation became much weaker (Figure 11).

Figure 11. Correlation between Dual-use Goods Exports to Russia and IFFs Inflows (without Ukraine)



Source: Eurostat, Easy COMEXT and UN Comtrade Database. CSD Calculations Based on IMF (Trade Statistical Database) and Estimated via UNCTAD's Method 1 (PCM+).

To conduct a more robust regression analysis and thoroughly assess the role of dual-use items as a driver of illicit financial flows, it would be necessary to further explore and include a broader set of independent and control variables.[133]

[133] Independent variables such as energy prices (key commodities), state capture and corruption indexes; Control variables such as size of the economy, level of political stability and governance effectiveness, trade policies etc.

WHAT'S NEXT

IFFs 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, while other countries – also known for their specific links and vulnerabilities to Russia, showed weaker and sporadic trends (Georgia, Bosnia and Herzegovina, and Moldova). While these spikes are not statistically significant on their own, **they reflect Russia's opportunistic approach to sourcing critical goods through any available channel and demonstrate how existing vulnerabilities can be exploited**. The data patterns and documented cases from investigative reporting highlight that while Russia's primary transhipment corridors may be concentrated, it is likely leveraging every available opportunity - regardless of scale or consistency - to stockpile and access dual-use items essential to its military-industrial complex.

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.[134,135] The complicity of both state and non-state actors contributes to this growing challenge, further eroding EU accession, rule of law and anticorruption capacity-building efforts.

The Geopolitics of Illicit Flows

For the EU to **become a geopolitical player and uphold its strategic interests and values**, 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 geoeco-

[134] Shentov, O., Stefanov, R, and Vladimirov, M. (eds.), The Kremlin Playbook in Europe, Sofia: Center for the Study of Democracy, 2020.

[135] Stefanov et al., The Kremlin Playbook in Southeast Europe, Sofia: CSD, 2020.

nomic 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 and corruption.

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 corruption and state capture**. Addressing these new challenges should further drive the EU to intensify its focus on policies for **strategic autonomy and economic security**, while reinforcing its core democratic values. The EU is actively pursuing strategic autonomy and economic security, to reduce reliance on external actors and enhance its capacity to act independently, balancing the need for resilience with its commitment to an open and competitive economy.

Economic Security through Diversification

In the new geoeconomic reality of rapidly increasing security threats, economic coercion and trade wars, the EU should 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 Germany[136]) to prevent illicit capital from entering critical infrastructure and key sectors.

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-free implementation and local buy-in. This

[136] 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.

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.

Early Warning at the 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. This system could be built on methodologies such as UNCTAD's Partner Country method, which measures IFFs in trade sector and further enhanced by integrating tracking of trade in sensitive goods under sanctions (e.g., dual-use items). 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*[137] 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.[138] And last, but not least, national governments should continuously engage with **state and non-state actors** (tech companies, shipping services and intermediaries) on the risks of **evading sanctions and of law enforcement consequences**.

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**[139] 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.[140] Moreover, offshore destinations and tax havens, such as the British Virgin Islands (BVI),

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

[138] Gerganov, A., Monitoring Anti-Corruption Policy Implementation in High-Risk Sectors: Benchmarking Reports of Nine Public Organisations in Bulgaria, Italy, Romania and Spain, Sofia, Center for the Study of Democracy, 2021.

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

[140] 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.

Panama, Curaçao, and the Cayman Islands, serve as major repositories for the financial assets of kleptocratic regimes and sanction evasion.[141]

Development assistance, when effectively implemented, can serve as a powerful tool against the global IFFs and state capture threat.[142] However, the Official Development Assistance (ODA) is facing growing cuts as donor countries significantly increase their defence spending in response to escalating global security threats. ODA budgets have come under growing pressure as many donor countries significantly ramp up their defence spending in response to heightened geopolitical tensions. There is a real risk that funding may be diverted away from long-term development objectives related to the democracy and rule of law towards short-term humanitarian and refugee assistance, addressing short-term problems over creating sustainable solutions. As fiscal space tightens, there is a real risk that ODA will be redirected from addressing systemic challenges to more immediate crises, weakening the broader effectiveness of international development cooperation. Therefore, maintaining a sustainable balance between defence, development, and diplomacy is essential to ensure that short-term security needs do not eclipse long-term stability and global development objectives.

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.
- 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.[143]

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

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

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