

MARCH 2019



THE KREMLIN PLAYBOOK 2

THE ENABLERS

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HEATHER A. CONLEY

RUSLAN STEFANOV

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A REPORT OF THE
CSIS EUROPE PROGRAM AND THE CSD ECONOMICS PROGRAM

CSIS | CENTER FOR STRATEGIC &
INTERNATIONAL STUDIES

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Acknowledgments

This project has given us an appreciation for what a filmmaker must feel like after producing an unexpected hit and has the audacity to contemplate producing a sequel. Will it be as popular and impactful as the first edition or will it fall flat? We never anticipated the success of *The Kremlin Playbook: Understanding Russian Influence in Central and Eastern Europe*, released in 2016, and we certainly had not contemplated producing a second study. But after receiving a great deal of encouragement and positive transatlantic feedback, we embarked on this second ride. It now seems like the right decision and the right time—nearly three years after the publication of our first report—to cover another set of European countries and their interactions with Russian malign economic influence. This report covers a study period from 2005 to 2016, with 2017 data whenever available. Our methodology to calculate the Russian corporate footprint and gather FDI data follows the first report’s methodology.¹

It takes a talented and dedicated crew to produce a sequel. *The Kremlin Playbook 2* would not have been possible without the invaluable contributions of many colleagues and experts beyond the report’s authors. We would like to sincerely thank our country experts—Gustav Gressel for Austria, Ana Otilia Nutu for Romania, Vit Simral for the Czech Republic, Filippo Torricelli for Italy, and Ruurd Oosterwoud and Jon Roozenbeek for the Netherlands—for their detailed country analyses that formed the core of our economic picture and provided important political and cultural context for each case study. We also benefitted enormously from many knowledgeable embassy officials from the case study countries as well as U.S. officials.

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Now, let’s roll the tape.

1 Heather Conley et al., *The Kremlin Playbook: Understanding Russian Influence in Central and Eastern Europe* (Lanham: Rowman & Littlefield, 2016), XVII-XIX.

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Executive Summary

In 2016, the major study *The Kremlin Playbook: Understanding Russian Influence in Central and Eastern Europe* concluded that the Kremlin has developed a pattern of malign economic influence in Europe through the cultivation of “an opaque network of patronage across the region that it uses to influence and direct decision-making.”¹ This network of political and economic connections—an “unvirtuous” cycle of influence—thrives on corruption and the exploitation of governance gaps in key markets and institutions. Ultimately, the aim is to weaken and destroy democratic systems from within.²

Despite the varied nature of the countries presented in the first volume, the names of specific jurisdictions, companies, and members of Vladimir Putin’s inner circle kept appearing in nearly every network of influence. Was this a coincidence? Or could there be enabling forces that unwittingly or purposely amplify Russian malign economic influence? Exploring the answers to these questions formed the basis of our second report, *The Kremlin Playbook 2: The Enablers*.

There has been a visible political awakening to the national security threat posed by Russian malign economic influence since 2016. From the Countering America’s Adversaries Through Sanctions Act of 2017 to strengthened anti-money laundering rules in the European Union, the transatlantic community has taken some steps to address this threat. But *The Kremlin Playbook 2* demonstrates just how much work remains to be done. Western democracies must acknowledge their enablement of malign economic influence and uproot it from their financial systems.

The Enabling Ecosystem

Merriam-Webster defines an enabler as “[o]ne that enables another to achieve an end. *Especially*: one who enables another to persist in self-destructive behavior [. . .] by providing excuses or by making it possible to avoid the consequences of such behavior.”³

Enablers of Russian malign influence allow the Kremlin to achieve its end and avoid some of the consequences of its behavior. By aiding and abetting Russia’s malign influence, enablers assist the Kremlin in self-destructive behavior that siphons funds

1 Heather Conley et al., *The Kremlin Playbook: Understanding Russian Influence in Central and Eastern Europe* (Lanham: Rowman & Littlefield, October 2016), 10.

2 For the purposes of this study, we use the definition and use of the term “corruption” established in *The Kremlin Playbook*: “the alleged or reported exercise of one’s power, position, or resources in order to exploit or exert undue influence over businesses, individuals, or state bodies and institutions, typically through nontransparent and questionable means. This may include actions that could be deliberate and/or unlawful, but may not necessarily be so. The examples we cite support our observations of how this unvirtuous circle works based on open-source facts and information, but these observations do not suggest or accuse any specific individuals or wrongdoing.” Ibid.

3 “Enabler,” Merriam-Webster, <https://www.merriam-webster.com/dictionary/enabler>.

offshore (often in or through Europe) and depletes the Russian tax base at a time of dire economic conditions. Crucially, by allowing Russian economic influence to cycle through their systems, **enablers actively participate in the weakening and discrediting of their own democratic structures.**

Enablers present several key features:

- Open economies with developed financial and banking systems that form part of the core European financial infrastructure.
- Sophisticated, permissive, and at times opaque business and legal environments with regard to company law, taxation, and incorporation.
- Large companies in enabling countries, often national champions, and their networks of ownership in Europe provide Russian-owned companies with broad access to the European markets through mergers and acquisitions.
- A highly developed corporate service provider sector (lawyers, accountants, incorporation agents, etc.) supports complex financial schemes and company structures.
- National authorities' oversight capabilities are overwhelmed by the complexity and multi-jurisdictional nature of schemes.
- Large national economic players are close to power circles and can receive political support of their financial interests, some of which are tied to Russia. These large players have long-standing investment relations in Russia and with its companies.

The concentration of financial and corporate services provider industries and activities, as well as energy ties to Russia, made Italy, Austria, and the Netherlands enabling hubs for Russian economic influence.

The Illicit Finance-National Security Nexus

Understanding Russian malign economic influence requires understanding the risks inherent in large Russian investment flows. Because enablers can facilitate or aid illicit financial flows,⁴ they jeopardize the integrity of open market economies and, ultimately, create a threat to national security. State-owned enterprises and large companies play an important role in the furtherance of Russian malign economic influence because of their dominant position and ability to distort market competition. The significant amounts of financial flows they oversee make them susceptible to illicit practices or abuse.

4 The World Bank defines illicit financial flows as “cross-border movement of capital associated with illegal activity or more explicitly, money that is illegally earned, transferred, or used that crosses borders.” This involves three main dynamics: (1) “the acts themselves are illegal (e.g., corruption, tax evasion)”; (2) “the funds are the results of illegal acts (e.g., smuggling and trafficking [. . .])”; (3) “the funds are used for illegal purposes (e.g., financing of organized crime).” “Illicit Financial Flows (IFFs),” The World Bank, July 7, 2017, <http://www.worldbank.org/en/topic/financialsector/brief/illicit-financial-flows-iffs>.

Enablers can facilitate the integration of illicit funds within legitimate global financial flows, assisted by shell companies and corporate facilitators like banks, attorneys, or accountants. Russian private holdings abroad total an estimated \$1 trillion.⁵ These significant capital flows create a potential dependence on illicit funds in which the enabler and the Kremlin both benefit from *and* are dependent on a system that helps these flows transit in and out of Russia and Europe. Illicit finance, particularly money laundering,⁶ can damage national security by corrupting government officials who can alter policies, impeding the free flow of capital, reducing the efficacy of sanctions regimes, and distorting entire markets and industries.

This link between illicit finance and national security can materialize in two separate channels—public corruption and organized crime—that follow the same track and at times overlap. In the case of Russia, these two flows converge at the behest of the Kremlin.⁷ Malign actors hiding funds and profits can do so through money laundering and tax avoidance or evasion.

Enabling countries' developed financial systems move these billions in investment and profits in and out of European countries every year. These financial systems offer specific tools that are designed to obscure the origins of certain investments and conceal illicit financing. Tactics that remove profits from the reach of tax authorities (and thus state revenue) may not be illegal, but some are meant to operate just **below the threshold of illegality**, where enablers excel—within a financial gray zone. They might be following the *letter* of the law, but certainly not its *spirit*, and industries like corporate service providers (CSPs) assist in this task by feeding the enabling ecosystem through complex, cross-border transactions and company constructions.

This complex ecosystem has grown exponentially in the past three decades with rapid globalization and Russia's deep integration within our financial system. It has become almost impossible to disentangle the reported \$1 trillion of Russian capital outflows from other financial flows, including for the most capable oversight bodies in the world.⁸

Channels of Influence

The sheer **size of financial flows** and foreign direct investment exposes the Kremlin's reliance on the enablers' financial networks to invest and send money across

- 5 Anders Aslund, "It's time to go after Vladimir Putin's money in the West," *Washington Post*, March 29, 2018, <https://www.washingtonpost.com/news/democracy-post/wp/2018/03/29/its-time-to-go-after-vladimir-putins-money-in-the-west/>.
- 6 Interpol defines money laundering as "any act or attempted act to conceal or disguise the identity of illegally obtained proceeds so that they appear to have originated from legitimate sources." See "Money laundering," Interpol, <https://www.interpol.int/Crime-areas/Financial-crime/Money-laundering>.
- 7 Karen Dawisha, *Putin's Kleptocracy: Who Owns Russia?* (New York: Simon & Schuster, 2015); Stephen Handelman, *Comrade Criminal: Russia's New Mafiya* (New Haven: Yale University Press, 1995).
- 8 Filip Novokmet, Thomas Piketty, and Gabriel Zucman, "From Soviets to Oligarchs: Inequality and Property in Russia 1905-2016," *The Journal of Economic Inequality* 16, no. 2 (June 2018).

Europe and abroad to offshore centers. Though capital inflows in Central and Eastern Europe have grown substantially since 2005, it is in several Western European countries that Russian companies have retained most of their assets and funds.

In Italy, Austria, and the Netherlands alone, Russian FDI stocks have expanded from just €5.4 billion in 2006 to close to €160 billion at the end of 2017. In the Netherlands, Russian companies' assets have jumped from €13.2 billion in 2007 to around €96 billion in 2017, including through the use of letterbox companies for tax optimization purposes.⁹ Russian assets thus represented roughly 13 percent of Dutch nominal GDP in 2017, despite the fact that only around 20,000 people work for Russian-owned companies in the Netherlands. In 2014, the Viennese branches of Sberbank and VTB Bank were exempted from EU sanctions.¹⁰ The massive influx of Russian FDI to Austria after 2014 could be the result of Russia channeling investment flows to Europe through Austria, in effect circumventing sanctions.

Enablers also present some levels of **corporatism** in which the closeness of national economic champions (majors) to political power provides a sort of covert guarantee of support and protection from the enabler's government for Russian strategic projects in which its national champions are involved. These business-political networks can ensure the country's strategic policies are in line with these economic projects, and by extension, with Russian objectives.

For example, in addition to its long-time strategic partnership with Gazprom, Austrian energy company OMV enjoys close ties with the Austrian People's Party (ÖVP), the leading party in the current government led by Chancellor Sebastian Kurz. Several high-level politicians, including successive Austrian chancellors and foreign ministers, have publicly supported Russian gas pipeline projects, including most recently Nord Stream 2. Austria has opposed the application of EU market rules on the offshore section of the Nord Stream 2 pipeline, and some experts have noted it is likely one of the member states that refused to give the Commission a mandate to negotiate with Gazprom.¹¹

One particularly attractive feature of enablers for Russian malign influence is their **deep connections throughout the European Union** and the Western Balkans, particularly through companies that have an extensive network of branches and subsidiaries across Europe. Enablers are economically and politically connected throughout Europe,

9 "A paper company, shell company or money box company, i.e. a company which has complied only with the bare essentials for organization and registration in a particular country. The actual commercial activities are carried out in another country." "Glossary of Tax Terms," OECD, <http://www.oecd.org/ctp/glossaryoftaxterms.htm#L>.

10 Miriam Widman, "Austria Shields Russian Banks from E.U. Sanctions," *Handelsblatt Global*, July 31, 2014, <https://global.handelsblatt.com/companies/austria-shields-russian-banks-from-e-u-sanctions-5078>.

11 Agata Loskot-Strachota, Rafal Bajczuk, and Szymon Kardas, "Nord Stream 2 divides the West," Centre for Eastern Studies (OSW), June 18, 2018, <https://www.osw.waw.pl/en/publikacje/osw-commentary/2018-06-18/nord-stream-2-divides-west>; "European Commission throws book at Russia's Nord Stream 2 natural gas link," S&P Global Platts, November 1, 2017, <https://blogs.platts.com/2017/11/01/ec-russia-nord-stream-2-gas-link/>.

from high-level political figures being vocal supporters of better relations with Russia to large companies' ties with Russian state-owned companies.

Enablers sometimes help **obscure the Russian origin of political malign influence** through the use of high-level political figures that have been engaged in the amplification of Russian soft power. For example, the Dialogue of Civilizations (DOC) is a research institute headquartered in Berlin (with an office in Vienna) and led by former KGB member and Russian Railroads head Vladimir Yakunin (under U.S. sanctions, though not European sanctions; he was granted a six-month German visa in 2018).¹² Walter Schwimmer, a conservative Austrian politician and former secretary general of the Council of Europe, was a co-founder of the institute.¹³ Every year the institute organizes the Rhodes Forum in Greece, which has been described as a “Kremlin propaganda-fest and a hotbed of Russian nationalists” by some news outlets.¹⁴

Finally, an underappreciated element of Russian malign influence is the **exposure of European businesses to the Russian market** (particularly in enabling countries) and their long-standing business ties with Russian companies. Manufacturing giants like Pirelli, Fiat, and Unilever export a large share of their production to Russia. Some of the largest Austrian banks and insurers generate the bulk of their profits in Russia: the international arm of Raiffeisen Bank, the second-largest Austrian banking group, made 78 percent of its corporate profits in Russia in 2014.¹⁵ Outbound investments from enablers to Russia are a catalyst for the commingling of public and private interests, as companies invested in Russia with access to high-level officials sometimes attempt to soften their governments' approach to Russia.¹⁶

Adaptation of Influence

The Kremlin Playbook 2 continues to document the adaptability of Russian malign influence through our analysis of the Czech Republic, Montenegro, and Romania. The common thread in each of these countries is the vulnerabilities created by institutional and governance weaknesses, in particular, lax approaches to tackling corruption and state capture. The unvirtuous cycle of influence remains at play in these three countries as the Kremlin exploits their weaknesses and governance gaps and tailors societally divisive strategies through a variety of malign instruments.

- 12 Irina Filatova and Mikhail Bushuev, “Sanctioned Putin ally Vladimir Yakunin granted German visa,” Deutsche Welle, August 21, 2018, <https://www.dw.com/en/sanctioned-putin-ally-vladimir-yakunin-granted-german-visa/a-45162025>.
- 13 “Governance,” DOC Research Institute, <https://doc-research.org/about-us/governacy/>.
- 14 Leonid Ragozin, “The Putin adoration society,” Politico, October 11, 2015, <https://www.politico.eu/article/the-putin-adoration-society>; See also: Neil Buckley, “Rhodes gathering blames the world’s woes on the west,” *Financial Times*, October 4, 2016, <https://www.ft.com/content/fc49d136-896d-11e6-8aa5-f79f5696c731>.
- 15 Raiffeisen Bank International, Annual Report 2014 (Vienna, Austria: Raiffeisen Bank International, 2015).
- 16 Rachel Sanderson and Christian Oliver, “Italy accused of blocking tougher sanctions on Russia,” *Financial Times*, July 13, 2014, <https://www.ft.com/content/ad743cae-0a8a-11e4-be06-00144feabdc0>.

Montenegro has significant exposure to Russian economic influence, particularly in the real estate sector: an estimated 70,000 properties belong to Russian owners, and Russian businessmen have acquired valuable hotels in attractive locations since 2006.¹⁷ Montenegro also has a strong cultural link with the Kremlin through the Serbian Orthodox Church.

The Czech Republic is both a recipient (in the nuclear power and financial sectors) and a conduit for Russian economic influence—a hybrid model of sorts. It has seen large investments in the engineering sector—for example, the acquisition of one of the largest suppliers of heavy vehicle parts in nuclear energy, Pilsen Toll, by a Russian state-owned bank. At the same time, the banking sector has been used to transit funds to offshore accounts.¹⁸

Romania has the weakest political and economic ties to Russia of all the case study countries, but Russian malign influence can still enter the country's bloodstream through the exploitation of institutional, political, and societal weaknesses (particularly corruption). Non-transparent privatizations, for example, have opened the door to Russian investors, particularly in the metallurgy sector.¹⁹

Countering Russian Economic Influence

Of all the nations currently under Western sanctions, Russia is one of the most integrated into our financial system. The Kremlin has repeatedly used this integration to exploit institutional weaknesses from within through the corrosive effect of corruption and illicit financial flows. Faced with complex schemes that are designed to cross many borders and operate below legal thresholds, our law enforcement and financial oversight bodies struggle to get a complete picture. And when one jurisdiction attempts to improve standards, malign actors can redirect their networks to other areas in a never-ending game of whack-a-mole. Illicit finance has reaped the benefits of a globalized financial network, while law enforcement and national security actors have remained bound by national rules and borders.

It is time for the United States and its European allies to take decisive action to limit Russia's malign behavior in the European and American financial systems.

Russian malign economic influence and illicit finance operate in a financial gray zone that is a clear and present danger to U.S. national security as well as transatlantic security. Simply put, if we are at war and illicit financing is a critical battle space, we must re-conceptualize our deterrence and offensive tools. To detect and deter the adversary, we must model the integration of intelligence, surveillance, and reconnaissance that has been used in military circles. By taking this approach to the financial

17 "Nesterenko: U Crnoj Gori živi do sedam hiljada Rusa," Vijesti.me, January 27, 2014, <http://www.vijesti.me/vijesti/nesterenko-u-crnoj-gori-zivi-do-sedam-hiljada-rusa-174290> (cache-based source).

18 "Česka spojka v ruske pracce," Investigace.cz, March 20, 2017, <https://www.investigace.cz/ceska-spojka-v-ruske-pracce/>.

19 "România furată. Cazul Mechel – cum au ajuns rușii să controleze mare parte din siderurgia românească," Digi24, January 6, 2015, <https://www.digi24.ro/special/campanii-digi24/romania-furata/romania-furata-cazul-mechel-cum-au-ajuns-rusii-sa-controleze-mare-parte-din-siderurgia-romaneasca-343777>.

gray zone, we can improve our ability to connect the dots of Russian malign economic influence. It is time for the United States and Europe to initiate a massive transparency and accountability offensive at home, focusing first and foremost on enabling actors.

We propose the following recommendations:

- **Create a transatlantic Intelligence, Surveillance, and Reconnaissance (ISR) system for financial flows** that would provide an integrated database and a common operating picture for national security, financial intelligence, and law enforcement actors.
 - The U.S. Department of Treasury's Office of Terrorism and Financial Intelligence would manage this system in cooperation with the Treasury's Financial Crimes Enforcement Network (FinCEN) and the Department of Justice's National Security and Asset Recovery Divisions.
 - This would build on the capabilities of the Egmont Group of Financial Intelligence Units, whose Secure Web (hosted by FinCEN) already provides a secure information sharing platform and operational capabilities.
- **Elevate money laundering as a priority threat to national security** within the Treasury and Justice Departments and encourage European allies to do so in their national jurisdictions.
- Better integrate bank supervision in the EU AML monitoring system.
- **Reform and considerably strengthen the European Union's AML/Counter-Terrorism Financing system** by ensuring much stronger coordination between EU and national banking and financial supervisors and EU and national security agencies.²⁰
 - Efforts should also be made to harmonize tax policy, to track tax evasion, and enhance asset recovery as a crucial part of the AML infrastructure.
- Adopt and rigorously implement the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017 in EU member states to make the approved intracompany pricing methodology consistent with general market levels.
- **The EU should strengthen its reporting and regulatory requirements for ultimate beneficial ownership (UBO)** by closing disclosure loopholes in a number of tax-treaty jurisdictions.
 - The United States should work with European partners to create international standards for UBO disclosure, limiting the use of nominee directors and standardizing disclosure requirements for foundations and trusts.

20 Joshua Kirschenbaum and Nicolas Veron, *A better European Union architecture to fight money laundering* (Brussels: Bruegel, 2018).

- Establish new international standards for suspicious activity reports (SARs) thresholds.
- **Elevate the risk level of corporate service providers in illicit finance and money laundering activities** for both the United States and the European Union.
- **Better align U.S. and European transparency policies on strategic sectors** that attract the most significant Russian economic activity and present corruption risks, such as energy, finance, and real estate.
- **Address the key risks and loopholes allowing the evasion of sanctions.** Remove bilateral exemptions and loopholes that have exempted grandfathered deals from the sanctions regime, particularly in the European Union. Joint projects between European and Russian companies have also created potential gaps in the sanctions regime.
- **Use disclosure (“name and shame”) to increase the reputational damage of harboring Russian illicit funds** or helping malign actors shift profits abroad, while acknowledging legitimate reasons for moving assets out of Russia.
- **Harness the potential of the Global Magnitsky Act**, particularly Section 3(a)(3) and (4) in targeting human rights violators and kleptocrats, as well as nominees for and people who assist these perpetrators.²¹
 - Encourage European allies to speed up the development and adoption of an EU-wide Magnitsky Act.
- **Use the U.S. Foreign Corrupt Practices Act**, if applicable, and leverage visa instruments to target companies in the European Union, as well as influential oligarchs and corrupt politicians, that do business with sanctioned firms and individuals in Russia.
- The European Union must end the use of the so-called golden visas, and the United States must increase the transparency of investment visas.

If it is said that “democracy dies in darkness,” then it must be that it thrives in the light.²² Transparency rebuilds confidence in democratic institutions. Enforcement of our rule of law guarantees trust in the system. In this fight, democracies win.

21 U.S. Congress, Senate, *Global Magnitsky Human Rights Accountability Act*, S. 284, 114th Cong. 2nd Sess., referred in House April 16, 2018, <https://www.congress.gov/114/bills/s284/BILLS-114s284rfh.pdf>.

22 Paul Farhi, “The Washington Post’s new slogan turns out to be an old saying,” *Washington Post*, February 24, 2017, <https://www.washingtonpost.com/lifestyle/style/the-washington-posts-new-slogan-turns-out-to-be-an-old-saying/2017/02/23/cb199cda-fa02-11e6-be05-1a3817ac21a5>.

Previously, on The Kremlin Playbook. . .

“Foreign politicians talk about Russia’s interference in elections and referendums around the world. In fact, the matter is even more serious: Russia interferes in your brains, we change your conscience, and there is nothing you can do about it.”

VLADISLAV SURKOV, ADVISER TO RUSSIAN PRESIDENT VLADIMIR PUTIN¹

“[. . .] the anti-money laundering regime must constantly innovate to keep up with the bad actors that continuously update their methods of accessing the U.S. financial system.”²

“Illicit money enables bad people to do the worst of things in this world. Where does it come from, where does it go, and who has it now? [. . .] Getting this right, saves lives. Period. This is a bi-partisan issue. This is both an American and global issue.”

U.S. SENATOR MIKE CRAPO³

“In order to hide Ukraine payments from United States authorities, [. . .] MANAFORT and GATES laundered the money through scores of United States and foreign corporations, partnerships, and bank accounts.”

INDICTMENT OF PAUL J. MANAFORT, JR. AND RICHARD W. GATES III⁴

“It was major deficiencies in controls and governance that made it possible to use Danske Bank’s branch in Estonia for criminal activities such as money laundering.”

DANSKE BANK⁵

“The CSIS report *The Kremlin Playbook* calls corruption the common thread among these various drivers of Russian influence. [. . .] Where Russia can work in darkness, Russian agents systematically exploit democratic institutions to acquire influence [. . .] using corruption.”

U.S. SENATOR SHELDON WHITEHOUSE⁶

- 1 Cristina Maza, “Vladimir Putin’s Adviser Tells Americans: ‘Russia Interferes in Your Brains, We Change Your Conscience,’” *Newsweek*, February 12, 2019, <https://www.newsweek.com/russia-president-vladimir-putin-election-americans-1327793>.
- 2 “Crapo Statement at Money Laundering Hearing,” United States Senate Committee on Banking, Housing, and Urban Affairs, November 30, 2018, <https://www.banking.senate.gov/newsroom/majority/11/30/2018/crapo-statement-at-money-laundering-hearing>.
- 3 “Crapo Statement at Money Laundering Hearing,” United States Senate Committee on Banking, Housing, and Urban Affairs, January 9, 2018, <https://www.banking.senate.gov/newsroom/majority/crapo-statement-at-money-laundering-hearing>.
- 4 United States of America v. Paul J. Manafort, Jr. and Richard W. Gates III, Case 1:17-cr-00201, United States District Court for the District of Columbia, 2017.
- 5 “Danske Bank expands investigation of Estonia branch,” Danske Bank, September 21, 2017, <https://danskebank.com/news-and-insights/news-archive/press-releases/2017/pr21092017>.
- 6 “Whitehouse Outlines Key Steps to Protect America from Russian Meddling,” Sheldon Whitehouse - United States Senator for Rhode Island, June 14, 2017, <https://www.whitehouse>.

Just weeks before the 2016 U.S. presidential election and days after the statement by the U.S. intelligence community of its confidence “that the Russian Government directed the recent compromises of e-mails from US persons and institutions . . . intended to interfere with the US election process,”⁷ the CSIS Europe Program and the Center for the Study of Democracy released a major study titled *The Kremlin Playbook: Understanding Russian Influence in Central and Eastern Europe*. By quantifying and examining Russia’s economic footprint in five countries, we described both the pattern and the destructive nature of Russian malign economic influence on democratic systems. We concluded that the Kremlin does so through its cultivation of “an opaque network of patronage across the region that it uses to influence and direct decision-making,”⁸ with the ultimate aim to undermine Western democratic systems and transatlantic unity.

This network of political and economic connections—described as an “unvirtuous” cycle of influence—thrives on corruption and the exploitation of governance gaps in key markets and institutions like antitrust and anti-money laundering bodies as well as state-owned companies. One of the most visible aspects of this cycle has been Russia’s abuse of its dominant market position in strategic sectors like energy. To achieve its objectives, Russia has captured political and business elites through lucrative projects and strategic business relations.

Despite the varied nature of the countries presented in the first volume, the names of specific jurisdictions, companies, and members of Vladimir Putin’s inner circle kept appearing in nearly each network of influence. Was this a coincidence? Or could there be enabling forces that unwittingly or purposely amplify Russian malign economic influence? Exploring the answers to these questions formed the basis of our second report, *The Kremlin Playbook 2: The Enablers*.

The Kremlin Playbook captured a remarkable amount of attention and contributed to a broader political awakening within the transatlantic policy community of the national security threat posed by Russian economic influence. But all the analysis of Russian malign tactics in Europe brings us back to the conclusion that Russia does not create our fault lines; it exploits the weaknesses that the West presents. It does so in order to pursue a central policy objective: to erode confidence in and discredit the Western democratic model. The Kremlin aims to manipulate and transform the policies of the West to better suit its national interests as well as to make democracy, market economies, and the dignity of the individual over the state as unattractive as possible to Russia’s neighbors and former Soviet nations.

senate.gov/news/release/whitehouse-outlines-key-steps-to-protect-america-from-russian-meddling.

7 “Joint Statement from the Department Of Homeland Security and Office of the Director of National Intelligence on Election Security,” Department of Homeland Security, October 7, 2016, <https://www.dhs.gov/news/2016/10/07/joint-statement-department-homeland-security-and-office-director-national>.

8 Heather A. Conley et al., *The Kremlin Playbook: Understanding Russian Influence in Central and Eastern Europe* (Lanham: Rowman & Littlefield, 2016).

Our research and policy focus is on the most advanced and egregious perpetrator of malign economic influence: Russia. But the Kremlin's playbook can easily be read and translated in other capitals like Beijing. There is a national security imperative to develop an effective strategy to counter malign economic influence. It must focus on three priorities: (1) rapidly detecting and recognizing malign economic influence, (2) immediately stabilizing and strengthening domestic institutions vulnerable to malign influence, and (3) operationalizing a bold new Western approach to financial transparency and anticorruption efforts.

Over the past three years, we have been encouraged by concrete policy actions on both sides of the Atlantic to address this challenge. In 2017, the U.S. Congress passed the Countering America's Adversaries Through Sanctions Act (CAATSA), which included provisions to combat corruption and strengthen independent judiciaries in NATO and EU countries that are deemed vulnerable to Russian influence. It was followed in 2019 by the introduction of the Defending American Security from Kremlin Aggression Act, which aims to increase transparency on beneficial ownership in real estate purchases and enhance sanctions on Russian banks and oligarchs involved in corrupt activities. The European Union has initiated a new anti-money laundering directive that entered into force in July 2018 and will be transposed in member states by January 2020.

Despite these efforts, successive malign influence campaigns and money-laundering scandals in Europe involving Russian and post-Soviet oligarchs as well as investigative journalists' efforts continue to reveal gaping holes in our ability to detect and punish the penetration of Russian malign influence into the West's economic and political systems. Western regulatory oversight and enforcement bodies are siloed and can only act within their own borders against international malign networks. Transnational illicit finance schemes actively seek out these blind spots and thrive within these seams. Large European companies remain involved with problematic economic actors in Russia despite known risks. Some governments protect the corporate services that assist these schemes either by turning a blind eye to them or by relying on laws that are easily skirted.

It is our hope that the release of *The Kremlin Playbook 2* will be equally timely as the first report, as Congress weighs legislative action on anti-money laundering and ultimate beneficial ownership. Transatlantic legislators will need to address loopholes in sanctions and counter-illicit finance tools, the provision of "golden visas," tax evasion and incorporation arrangements, and more stringent prosecution of illicit activity. Western sanctions, political declarations, and increased defense spending against an aggressive Russia simply ring hollow when illicit Russian funds, taken from the Russian people, frequently transfer and are held in Western banking systems or used by the Kremlin to foment divisions within the West.

The Kremlin Playbook 2 demonstrates just how much work remains to be done. Western democracies must acknowledge their enablement of malign economic influence and uproot it from their financial system. Only then can transparency and trust be restored in democratic institutions and the cycle of malign influence can be broken.

Enabler: noun, \ i- 'nā- blər.

One that enables another to achieve an end. **Especially:** one who enables another to persist in self-destructive behavior [...] by providing excuses or by making it possible to avoid the consequences of such behavior.¹

The Enabling Ecosystem

Enablers of Russian malign influence allow the Kremlin to achieve its end—to “break the internal coherence of the enemy system”²—and avoid some of the consequences of its behavior. To the Kremlin, the enemy system is the democratic West and its system of alliances. By aiding and abetting Russia’s malign influence, enablers assist the Kremlin in self-destructive behavior that siphons funds offshore (often in or through Europe) and depletes the Russian tax base at the expense of Russian citizens. Crucially, by allowing Russian economic influence to cycle through their systems, **enablers actively participate in the weakening and discrediting of their own democratic structures.**

The Kremlin Playbook highlighted Russia’s strategy of exploiting the inherent weaknesses within the Western capitalist democratic system. It demonstrated that Russia uses different mechanisms to further its economic influence in Europe, from leveraging energy dependence to capturing policy and economic elites. Rather than being direct targets of these mechanisms, enablers offer permissive investment environments that embody our governance weaknesses. They become magnets for funds—licit or not—coming out of Russian companies and individuals by facilitating and protecting complex, untraceable networks of companies and financial actors. These networks can become so extensive as to create entire **enabling ecosystems** in which the commingling of business and political interests allows Russian malign influence to penetrate and spread through Europe and even the United States. These ecosystems are often supported by industries such as corporate service providers that help navigate and abuse our system’s weaknesses. They do so by using advantageous incorporation laws, obscuring ownership chains, and transferring profits out of the reach of tax authorities and financial intelligence.

This report’s focus on enablers arose from a select group of European countries that surfaced again and again in *The Kremlin Playbook* as lightning rods for Russian eco-

1 “Enabler,” Merriam-Webster, <https://www.merriam-webster.com/dictionary/enabler>.

2 Dmitry Adamsky, “Cross-Domain Coercion: The Current Russian Art of Strategy,” Proliferation Paper no. 54, Institut Français des Relations Internationales, November 30, 2015, <https://www.ifri.org/en/publications/enotes/proliferation-papers/cross-domain-coercion-current-russian-art-strategy>.

conomic activity, from incorporation to energy contracts. A lot of this activity appeared in Italy, Austria, and the Netherlands; these countries' financial and corporate provider industries, as well as energy ties to Russia, make them true enabling hubs for Russian economic influence. For example, in 2014, Financial Intelligence Units (FIUs) in EU member states received close to one million suspicious transaction reports (flagging potential money laundering or terrorist financing) but more than 65 percent of these were flagged in only two countries—the United Kingdom and the Netherlands.^{3,4} These reports were not all related to Russia, but they illustrate the concentration of potentially illicit financial activity⁵ in a few European centers. As noted in *The Kremlin Playbook*, “Russian economic influence seeks to manipulate sectoral market dynamics and exploit governance loopholes to generate unfair profits and influence national decision-making.”⁶ Enablers at the heart of Europe have both made this possible and been exploited as well.

Enablers present several key features:

- They are open economies with developed financial and banking systems that have networks of branches across Europe. Banks in enabling countries are often heavily invested in Russia, while smaller banks can serve as conduits for Russian funds.
- Companies in enabling countries and their networks of ownership in Europe (particularly in the energy sector) have provided Russian-owned companies with broad access to the European goods and capital markets through mergers and acquisitions.
- They present sophisticated, permissive business and legal environments with regard to company law, taxation, and incorporation.
- They offer a highly developed Designated Non-Financial Businesses and Professions (DNFBPs)⁷ or corporate service provider sector (such as lawyers, accountants, and incorporation agents) that supports complex financial schemes and company structures. The level of complexity has

3 “Global Anti-Money Laundering Framework – Europol Report Reveals Poor Success Rate and Offers Ways to Improve,” Europol, September 5, 2017, <https://www.europol.europa.eu/newsroom/news/global-anti-money-laundering-framework-%E2%80%93-europol-report-reveals-poor-success-rate-and-offers-ways-to-improve>.

4 The United Kingdom is also an important holding and transit location for Russian funds and as such enables Russian malign influence, but it is beyond the scope of this report.

5 The World Bank defines illicit financial flows as “cross-border movement of capital associated with illegal activity or more explicitly, money that is illegally earned, transferred, or used that crosses borders.” This involves three main dynamics: (1) “the acts themselves are illegal (e.g., corruption, tax evasion);” (2) “the funds are the results of illegal acts (e.g., smuggling and trafficking[. . .]);” (3) “the funds are used for illegal purposes (e.g., financing of organized crime).” “Illicit Financial Flows (IFFs),” The World Bank, July 7, 2017, <http://www.worldbank.org/en/topic/financialsector/brief/illicit-financial-flows-iffs>.

6 Heather Conley et al., *The Kremlin Playbook: Understanding Russian Influence in Central and Eastern Europe* (Lanham: Rowman & Littlefield, October 2016), 10.

7 DNFBPs range from lawyers, accountants, and trust services to real estate agents and formation agents. See “Glossary,” Financial Action Task Force, <http://www.fatf-gafi.org/glossary/d-i/>.

long outgrown the capacity of national authorities or supranational cooperation structures to exert effective oversight.

- The combination of large national champions that depend heavily on outside trade and authorities that lack the resources and capacity to conduct proper investigations across borders dampen whatever little political will there is to address the risks of money laundering and tax evasion present in these permissive environments.
- They showcase a certain level of corporatism, whereby some large businesses (usually large national players) are close to power circles and can receive political support of their financial interests. They are often “too big to fail,” increasing their access to policymaking circles and thus the risk of state capture.
- These national economic champions, such as Royal Dutch Shell, Uni-Credit, or OMV, account for large economic flows domestically and have long-standing investment relations in Russia and with its companies. The Kremlin has at times tried to involve these companies in its web of state-run or -controlled corporations in Russia, offering lucrative projects and joint-ventures.

Yet not all enablers follow exactly the same format, once again highlighting the adaptability of Russian influence to domestic conditions.

Austria could be seen as an enabler in the fullest sense: its long-standing ties with Russia have recently been strengthened at the governmental level through the close cooperation between President Putin and the far-right Freedom Party. Its extensive banking and energy networks in Central and Eastern Europe dramatically expand Russia’s economic reach into the region. Austria exploits its role as a neutral space between East and West, serving as a conduit for Russian influence and a safe haven for former Communist countries’ ill-gotten gains.⁸

Italy is a major investor in Russia and a preferred destination for real-estate investments for Russian oligarchs and political figures like Dmitri Medvedev.⁹ Its lax governing standards and political instability make it a permissive environment and have allowed Russia to forge political alliances there. Political ties to Russia are strong through Silvio Berlusconi’s personal friendship with Vladimir Putin and current Deputy Prime Minister Matteo Salvini’s ties to Putin’s party. Yet Italian authorities, in particular the judiciary and anti-money laundering bodies (seasoned by decades of experience with organized crime in Italy), have recognized the threat of Russian malign influence and tried to respond to it in recent years.

8 Filip Novokmet, Thomas Piketty, and Gabriel Zucman, “From Soviets to Oligarchs: Inequality and Property in Russia 1905-2016,” *The Journal of Economic Inequality* 16, no. 2 (June 2018).

9 Ivan Nechepurenko, “Kremlin Critic Says Russian Premier, Dmitri Medvedev, Built Property Empire on Graft,” *New York Times*, March 2, 2017, <https://www.nytimes.com/2017/03/02/world/europe/russia-dmitri-medvedev-aleksei-navalny.html>.

Finally, the **Netherlands** represents an enabler paradox of sorts or an unwitting enabler: its open economy, permissive incorporation laws, and associated corporate services have made it a magnet for Russian firms and capital. Still, Dutch authorities have remained independent and highly competent. The Dutch have suffered repeatedly at the hands of Russian malign influence, but authorities have been reluctant to alter the country's permissive economic environment. Yet, the Netherlands, as a founding EU member and a strong advocate for better governance standards, is likely to remain a key proponent for a common EU approach vis-à-vis Russia.

The Illicit Finance-National Security Nexus

Most analyses of Russian influence have underestimated Russia's economic footprint because they largely ignore the political motivation behind strategic Russian capital inflows. These motives are key to understanding the risks inherent in the large Russian investment flows transiting through Europe, particularly the illicit nature of some of these flows.

Because enablers can facilitate or help launder illicit financial flows, they jeopardize the integrity of open market economies and ultimately create a real threat for national security—their own and their allies'. As early as 2005, the United States recognized the threat that money laundering posed for international and national security,¹⁰ while a 2011 report on transnational organized crime highlighted the role of “facilitators” (“semi-legitimate players such as accountants, attorneys, notaries, bankers, and real estate brokers”) in servicing illicit aims and crime groups wittingly or not.¹¹ According to Interpol, financial crimes have a serious impact on international banking and financial systems and “affect individuals, companies, organizations and even nations.”¹² Money laundering can damage national security by corrupting government officials, impeding the free flow of capital, and distorting entire markets and industries.¹³ It can incentivize a race to the bottom as companies want to avoid a competitive disadvantage if “everybody else cheats.” State-owned enterprises (a staple in Russia) and large companies, in particular, play an important role in the distortion of market competition because of their dominant position and because the significant amount of financial flows they oversee makes them susceptible to illicit practices or abuse.

Importantly, enablers can facilitate the integration of illicit funds within legitimate global financial flows, assisted by shell companies and corporate facilitators like banks,

10 Bureau for International Narcotics and Law Enforcement Affairs, *Money Laundering and Terrorist Financing – A Global Threat*, (Washington, D.C.: U.S. Department of State, 2005).

11 “Transnational Organized Crime: A Growing Threat to National and International Security,” The Obama Administration National Security Council, <https://obamawhitehouse.archives.gov/administration/eop/nsc/transnational-crime/threat>.

12 “Financial crime,” Interpol, <https://www.interpol.int/Crime-areas/Financial-crime/Financial-crime>.

13 Interpol defines money laundering as “any act or attempted act to conceal or disguise the identity of illegally obtained proceeds so that they appear to have originated from legitimate sources.” See “Money laundering,” Interpol, <https://www.interpol.int/Crime-areas/Financial-crime/Money-laundering>.

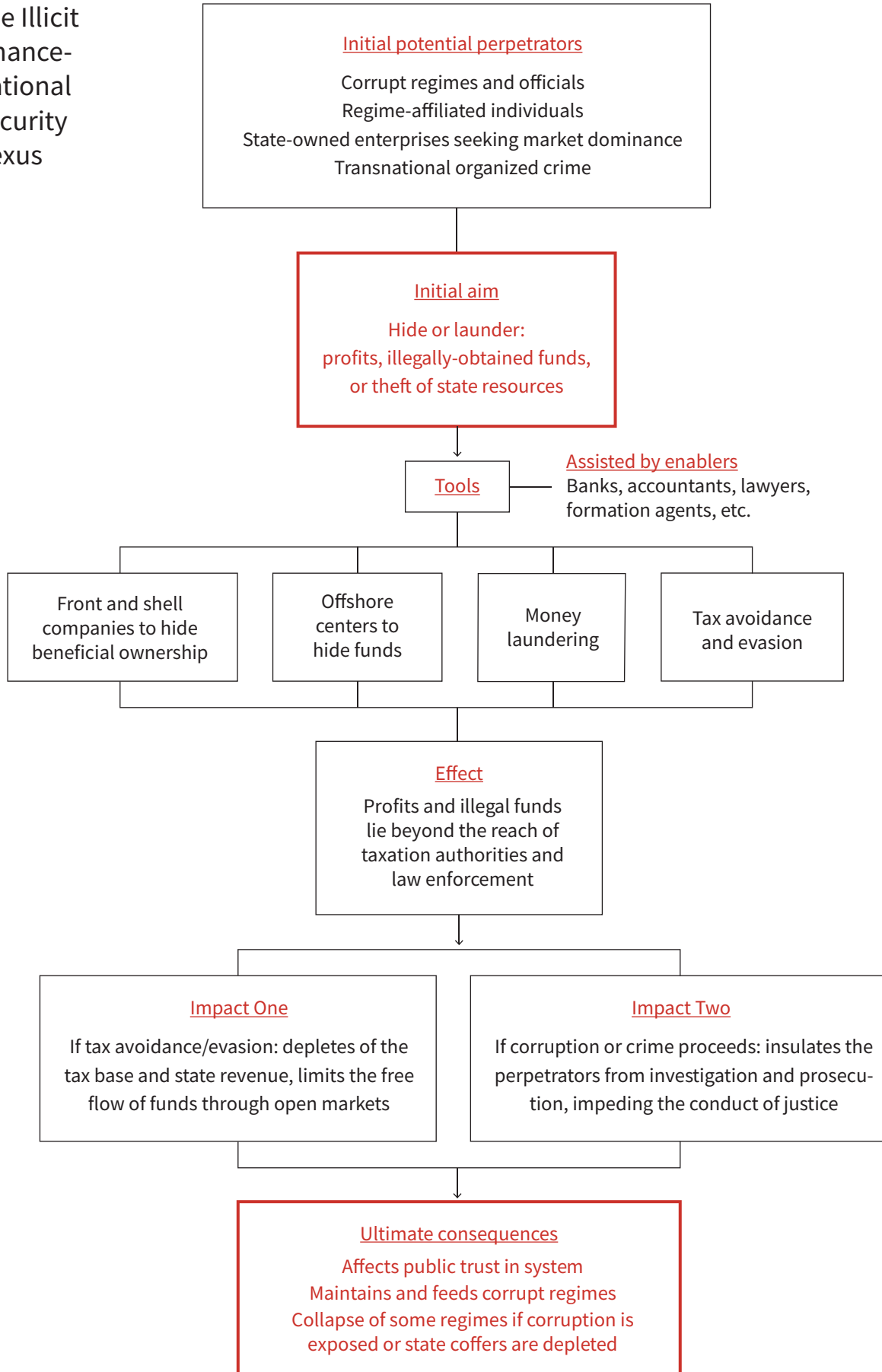
attorneys, or accountants. The sheer size of some of the flows transiting through the global financial system can overinflate parts of an enabler's economy and put the country's economic stability at risk in case these flows disappear (e.g., flowing to offshore centers often used for incorporation of shell companies, like Bermuda or the Virgin Islands).¹⁴ Russian private holdings abroad total an estimated \$1 trillion, a remarkable amount for an economy that is in decline.¹⁵ These huge capital flows create a potential dependence on illicit funds in which the enabler and the Kremlin both benefit from and are dependent on a system that helps these flows transit in and out of Russia and Europe (through structures that obscure beneficial ownership, enable tax avoidance, etc.).

This link between illicit finance and national security can materialize in two separate channels—public corruption and organized crime—that follow the same track and at times overlap. In the case of Russia, these two flows converge at the behest of the Kremlin.¹⁶ Malign actors hiding funds and profits can do so through money laundering or tax avoidance and evasion.

The paradox inherent in enabling countries is that they protect the large enabling industries that have grown instead of cleaning up the financial sector, but the state does not seem to benefit much from the revenues obtained from these transactions compared to the sheer size of financial flows. These industries have grown too big to fail and have created close ties with governmental bodies and politicians. For example, in 2009, an estimated €12 trillion flew through the Netherlands through trusts and companies that made use of corporate service providers, but this only created €1 billion in tax revenue for the Dutch state (even down from €1.3 billion in 2006).¹⁷ This is not a small amount, but it does not support the country's social system nor does it feed a healthy economic growth. Not only do these industries deplete the tax base and reduce state revenue (the bulk of funds transiting through are headed offshore), they also risk fueling public frustration by concentrating wealth in the hands of a few—or removing it entirely from the country. People thus perceive their own institutions as serving the elite and insulating the perpetrators of illicit schemes from investigation and prosecution. This impediment to the rule of law degrades public trust in democracy, which Russian state propaganda can worsen and turn against Western institutions (e.g., the European Union and its fragile cohesion). At its worst, illicit finance can degrade this trust past the point of repair and lead to the collapse of an economic system or government—sometimes in neighboring countries or partners.

- 14 Javier Garcia-Bernardo, Jan Fichtner, Frank W. Takes, and Eelke M. Heemskerk, "Uncovering Offshore Financial Centers: Conduits and Sinks in the Global Corporate Ownership Network," *Scientific Reports* 7, no. 6246 (July 2017).
- 15 Anders Aslund, "It's time to go after Vladimir Putin's money in the West," *Washington Post*, March 29, 2018, <https://www.washingtonpost.com/news/democracy-post/wp/2018/03/29/its-time-to-go-after-vladimir-putins-money-in-the-west/>.
- 16 Karen Dawisha, *Putin's Kleptocracy: Who Owns Russia?* (New York: Simon & Schuster, 2015); Stephen Handelman, *Comrade Criminal: Russia's New Mafiya* (New Haven: Yale University Press, 1995).
- 17 Jeroen Trommelen, "Een geldstroom van 12,000 miljard," *de Volkskrant*, November 15, 2012, <https://www.volkskrant.nl/nieuws-achtergrond/een-geldstroom-van-12-000-miljard~b45b118c/>.

The Illicit Finance-National Security Nexus



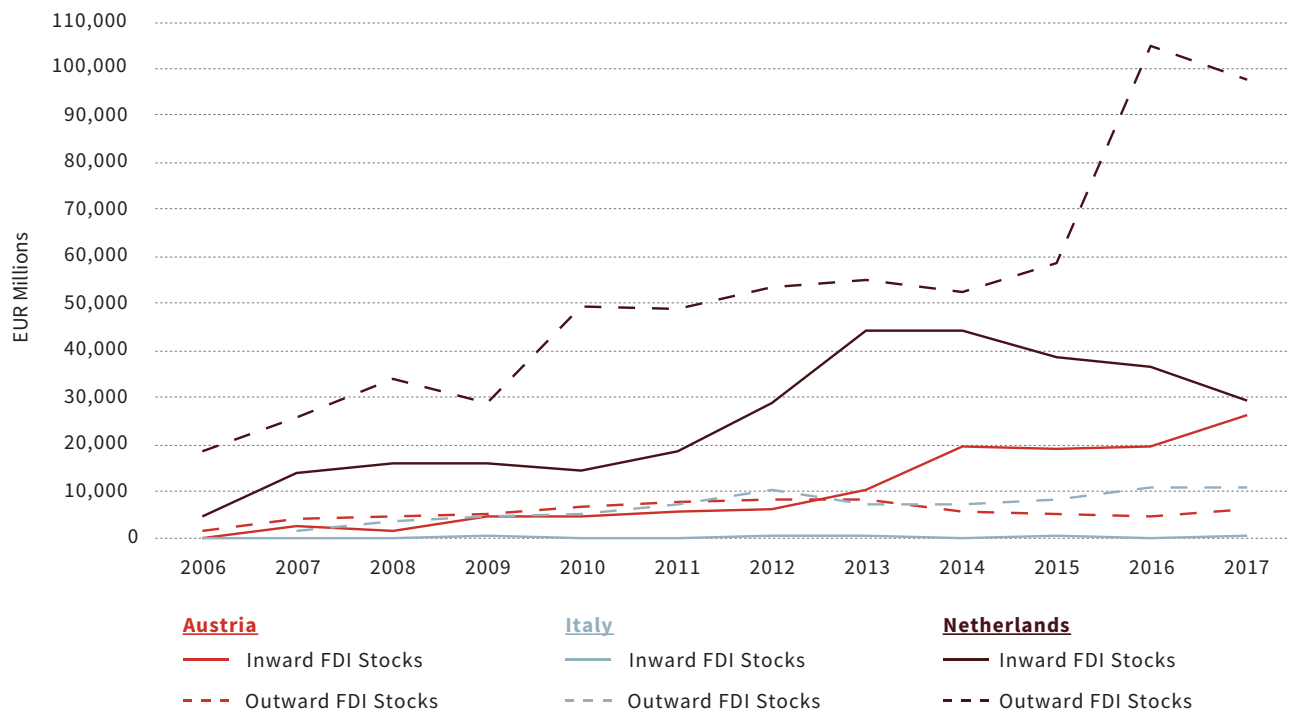
Russian companies and individuals have perfected the art of channeling capital and assets through complex financial schemes.¹⁸ Total capital flight from Russia in the past two decades is estimated to represent 300 percent of Russia's national income.¹⁹ In the past decade, Russian companies have shifted considerable corporate holdings to Western European financial hubs that are notable for their easy registration procedures and lax standards for ownership transparency.²⁰ Russian individuals have spent a total of \$12.5 billion on real estate abroad since 2009, representing 4 percent of total Russian FDI abroad. It is increasingly visible that real estate investment is not simply luxury consumption by Russian wealthy elites, but a tool for storing and expanding capital and obscuring beneficial ownership (a large share of these real estate investments are channeled via offshore special purpose vehicles, also known as SPVs).²¹ The consistently high current-account surpluses Russia has been generating from selling oil, gas, and raw materials abroad have provided the capital for the acquisition of these foreign assets.

Channels of Influence

In the first *Kremlin Playbook*, the key economic indicator to gauge Russian influence in the case study countries was Russia's economic footprint, the threshold of which we estimated to be at 12 percent of a country's economy to determine the strength and type of influence at play in said country. But the metric for enablers is different and does not warrant establishing a specific threshold: instead, the sheer size of financial flows and FDI (decoupled from the direct corporate footprint, which is marginal in those large economies) is a better measure of the Kremlin's reliance on the enablers' financial networks to invest and send money across Europe—and abroad to offshore centers. Although capital inflows

- 18 In 2013, the governor of the Russian central bank estimated that funds worth 2.5 percent of GDP leave the country every year through illicit transactions involving money laundering or tax evasion operations. Howard Amos, "Russia loses £52bn a year in tax evasion and illegal transfers, says bank chief," *Guardian*, February 21, 2013, <https://www.theguardian.com/world/2013/feb/21/russia-loses-52-billion-tax-evasion>.
- 19 Novokmet et al. The authors estimate that Russia's offshore wealth could have grown to 75 percent of national income by 2015.
- 20 Although the majority of financial transactions from Russia to Western Europe is related to transfer pricing schemes aimed at tax optimization strategies (used by companies all around the world), the Laundromat case involving Moldovan, Latvian, and Western European banks showed that suspicious money transfers between shell companies can be used for money laundering and can lead to financial and security implications. "The Russian Laundromat Exposed," OCCRP, March 20, 2017, www.occrp.org/en/laundromat/the-russian-laundromat-exposed/.
- 21 These investments are channeled offshore to lower taxation and make ultimate beneficial ownership untraceable. The deals are structured in such a way as to appear solely in the interest of the SPV, which then enables the assets to be used in intercompany loan schemes for tax avoidance. This is because both real estate income and capital gains taxes are much lower for such transactions. The use of SPVs in the case of the U.S. real estate market, for example, provides a loophole in U.S. anti-money laundering legislation and the Bank Secrecy Act that makes concealing the beneficial ownership easy. Similar loopholes exist in a number of common locations for real estate investment, for example, the United Kingdom, Italy, or Switzerland. Rodrigo Fernandez, Annelore Hofman, and Manuel B. Aalbers, "London and New York as a safe deposit box for the transnational wealth elite," *Environment and Planning A: Economy and Space* 48, no. 12 (July 2016).

Investments Flows



Source: National Central Banks of Austria, the Netherlands, and Italy.

in Central and Eastern Europe have grown substantially since 2005, it is indeed Western Europe where Russian companies have retained most of their assets and funds.

In Italy, Austria, and the Netherlands alone, Russian FDI stocks have expanded from just €5.4 billion in 2006 to close to €160 billion at the end of 2017. In the Netherlands, Russian companies' assets have jumped from €13.2 billion in 2007 to over €96 billion in 2017 through the use of letterbox companies for tax optimization purposes.²² Russian assets thus represented 13 percent of the country's nominal GDP in 2017, despite the fact that only around 20,000 people work for Russian-owned companies in the Netherlands.

Russian companies' use of tax havens explains this increase in FDI flows, particularly given the Netherlands's low withholding taxes and flexible double taxation treaty, which allows for large round-tripping arrangements to invest back in Russia and Central and Eastern Europe. In Austria, a large share of the FDI stocks have been focused in the services and banking sectors in addition to the asset swaps conducted between OMV and Gazprom, which have increased Russia's equity stake in the strategic energy sector. The three largest Russian state-owned banks, Sberbank-Europe, VTB Bank, and Gazprombank, have representations in Vienna and manage much of their European businesses through Vienna. In 2014, the Viennese branches of Sberbank and VTB Bank were exempted from the newly-imposed EU sanctions.²³ The three banks thus main-

²² "A paper company, shell company or money box company, i.e. a company which has complied only with the bare essentials for organization and registration in a particular country. The actual commercial activities are carried out in another country." "Glossary of Tax Terms," OECD, <http://www.oecd.org/ctp/glossaryoftaxterms.htm#L>.

²³ Miriam Widman, "Austria Shields Russian Banks from E.U. Sanctions," *Handelsblatt Global*, July

tained their operative presence on the European market, and the massive influx of Russian FDI to Austria after 2014 could be the result of their channeling investment flows to Europe through Austria in an attempt to circumvent sanctions.

Thus enablers, through their favorable investment conditions, de facto encourage large Russian economic players to gain a foothold through joint ventures, asset swaps, mergers and acquisitions, and long-term contracts with European companies. Though it may create rewards for the enablers, it principally achieves a strategic goal for the Kremlin—particularly for energy firms given Russia’s energy wealth and reliance on energy revenue. As *The Kremlin Playbook* highlighted and many studies have shown, state-owned or state-affiliated enterprises in Russia are often instruments of influence and cannot be understood as regular business actors like Western multinational companies and corporations.²⁴ The vertical integration of power between the state and the private sector observed in Russia is unparalleled in the West, an asymmetry that U.S. and particularly EU policymakers have been slow to recognize.

Enablers also present some levels of corporatism in which the closeness of national economic champions (majors) to political power provides a sort of guarantee of support and protection from the government for Russian-supported projects in which these majors are involved. This serves the Kremlin’s interests by expanding Russia’s indirect corporate footprint as it seeks “to maintain its influence by cultivating a network of local affiliates and power-brokers.”²⁵ This indirect footprint translates into the exposure of domestic companies to the Russian market, principally through the energy and manufacturing sectors’ dependence on Russia (e.g., Dutch companies dependent on oil and gas production and trading or Italian manufacturers deeply integrated into the European supply chains that export to Russia). These business-political networks can then ensure strategic policies are in line with these economic projects, and by extension, with Russian objectives.

Some large companies in our case study countries have also gone back into joint ventures or contracts that are either with Russian companies or in Russia, despite past failed experiments or financial losses (e.g., Royal Dutch Shell’s investments into the Sakhalin-II oil and gas development project; in 2007, the Russian government forced Shell to reduce its majority stake in the project from 55 to 27.5 percent, allegedly for environmental concerns and after threats of having its license to operate in Russia revoked).²⁶ Some projects receive continued support from some enablers despite their lack of a clear business case and their potential breach of European investment rules (for example, energy diversification in the case of Nord Stream 2).²⁷ In May 2018, two Sber-

31, 2014, <https://global.handelsblatt.com/companies/austria-shields-russian-banks-from-e-u-sanctions-5078>.

24 Conley et al., *The Kremlin Playbook*; See also: Dawisha, *Putin’s Kleptocracy*; and Handelman, *Comrade Criminal*.

25 Conley et al., *The Kremlin Playbook*, 12.

26 Abrahm Lustgarten, “Shell shakedown,” *Fortune*, February 1, 2007, http://archive.fortune.com/magazines/fortune/fortune_archive/2007/02/05/8399125/index.htm.

27 The expansion of Nord Stream and the redirection of Russian gas supply through Germany would

bank analysts drafted a report concluding that Gazprom's capital expenditures for Nord Stream 2 did not make any economic sense and aimed to fund specific contractors.²⁸

- Nord Stream 2: Embodying the Channels of Influence -

Gazprom's Nord Stream 2 exemplifies the linkages between enabling countries, companies, and influence networks. Support for Nord Stream 2 is the culmination of decades of expanding cooperation between some of the biggest Western European energy companies and Russia. The project not only enables Gazprom's monopoly over Central and Eastern Europe, but it also helps oligarchic networks close to the Kremlin benefit from large procurement deals. Indeed, the main beneficiaries of these energy infrastructure projects are the companies Stroygazmontazh, owned by Arkady Rotenberg (under U.S. and EU sanctions), and Stroytransgaz, partially controlled by Genadii Timchenko (also under sanctions).²⁹

The pipeline project involves, among others, Austria's OMV, Germany's Uniper and Wintershall, the Netherlands's Royal Dutch Shell, and France's Engie. Royal Dutch Shell has lobbied the Dutch government to ensure its backing of the Nord Stream pipeline projects.³⁰ The project is currently managed by former German Chancellor Gerhard Schröder. Successive Austrian Chancellors and foreign ministers have publicly supported the project, and former Austrian Finance Minister Hans Jorg Schelling is a high-ranking consultant for Gazprom. OMV's CEO Rainer Seele has concentrated OMV's business strategy on receiving gas from Russia and deepening cooperation with Gazprom.³¹

Before Royal Dutch Shell joined Nord Stream 2, Europe's biggest gas distribution company Gasunie (a Dutch state-owned company) had already invested in a 9 percent stake in Nord Stream's first line commissioned in 2011–2012.³² The close links between Gasunie and Gazprom reach up to high levels. The Dutch company's former CEO, Marcel Kramer, joined Gazprom's Management Board and was also in charge of the now-defunct South Stream gas pipeline (although this project has found a second life in TurkStream). Without significant domestic output, the Netherlands will be scrambling to preserve its position as the most liquid gas hub in Continental Europe. Nord Stream 2 would likely help maintain the status quo.

widen the already large gap between Eastern and Western European prices and would slow down market integration, a key energy policy priority for the European Union. Peter Kotek, Adrienn Selei, and Borbala Takacsne Toth, *The Impact of the Construction of the Nord Stream 2 Gas Pipeline on Gas Prices and Competition* (Budapest, Hungary: Regional Centre for Energy Policy Research, 2016).

28 Their estimates (costing them their jobs) showed that Nord Stream 2 would not be profitable for the first 20 years of its operation. The report points out that the Ukrainian transit system would have been able to accommodate all the necessary Russian gas volumes without the extra cost. Leonid Bershidsky, "A Fired Analyst Got Too Close to Gazprom's Truth," Bloomberg, May 23, 2018, <https://www.bloomberg.com/view/articles/2018-05-23/sberbank-analyst-got-too-close-to-gazprom-s-truth>.

29 Vladimir Afanasiev, "Nord Stream 2 award for Stroygazmontazh," *Upstream*, August 22, 2018, <https://www.upstreamonline.com/hardcopy/1559596/nord-stream-2-award-for-stroygazmontazh>. See also: Ibid.

30 Andrew Rettman, "Nord Stream 2: Business unusual," *EUobserver*, June 7, 2016, <https://euobserver.com/business/133720>.

31 Eduard Steiner and Jakob Zirm, "OMV rückt mit Gazprom zusammen," *Die Presse*, September 9, 2015, <https://diepresse.com/home/wirtschaft/energie/4813971/OMV-rueckt-mit-Gazprom-zusammen>.

32 "Our Shareholders," Nord Stream, <https://www.nord-stream.com/about-us/our-shareholders/>.

An Enabling Financial Sector and Affiliated Industries

Enablers are characterized by developed financial systems that move billions in investment and profits in and out of European countries every year. These systems are the foundation for the permissive financial and fiscal environments that allow Russian companies and individuals (as much as Western ones) to circulate funds and profits across Europe, to hide beneficial ownership, to run money-laundering rings, or to operate schemes like transfer mispricing and round-tripping. Russian-linked financial flows and FDI figures from enablers to third countries also raise flags in that they tend to be larger than the size of the enablers' economies (or the nature of their ties with those third countries) would justify. These financial systems have grown exponentially in the past three decades with rapid globalization and Russia's deep integration within the systems. It has become almost impossible to disentangle the reported \$1 trillion of Russian capital outflows from other financial flows, including for the most capable oversight bodies in the world.³³

- Definitions -

Round-tripping: "Finance. [. . .] The practice of investing capital abroad and then reinvesting it in its country of origin, in order to take advantage of favorable tax rates, etc., given to foreign investors."³⁴ Applied to Russian funds, round-tripping could explain the surge of outward FDI stocks from Western European countries in Russia (Dutch FDI went from €52 billion in 2014 to €97 billion in 2017).³⁵ Indeed, inward Russian FDI stocks in countries with favorable corporate tax and ownership regulatory framework follow an almost identical growth pattern as outward FDI until 2014, when outward FDI flows (from Western Europe to Russia) began to increase sharply. The continued rise of seemingly Western investment in Russia (despite the fall in genuine investment under the sanctions regime) signals that Russian businesses have expanded their use of the European financial system as a conduit for moving funds back to Russia.

Transfer pricing and abuse (mispricing): "[R]efers to the value attached to transfers of goods, services, and technology between related entities, such as parent and subsidiary corporations [. . .] The net effect of transfer pricing abuses is that profits properly attributable to one jurisdiction are shifted to another jurisdiction."³⁶ Companies like Lukoil have been accused in the past (though not convicted) of abusing transfer pricing methods to shift profits to low-tax jurisdictions and creating loss-making entities in some of the countries in which it operates, for example, Bulgaria.³⁷

Corporate Service Providers: "[A]ny company or sole practitioner whose business is to: form companies or other legal persons; provide a registered office, business address [. . .] for a

33 Novokmet et al., "From Soviets to Oligarchs."

34 "Round-tripping," Oxford Dictionaries, <https://en.oxforddictionaries.com/definition/round-tripping>.

35 National Central Banks of Austria, Netherlands, and Italy.

36 Charles Irish, "Transfer Pricing Abuses and Less Developed Countries," *The University of Miami Inter-American Law Review* 18, no. 1 (1986), 86.

37 Ognian Shentov, Martin Vladimirov, and Ruslan Stefanov, *The Russian Economic Grip on Central and Eastern Europe* (New York: Routledge, 2019).

company[. . .]; act or arrange for another person to act as a: director or secretary of a company, [. . .] trustee of an express trust [. . .], [or] nominee shareholder for another person.”³⁸

Conduit arrangement: Mechanism used by Russian entities (not exclusively) to move funds abroad, in which companies registered in a tax-treaty jurisdiction such as the Netherlands are used to route transactions originating in another jurisdiction in order to reduce the tax burden there. The Netherlands is also the biggest conduit-offshore financial center (OFC), which means that it facilitates the largest operations between sink-OFCs (traditional offshore tax havens, which store capital) and other countries including Russia.³⁹

The complexity of the enablers’ financial systems offers tools that are designed to obscure the origins of certain investments and conceal illicit financing. According to Europol, to this day “professional money launderers [. . .] are running billions of illegal drug and other criminal profits through the banking system with a 99 percent success rate.”⁴⁰ Indeed, despite increased scrutiny of the European banking system in the past few years, this system has repeatedly been the focus of money laundering scandals, from the Russian Laundromat to Danske Bank’s alleged laundering of over €200 billion over several years.⁴¹

Tactics that remove profits from the reach of tax authorities (and thus state revenue) are not always illegal, and some operate just **below the threshold of illegality**, where enablers excel—within a financial gray zone. They might be following the *letter* of the law, but certainly not its *spirit*, and industries like corporate service providers (CSPs) assist in this task by feeding the enabling ecosystem. DNFBPs also typically have laxer due diligence standards and AML requirements, a risk that has been repeatedly raised by the Financial Action Task Force (FATF), an intergovernmental body established in 1989 to provide standards and effective ways to combat money-laundering and terrorist financing (Russia is a member of the FATF).⁴² In the Netherlands alone, each year around \$4.5 trillion flow through the country via companies making use of Dutch CSPs.⁴³ This makes the Dutch CSP sector about as large as Japan’s, despite the fact that Japan’s economy is six times the size of the Netherlands.

Efforts to avoid taxes are not inherently illegal (they differ from tax *evasion*),⁴⁴ as

- 38 “Money laundering supervision for trust or company service providers,” Government of the United Kingdom, February 25, 2014, <https://www.gov.uk/guidance/money-laundering-regulations-trust-or-company-service-provider-registration>.
- 39 There are 24 sink-OFCs, including the five largest: Luxembourg, Hong Kong, the British Virgin Islands, Bermuda, and Jersey. Garcia-Bernardo et al., “Uncovering Offshore Financial Centers.”
- 40 Giulia Paravicini, “Europe is losing the fight against dirty money,” Politico, April 2, 2018, <https://www.politico.eu/article/europe-money-laundering-is-losing-the-fight-against-dirty-money-europol-crime-rob-wainwright/>.
- 41 Richard Milne, “Danske Bank charged over €200bn money-laundering scandal,” *Financial Times*, November 28, 2018, <https://www.ft.com/content/6ae5f7f6-f324-11e8-ae55-df4bf40f9d0d>.
- 42 “Who we are,” Financial Action Task Force, <http://www.fatf-gafi.org/about/>.
- 43 Rodrigo Fernandez, “Dutch efforts to combat letterbox companies have no effect,” SOMO, March 29, 2018, <https://www.somo.nl/dutch-efforts-combat-letterbox-companies-no-effect/>.
- 44 Tax avoidance is an “action taken to lessen tax liability and maximize after-tax income” while tax evasion is “the failure to pay or a deliberate underpayment of taxes.” See “The Difference Between Tax Avoidance and Tax Evasion,” Internal Revenue Service, <https://apps.irs.gov/app/>

many corporations around the world have attempted to reduce their tax burden, but they fit in the category of below-threshold activities and can sometimes blur the line with tax evasion. These efforts can be operated through tax-treaty jurisdictions and classic tax havens. Low-tax countries like the Netherlands allow for the movement of profits from corporations registered in such countries to offshore zones and on to the ultimate owner of the assets through the payment to subsidiaries of dividends on the profits. Low-tax jurisdictions usually have very limited taxation on dividends (sometimes 0 percent), thus allowing for profits to go through almost untaxed.⁴⁵ This is the case for the company structure of Mikhail Fridman's VEON (see the Netherlands case study in Appendix), which involves Dutch-registered and offshore entities.⁴⁶

In enabling countries, both large and small banks are susceptible to financial abuse and money laundering. Large banks that are heavily invested in Russia are exposed to political forces and corruption there and thus present a potential risk for their own domestic economies. More problematically, these banks risk getting enmeshed in Russia's state-run public and private company sector—and its associated networks of political patronage—by becoming financial guarantors for business projects led by those state-owned businesses. These banks might also see a risk in addressing illicit finance or pursuing compliance too aggressively for fear of blowback from the Kremlin (given their exposure) should these efforts jeopardize Russian assets and financial flows. Austrian, Italian, and Dutch bank loans now make up 36 percent of all foreign bank claims in Russia, equaling €46.5 billion.⁴⁷ But smaller banks also matter because they appear to be important conduits of Russian funds within Europe (licit or not) as they are usually under less scrutiny and can fly below the financial radar (e.g., Meinel Bank AG and Amsterdam Trade Bank).

Ironically, European banks spend significant amounts on financial sector compliance and due diligence; an estimated \$20 billion a year is spent on these efforts,⁴⁸ while the average annual cost of anti-money laundering compliance for Italy and the Netherlands is estimated at \$20.3 million and \$17.5 million respectively.⁴⁹ Yet the effectiveness of the compliance regime has proven wildly insufficient for years, as demonstrated by a spate of recent money-laundering scandals like Danske Bank (reaching an estimated €200 billion, a quarter of which originated in Russia), Latvia's ABLV, or Deutsche

[understandingtaxes.org/whys/thm01/les03/media/ws_ans_thm01_les03.pdf](https://www.understandingtaxes.org/whys/thm01/les03/media/ws_ans_thm01_les03.pdf).

45 Jan Willem van Gelder and Joeri de Wilde, Case Study: Dutch banks and tax avoidance (Amsterdam, The Netherlands: Profundo, 2014), <https://fairfinanceguide.org/media/277131/dutch-banks-and-tax-avoidance-2014-nl.pdf>.

46 Igor Korolev, "Владельцы «Альфа-групп» спрятали свои акции «Билайна»," Cnews.ru, February 4, 2016, http://www.cnews.ru/news/top/2016-04-02_vladeltsy_alfagrupp_spryatali_svoi_aksii_bilajna. Also: CSD based on Corporate Registers and Databases.

47 The overall exposure to the Russian market has been cut in half since 2014 due to the sanctions regime, but Austria's exposure has doubled. Bank of International Settlements.

48 Paravicini, "Europe is losing the fight."

49 LexisNexis Risk Solutions, *The True Cost of Anti-Money Laundering Compliance, European Edition* (LexisNexis Risk Solutions, 2017), 8.

Bank.⁵⁰ Failed internal controls and complacency from these banks' management amid extraordinarily high profits were key to allowing so much money to flow unimpeded into Western Europe.⁵¹ Some of Europe's largest banks beyond Danske Bank have facilitated some of the transactions involved in these scandals, including Deutsche Bank, which has already paid fines equally €600 million over a \$10 billion Russian money-laundering scheme.⁵² Consultancies and auditing services can also contribute to downplaying the risks of certain financial institutions, presenting a clean audit but sometimes concealing serious problems for which a solution will either be delayed or absent (e.g., EY's audit of Danske Bank, which is currently under investigation).⁵³

There is also an important blind spot in oversight: while illicit financing is designed to be complex and thus is often multi-jurisdictional, each enabling country is responsible for its own national anti-money laundering (AML) regime, the oversight of its national FIU, and the regulation of its banks. Malign actors operate best within these blind spots—below the threshold of illegality—since each jurisdiction can implement the strict minimum of legal requirements but these requirements are often inadequate to address the growing threat of illicit finance. And though the European Union is increasing efforts to improve AML coordination and FIU cooperation, much greater attention must be paid at the European level to tackling massive, multi-jurisdictional AML cases.

To remain below the radar of scrutiny, there is an increasing array of financial gray zone tools at the disposal of enablers, many of which have proven fertile for abuse and hard for authorities to trace, oversee, and regulate. They include: the use of trusts to conceal the origin of funds and obtain attractive tax conditions; the prevalence of preferential tax treaties, and the blurring of the line between efforts to *avoid* taxes and the purposeful *evasion* of taxes; the frequent use of “letterbox” companies (particularly in the Netherlands), special purpose vehicles, and shell companies; and the exploitation of dividend arbitrage (e.g., CumCum and CumEx schemes). The use of bearer shares, asset swaps, and joint stock companies has also become attractive to some Russian firms and individuals because they obscure ownership and provide access to European markets for those companies that have been shut out of capital markets and loans by sanctions.

Simply put, an enabler offers a range of services that can obscure the origin of financial flows and ultimate beneficial ownership of companies operating in Europe. This also has consequences for the accuracy and transparency of FDI data, as Russian economic presence can be concealed and some jurisdictions offer little detail in the data. The

50 Richard Milne, “Danske Bank charged”; See also: Silvia Merler, “Latvia’s money laundering scandal,” Bruegel, April 9, 2018, <http://bruegel.org/2018/04/latvias-money-laundering-scandal/>.

51 Bruun & Hjejle, *Report on the Non-Resident Portfolio at Danske Bank’s Estonian branch* (Copenhagen, Denmark: Bruun & Hjejle, 2018).

52 Jethro Mullen, “Deutsche Bank fined for \$10 billion Russian money-laundering scheme,” CNN, January 31, 2017, <https://money.cnn.com/2017/01/31/investing/deutsche-bank-us-fine-russia-money-laundering/index.html>.

53 Christian Wienberg, “Denmark Starts Formal Investigation Into Danske Bank’s Auditors,” Bloomberg, October 5, 2018, <https://www.bloomberg.com/news/articles/2018-10-05/denmark-starts-formal-investigation-into-danske-bank-s-auditors>.

enabler typically protects the industries and service providers that facilitate those aims, while its political class prevents greater transparency into the country's financial sector and DNFBPs either because of fear of economic downturn or, worse, out of the problematic commingling of business and political interests.

Russian firms can also seek out local affiliates within an enabling country—particularly enablers that have decentralized governing models that may receive less scrutiny—to engage in rent-seeking behavior or attract state funding (both for the Russian company and for the local affiliate). For example, in 2009, an Austrian politician serving as deputy governor of the state of Carinthia allegedly conveyed to a Russian businessman that Austrian citizenship could be offered for a substantial investment in the country and a donation to his party.⁵⁴ In this case, the Russian investor could have attained EU citizenship and moved funds abroad while the local actor could have profited from the transaction. The politician was fined €67,500 and sentenced to seven months of probation.

As we discussed above, the direct benefit to state coffers in enabling countries is relatively small in terms of revenues obtained from these industries. They can shrink the tax base of both the enabler *and* Russia through schemes and double taxation treaties that hide profits and other funds abroad. But these funds effectively feed supporting industries and an entire ecosystem that caters to companies and individuals looking to move funds around. The appeal of a short-term reward, particularly for a vulnerable banking sector (as in Italy), or the attractiveness of potentially high profits for European banks that have suffered low returns, may trump longer-term impacts on the health of the financial sector and these industries may come to view Russian funds as essential.

Extensive Political and Economic Networks

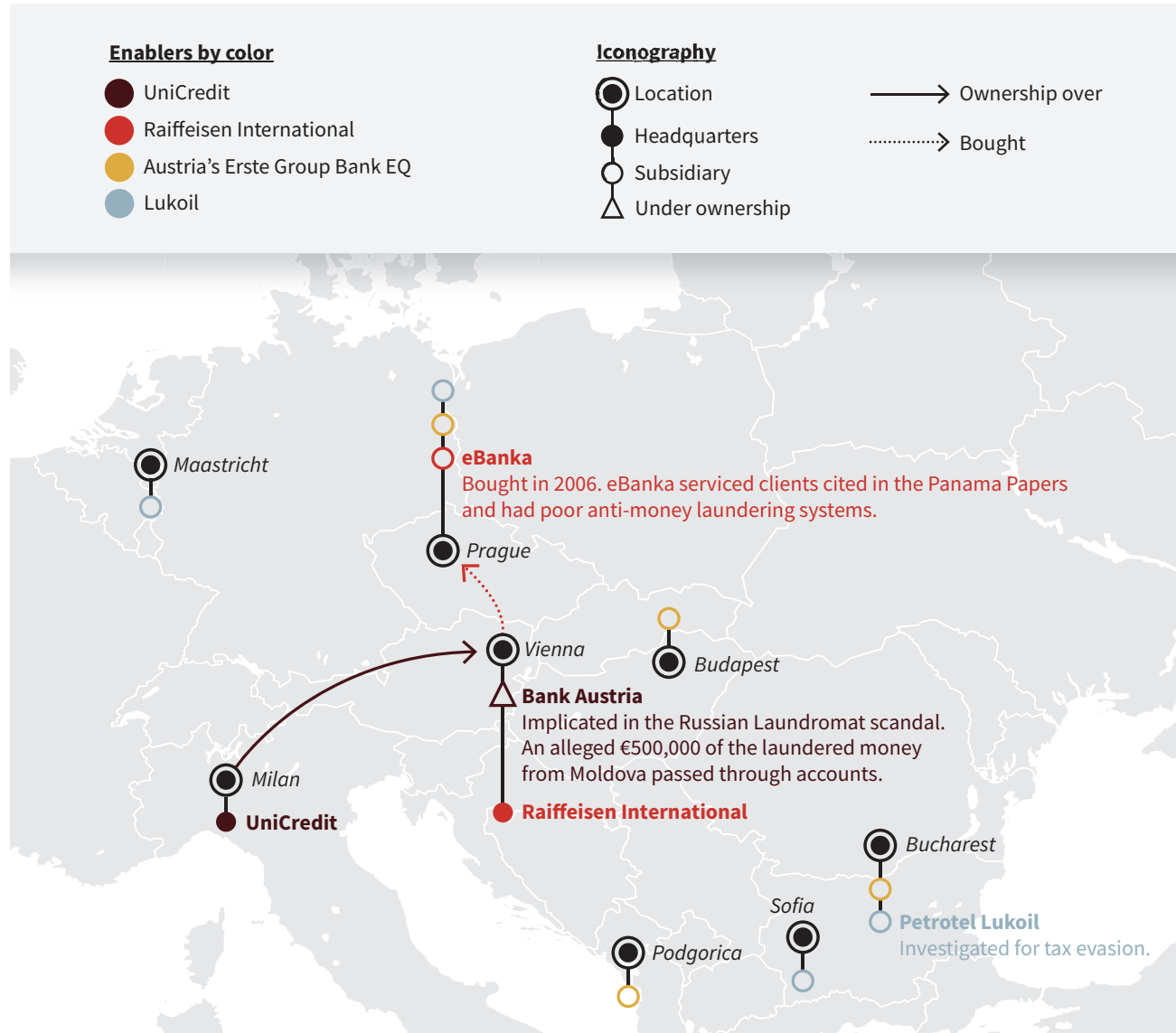
What makes enablers so attractive for Russian malign influence is that they are deeply connected to the rest of the European Union, and enabling companies have an extensive network of branches and subsidiaries across Europe. On occasion, these companies' networks interact with and amplify each other, and in turn, Russian economic influence. They sometimes have direct, strong ties with Russian majors; in June 2018, OMV and Gazprom celebrated the 50th anniversary of their first gas supply contract in fanfare and signed additional contracts in the fall.⁵⁵ UniCredit, for example, has subsidiaries in the Czech Republic, Slovakia, Hungary, Serbia, and Romania, in addition to owning Bank-Austria. The First Czech-Russian Bank, which was owned by Russian financier Roman Popov before its closure in 2016, was investigated for money laundering through an Austrian real estate company.⁵⁶ Notably, the bank provided French far-right leader

54 Sahel Zarinfard, "Visa Scandals Slammed Austria's Door Shut – or did they?" Organized Crime and Corruption Reporting Project, March 5, 2018, <https://www.occrp.org/en/goldforvisas/visa-scandals-slammed-austrias-door-shut-or-did-they>.

55 "50th Anniversary of the Gas Supply Contract," OMV Group, June 1, 2018, <https://www.omv.com/en/blog/50th-anniversary-of-the-gas-supply-contract>.

56 Jana Klímová and Jakub Troníček, "Okolnosti pádu ruské ERB banky: vlídnost pro byznysmeny

Enabler Linkages Across Europe



Marine Le Pen's party with a loan of €9 million in 2014, which was allegedly extended in exchange for her support of the Russian annexation of Crimea.⁵⁷

Enablers are politically connected throughout Europe, sometimes serving Russian interests. In Italy, one of Matteo Salvini's close advisors, Gianluca Savoini, reportedly has ties to mercenaries who have recruited for and fought alongside pro-Russian militias in Ukraine.⁵⁸ He is also the president of the Lombardy-Russia Association and has been a

z okolí Gazpromu," *iRozhlas.cz*, November 24, 2017, https://www.irozhlaz.cz/ekonomika/rus-ko-cesko-banka-gazprom-erb_1711240655_rez.

57 "Le Penová usvědčena. Ruská půjčka 9 milionů eur byla odměna za Krym," *Echo24.cz*, April 4, 2015, <https://echo24.cz/a/i3SW4/le-penova-usvedcena-ruska-pujcka-9-milionu-eur-byla-odmena-za-krym>; See also: Gabriel Gatehouse, "Marine Le Pen: Who's funding France's far right?," BBC, April 3, 2017, <https://www.bbc.com/news/world-europe-39478066>.

58 Alberto Nardelli and Olga Tokariuk, "Here's a Totally Incredible Story About Pro-Russian Merce-

vocal supporter of close economic and geopolitical ties with Russia.⁵⁹ Former Austrian socialist Chancellor Alfred Gusenbauer was allegedly part of the Hapsburg Group, a grouping of former senior European politicians which also reportedly included former Italian prime minister Romano Prodi. The group's members met with senior U.S. leaders to promote a positive image of former Ukrainian president Viktor Yanukovych.⁶⁰

Enablers also assist in obscuring the Russian origin of political malign influence through the use of high-level political figures from enabling countries—sometimes giving the appearance of “influence for sale.” These are typically former prime ministers, chancellors, or finance ministers who occupied important roles in the economic, political, and soft power spheres in their respective countries and have remained prominent, trusted voices. In the economic sphere, for example, a member of the executive committee of the Austrian conservative party OVP is the head of the Austrian Chamber of Commerce and a pro-Russian lobbyist who has openly criticized sanctions.⁶¹ Jorg Haider, the former governor of the Austrian region of Carinthia, allegedly assisted two Russian businessmen in their attempt to obtain Austrian citizenship (this case ended in acquittals).⁶²

Former senior political figures are also engaged in the amplification of Russian soft power. The Dialogue of Civilizations (DOC) is a research institute headquartered in Berlin and led by former KGB member and Russian Railroads head Vladimir Yakunin (under U.S. sanctions, though not European sanctions; he was granted a six-month German visa in 2018).⁶³ Walter Schwimmer, a conservative Austrian politician and former secretary general of the Council of Europe, was a co-founder of the institute.⁶⁴ Alfred Gusenbauer and Vaclav Klaus (a former Czech president and pro-Kremlin voice) both sit on its board. Every year the institute organized the Rhodes Forum in Greece, which has been described as a “Kremlin propaganda-fest and a hotbed of Russian nationalists” by some news outlets.⁶⁵

naries And A Close Aide To Italy's De Facto Leader,” BuzzFeed News, September 13, 2018, <https://www.buzzfeednews.com/article/albertonardelli/matteo-salvini-russia-gianluca-savoini>.

- 59 Alessandro Catto, “Associazione Lombardia – Russia, uno sguardo geopolitico per una nuova amicizia con Mosca,” Blog.ilgiornale.it, December 2, 2015, <http://blog.ilgiornale.it/catto/2015/12/02/associazione-lombardia-russia-uno-sguardo-geopolitico-per-una-nuovaamicizia-con-mosca/>.
- 60 Adam Taylor, “The Mueller indictment mentioned the ‘Hapsburg group.’ Now European ex-politicians are under scrutiny,” *Washington Post*, February 24, 2018, https://www.washingtonpost.com/news/worldviews/wp/2018/02/24/after-hapsburg-group-disclosure-in-mueller-indictment-former-european-politicians-come-under-scrutiny/?utm_term=.09bc36b47e92.
- 61 Michael Shields and Alexandra Schwarz-Goerlich, “Austrian business grits teeth, would back Russia sanctions,” Reuters, July 29, 2014, <https://www.reuters.com/article/us-ukraine-crisis-austria/austrian-business-grits-teeth-would-back-russia-sanctions-idUSKBN0FY10I20140729>.
- 62 Sahel Zarinfard, “Visa Scandals Slammed Austria’s Door Shut – or did they?”
- 63 Irina Filatova and Mikhail Bushuev, “Sanctioned Putin ally Vladimir Yakunin granted German visa,” Deutsche Welle, August 21, 2018, <https://www.dw.com/en/sanctioned-putin-ally-vladimir-yakunin-granted-german-visa/a-45162025>.
- 64 “Governance,” DOC Research Institute, <https://doc-research.org/about-us/governacy/>.
- 65 Leonid Ragozin, “The Putin adoration society,” Politico, October 11, 2015, <https://www.politi->

In addition to harboring enabling political figures, political parties from enabling countries have grown increasingly vocal in their support for strong economic ties with Russia and the lifting of EU sanctions against Russia. Austria's Freedom Party and Italy's League, in particular, have signed cooperation agreements with Putin's United Russia Party, have openly opposed the sanctions regime, and presented Russia as an economic and geopolitical ally.

A Negligent Lack of Oversight

The lack of political will on the part of political leaders and effectiveness on the part of oversight authorities in enabling countries, such as tax authorities, FIUs, and bank regulators, is difficult to understand. Indeed, the International Monetary Fund estimates that the scale of money laundering worldwide is equivalent to between two and five percent of global GDP.⁶⁶ In the European Union alone, illicit markets generate around €110 billion yearly (0.9 percent of the 2010 EU GDP, an amount comparable to the budget of the European Union itself). At the same time, Europol estimates that only 1.1 percent of criminal proceeds are confiscated in the European Union, creating huge losses for states—and huge wins for money launderers and malign actors.⁶⁷ Lax regulatory standards over tax avoidance and transfer pricing have allowed Russian companies to hide billions of profits generated through their core operations in Russia and Central and Eastern Europe.

While it is true that regulators are typically a step or two behind industry innovation, what Europe and the United States are facing is a serious lack of cross-national cooperation or one that is at least on par with the magnitude of transnational financial crime, even after new money-laundering scandals come to light. Despite their best efforts, national financial intelligence and crime agencies are not always equipped to scrutinize large and complex transnational structures, sometimes due to understaffing and a lack of resources. Smaller countries with important banking sectors are especially vulnerable due to a lack of monitoring resources—or a lack of political will. As Bill Browder, a vocal critic of corruption in Russia and advocate for the passage of the Global Magnitsky Act, stated: “money launderers target countries where defences [sic] are weak.”⁶⁸ Lagging financial oversight ensures a permissive environment for illicit financing schemes. Indeed, Interpol has flagged the differences between countries and national jurisdictions as a key difficulty for law enforcement to trace financial crime and the laundering of assets, along with the disparities in “their implementation of international conventions” as well as in expertise levels in “investigative and prosecutorial authorities.”⁶⁹

co.eu/article/the-putin-adoration-society; See also: Neil Buckley, “Rhodes gathering blames the world’s woes on the west,” *Financial Times*, October 4, 2016, <https://www.ft.com/content/fc49d136-896d-11e6-8aa5-f79f5696c731>.

66 Europol Criminal Assets Bureau, *Does crime still pay? Criminal asset recovery in the EU*, Europol (The Hague: European Police Office, 2016), 5.

67 Ibid., 4.

68 “ING and Danske Bank are in the spotlight for their handling of dirty money,” *Economist*, September 6, 2018, <https://www.economist.com/finance-and-economics/2018/09/06/ing-and-danske-bank-are-in-the-spotlight-for-their-handling-of-dirty-money>.

69 “Financial crime,” Interpol.

Reverse Investment Flows: The Cycle of Dependency⁷⁰

An important new angle of Russian economic influence in enabling countries is the exposure of European businesses to the Russian market and their long-standing business ties with Russian companies. Manufacturing giants like Pirelli, Fiat, and Unilever export a large share of their production to Russia. Meanwhile, some of the largest Austrian banks and insurers generate the bulk of their profits in Russia.⁷¹ The biggest energy companies from the three enabling countries in this report have bet on Russia to increase their exploration and production portfolio and have been more than willing to provide technology and capital to Russian state-owned giants in developing joint projects. Mergers and acquisitions conducted by Russian companies in the metallurgical, food-processing, and telecommunications technology sectors have deepened the economic interdependence between the European Union and Russia.

Russia's indirect corporate footprint is an important element of economic influence. The Russian-Italian business relationship resembles closely the indirect Russian corporate footprint in Central Europe (particularly in the Czech Republic, Hungary, and Slovakia). Direct corporate presence of Russian companies in these three countries is small to marginal. However, with the deep integration of supply chains in Europe, Russian economic influence could be channeled through the dependence of some enabling countries' manufacturing sectors and outsourcing industries on exports to Russia. This dependence derives from Western European companies moving their production chains into Central and Eastern Europe after their EU accession and the subsequent increase in exports from the European Union to Russia over the past decade. This provided a springboard for entry into the Russian market, where the lack of domestic manufacturing and increased oil revenues in the 2000s prompted a consumption boom. EU exports to Russia quintupled in the 2000s and early 2010s (an estimated 10 percent of which came from Italy), reaching their highest point at €123 billion in 2012 but then contracted by some 45 percent with the fall of oil and gas prices and the tumbling of the Russian currency between 2013 and 2016.⁷²

The outbound investment from the enabler to Russia is also a catalyst for the commingling of public and private interests, as companies invested in Russia sometimes

70 Our use of reverse flows in this instance is not to be confused with round-tripping, or the reinvesting of laundered money into the home economy.

71 For example, Austria's UNIQA (the largest insurance group in the country) has operated in Russia since 2009 in collaboration with Raiffeisen, and this venture held a market share of 3.3 percent in 2013 (€62.15 million in premiums). The insurer reaffirmed its intention to maintain its business in Russia and Ukraine in mid-2014 despite the invasion of Crimea. Olesea Adonev, "UNIQA reaffirms its commitment to Russia and Ukraine," Xprimm.com, August 21, 2018, <http://www.xprimm.com/UNIQA-reaffirms-its-commitment-to-Russia-and-Ukraine-articol-1,8-5429.htm>.

72 European Commission Directorate General for Trade, European Union, Trade in Goods with Russia (Brussels: European Commission Directorate General for Trade, 2016) http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113440.pdf.

lobby their governments for a milder approach to Russia. In Italy, for example, large companies have made it clear to the government that they would prefer to avoid an escalation in sanctions.⁷³ In other cases, companies have even attempted to circumvent sanctions altogether, as was the case of Dutch companies allegedly involved in helping Russia build a bridge to Crimea.⁷⁴

Outbound investment can also prompt the use of export credit agencies, which absorb the credit risk of investing in difficult markets (say, Russia). This can create problems for enabling countries when these agencies are state-owned or saddle them with sunk costs, as projects in Russia are susceptible to a degradation of the economy there and to local or national abuse of funds and regulations. Russian actors can take advantage of the insurance that is provided by foreign governments for potentially risky projects. Should losses accumulate due to failure or mishandling of these projects, the enabler's economy would be at risk while growing more dependent on inbound and outbound investments with Russia.

Economic influence is enhanced when investment flows are significant in both directions. This is the case for Russian energy. The outsized role of energy in the furtherance of malign Russian economic influence is a common thread between the first and second *Kremlin Playbook*. Italy, Austria, and the Netherlands are themselves dependent on Russian energy, while their oil and gas majors are invested in Russia or Russian projects. For example, Russia covered over 30 percent of Italy's natural gas consumption in 2017, and the country's oil giant ENI has a 50 percent stake in the Blue Stream pipeline.^{75,76} This creates an unvirtuous cycle of dependency: enabling countries are dependent on Russian energy, while their energy majors count on Russian supplies to maintain their position as distributors in Europe. The majors are also invested in Russia, making them dependent on sustained ties with Moscow to avoid being shut out of that market. In turn, Russia depends on these companies to further its ability to reach European markets and on their investments domestically amid a prolonged economic downturn.

While there is nothing inherently wrong with cooperation between Russian and European corporate interests or with the growing integration of Russian capital into the European financial system, the Kremlin's indirect control over Russian businesses makes them susceptible to pressure. They can be compelled to promote political objectives or develop a network of useful advocates for Russian interests. These

73 Rachel Sanderson and Christian Oliver, "Italy accused of blocking tougher sanctions on Russia," *Financial Times*, July 13, 2014, <https://www.ft.com/content/ad743cae-0a8a-11e4-be06-00144fe-abdc0>.

74 Bart Meijer, "Dutch firms probed for alleged breaches of EU sanctions on Russia," Reuters, May 4, 2018, <https://www.reuters.com/article/us-russia-netherlands-sanctions/dutch-firms-probed-for-alleged-breaches-of-eu-sanctions-on-russia-idUSKBN1I5201>.

75 "Natural gas supply statistics," Eurostat, July 2018, https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Natural_gas_supply_statistics&oldid=401136.

76 "Blue Stream," ENI, September 25, 2018, https://www.eni.com/en_RU/eni-russia/partners-projects/gazprom/bluestream/bluestream.shtml.

networks in European countries have vied for and received economic and political support from Russian companies to engage in rent seeking with their national governments, exploiting the lack of oversight and legal blind spots. In exchange, Russian companies have gained access not only to lucrative markets but also to strategic sectors of the economy.

The Adaptation of Influence

The Kremlin Playbook's analytical framework examines the unique attributes of Russian economic influence in disparate European countries to identify the patterns of its evolution and adaptation as well as the instruments of its malign impact. The study of the Czech Republic, Montenegro, and Romania closely followed conclusions drawn from our first study: Russia has exploited the prevalence of corruption, unstable or underdeveloped democratic institutions, and chronic political and economic volatility to attain state capture in some countries. But differences in each country demonstrate the continuous adaptability of Russia's economic influence. All three countries observed an increase in Russian economic penetration at the local level—be that through concentration in the real estate sector in Montenegro or in local transportation and energy tenders in the Czech Republic—that typically go undetected at the national level. This can have an outsized impact on jobs and the local tax base, a greater potential to disrupt the local economy, and greater leverage for malign actors by cementing close-knit networks of political and economic patronage. Local real estate markets in Montenegro and the Czech Republic have become a favored tool of payment and reward in these state capture networks. This report also demonstrates the enablers' deep reach into and impact in Central and Eastern Europe as an amplification of Russian economic influence. For example, the Russian aluminum producer Vimetco, registered in the Netherlands and appearing as a Dutch investment, has over the years obtained a quasi-monopoly status on the Romanian aluminum market, which has allowed it preferential access to and leverage over local political elites.

Patterns across the Region

The Kremlin Playbook 2 purposely analyzes European countries that have been the recipients of Russian malign influence campaigns yet have developed some antibodies and instruments to fend them off. Romania, the Czech Republic to some extent, and most recently Montenegro, fall into this general category. Yet neither the antibodies nor membership in NATO or the European Union (or both) were sufficient to guard against the vulnerabilities created by institutional and governance weaknesses, in particular lax approaches to tackling corruption. These findings reinforce *The Kremlin Playbook's* conclusion that Russia malign economic influence is “penetrating and utilizing [our] system from within” and using “Western rules and institutions and exploit[ing] their systemic weaknesses.”¹ While none of these countries have altered their Euro-Atlantic course thus far, the presence of corruption and malign capital has created the risk of opportunistic abuse of the system, potentially affecting each nation's stability and reinforcing internal weaknesses.

A key entry point for Russia's structural investments in these countries has been the non-transparent privatization of formerly state-owned companies and plants. Rus-

1 Heather Conley et al., *The Kremlin Playbook: Understanding Russian Influence in Central and Eastern Europe* (Lanham: Rowman & Littlefield, 2016), 2.

sian entities have long had a natural advantage in this sphere due to their appetite for higher-risk projects, technological path dependence in target countries, and informal access to political decision-making through former intelligence and security networks. Such privatizations or acquisitions are sometimes conducted through companies registered elsewhere in Europe, potentially obscuring the origin of the investment. This was the case for the notable 2005 purchase of the Podgorica Aluminum Plant (KAP) in Montenegro by Oleg Deripaska's Central European Aluminum Company, which is registered in Cyprus. In most post-communist countries, early privatization agreements generally included features like minimum investment clauses and plant repairs, as well as state subsidies and debt forgiveness for the buyer. However, in some cases, the acquiring company did not meet the conditions of the privatization agreement. Instead, the plants were not modernized and were instead sold off in parts to create cash revenue. Importantly, such privatizations have allowed oligarchs close to the Kremlin to legitimize their presence in a country's economic decision-making by gaining access to the negotiations between government, industry, and unions.

These types of acquisitions leave a heavy financial burden on the state and aggravate local unemployment, deepening mistrust in and weakening the government and institutions. Governments have not always been able to enforce these privatization contracts, either because (1) local politicians involved in the deal prevented it, (2) the state lacked the technical capabilities to conduct proper oversight of the contracts, or (3) the industry was already in a dire state. The acquiring company may also have signed the agreement in the full knowledge that there was limited potential to revive the firm or plant, and the aim was always to sell off the most viable parts without paying for the damage or debt that is left. This business strategy is by no means unique to Russia, and certainly not all deals involving Russian businesses or buyers are designed to inflict such damage. But our research suggests it is an attractive byproduct of opaque privatization and acquisition deals for plants that have been operating at a loss for years.

Russian businesses have been most active in the privatization and acquisition of assets in the structural economic sectors that were linked to the former Soviet system between Moscow and its satellites (i.e., energy and energy-intensive heavy industries such as metallurgy). Russian penetration has also been eased by the rapid devaluation of the assets' value in the wake of Central and Eastern Europe's transition to market economies. Some acquisitions have been championed by local businessmen or politicians who would benefit from the deal, and government authorities have failed to grasp the larger strategic picture. In Romania, aluminum producer Alro Slatina accounts for approximately 6 percent of the country's total energy consumption (Alro is controlled by Vimetco, which itself is owned by Russian investor Vitali Mashitski). This pattern of controlling the chain of production in metallurgy and its energy supply was visible in Montenegro, where Oleg Deripaska tried to purchase the Thermal Power Plant that would provide cheap electricity to KAP, which he had acquired two years prior.²

2 This effort ultimately failed after strong opposition from members of parliament. "DPS izgubio bitku ali se ne predaje," *ND Vijesti*, June 13, 2007.

Control over energy-consuming assets in relatively small economies and in cash-starved municipalities creates leverage on many counts. This leverage can come through the investors' penetration of the dialogue between the government and industry or through their provision of employment and tax revenue, which can be an electoral boon to local politicians. The gap between local oversight capabilities and the size of the deals and assets at hand, coupled with the non-transparent practices of local actors, opens the door to the abuse of state aid and EU subsidies fraud. For example, in 2012 the deputy governor of the Czech region of Usti (bordering Germany) was charged with misuse of EU funds,³ and in 2016, over 20 politicians from the same region, including mayors and the former governor, were suspected of participating in EU subsidies fraud as well.⁴ The deputy governor was convicted in 2016 and sentenced to three years of probation, though they denied participating in any illegal activity.⁵ The lack of effective national oversight and enforcement power over local activities is concerning; in the Czech Republic, the Supreme Audit Office remains unable to audit local and regional administrations and their financial management. The environmental impact of some of these acquisitions also allows the host country to apply for EU subsidies, which has typically been poorly supervised by local governments.

The Kremlin has sought to exploit local dependencies through large energy projects, which are very attractive politically to the recipient country but overwhelm the limited capacities of local governance and oversight bodies. Nuclear power in recent years has been one of the principal conduits for new and lucrative contracts Russia has sought to push through, involving large amounts of state funds as Soviet-era nuclear power plants across Europe begin to reach the end of their life cycles and require upgrades. The need for state guarantees for such projects raises the stakes. In the Czech Republic, the potential costs for the state-controlled utility operator CEZ in building new reactors for the Dukovany and Temelin nuclear power plants are almost prohibitive. This has created delays in the modernization process along with political disagreements over the tender. President Milos Zeman favors a no-bid intergovernmental deal with Russia's Rosatom (along the lines of Hungary's Paks II plant expansion, for which the Russian government provided a €10 billion loan to the Hungarian government).⁶ The government, however, favors a delay in the modernization or an open tender process as a no-bid deal would likely run afoul of EU state aid rules (and risks creating important leverage for the Kremlin over the Czech energy sector).⁷

3 Jeremy Druker, *Nations in Transit, Czech Republic* (Washington, D.C.: Freedom House, 2013), <https://freedomhouse.org/report/nations-transit/2013/czech-republic>.

4 "Czech senior official detained over EU money fraud," *Prague Daily Monitor*, December 15, 2016, <http://www.praguemonitor.com/2016/12/15/czech-senior-official-detained-over-eu-money-fraud>.

5 Radek Nohl, "Mé stíhání je útok proti ČSSD. Do politiky se nevrátím, řekl exnáměstek hejtmána odsouzený za dotace," *Aktualne.cz*, March 23, 2016, <https://zpravy.aktualne.cz/regiony/ustecky/me-stihani-je-utok-proti-cssd-do-politiky-se-nevratim-rekl-e/r~d66fc-146f11011e5a652002590604f2e/>.

6 David M. Herszenhorn, Sara Stefanini, and Nicholas Hirst, "Shrugging off concerns, Europe waves through Hungary's controversial nuke deal," *Politico*, December 14, 2016, <https://www.politico.eu/pro/europes-radioactive-embrace-hungary-russia-paks-ii-project-nuclear-reactors/>.

7 Nicholas Watson, "Czechs risk wrath of EU over nuclear power project," *Politico*, February 22, 2018,

Just as many Western firms do, Russian firms frequently use complex tax arrangements and corporate registration to limit their tax burdens and maximize profits. They also use this complexity to layer these profits or simply to allow for quick changes in ownership and avoid legal persecution if local authorities decide to investigate potential wrongdoing. These malign aims are often attained through legal corporate constructions hosted in enabling countries, especially those offering double taxation treaties and easy company registration that reduce the “Russian-ness” of the company.

One particularly useful tool in the malign arsenal is the use of transfer pricing—or, to be more accurate, mispricing—which has significantly impacted tax revenues in Central and Eastern European countries (e.g., Romania) as profits are removed from the reach of tax authorities, creating loss-making entities in these countries. Lukoil’s Romanian subsidiary is currently under investigation for such a transfer pricing and tax evasion scheme (although the bulk of the case was previously dismissed for lack of evidence).⁸ Lukoil works with associated companies on the entry and exit of final fuel products and crude oil from Russia including the Swiss-registered trading subsidiary Litasco Group, which is not only Lukoil’s crude oil importer intermediary but also its main exporting vehicle. Since tax law in the Netherlands treats parent companies and their subsidiaries as separate entities (not as being owned by the same corporation), Litasco’s profits from reselling crude oil are not reported by the Dutch entity and are only taxed in Switzerland. Russian oil trading companies have used a similar tax optimization mechanism in most of their operations in Central and Eastern Europe, including by Lukoil in the Czech Republic, Bulgaria, Montenegro, and Serbia.

Adaptation to Domestic Environments

While Russian malign influence follows certain patterns across Europe, *The Kremlin Playbook*’s case study approach highlights nuanced but important differences. The Kremlin does not take a cookie-cutter approach to its malign influence operations; it uses its economic tools and networks of patronage and fully exploits the leverage it has in some countries as well as the weaknesses those countries present. Understanding the adaptability of Russian tactics is essential in order to preemptively counter them.

It is important to note that Russian economic activity in Romania, the Czech Republic, and Montenegro is concentrated in foreign direct investments (FDI) rather than in direct corporate activity. Indeed, Russian FDI represents approximately 13.6 percent of all FDI stock in Montenegro.⁹ Trade in services has become more important, particularly in the tourism sector (now accounting for close to 20 percent of GDP in Montenegro).¹⁰

<https://www.politico.eu/article/dukovany-czech-risk-wrath-of-eu-over-nuclear-power-project/>.

8 “Petrotel Lukoil nu mai este anchetată pentru evaziune și spălare de bani,” *Economica*, November 17, 2017, http://www.economica.net/petrotel-lukoil-ploiesti-cercetata-pentru-subevaluarea-valorii-construcțiilor-si-instalațiilor_146386.html.

9 CSD estimates based on data from the national central bank of Montenegro.

10 “Predrag JELUŠIĆ: Turizam daje petinu BDP-a i čini više od polovine izvoza Crne Gore,” Portal Analitika, September 27, 2015, <http://www.portalanalitika.me/clanak/203071/predrag-jelusic-turizam-daje-petinu-bdp-a-i-cini-vise-od-polovine-izvoza-crne-gore>.

In the case of Romania and the Czech Republic, exports to Russia have also taken up a larger piece of the economic relationship, as both countries have become more deeply integrated into European production chains that in turn export to Russia.

Unlike some of their neighbors, the three case study countries' dependency on Russian energy has decreased thanks to economic growth, lower energy prices (those outside long-term contracts), and lower oil and gas imports (particularly in the Czech Republic, which went from a peak of around €5 billion in 2012 to around €1.5 billion in 2016).¹¹ Early on in its transition, the Czech Republic ensured it was well-connected to other European energy hubs that provide more flexible, market-based contracts—which may be why Russia has focused its economic attention on nuclear power. Montenegro has a very low domestic energy consumption and is not part of the EU energy market, though energy resources matter for metallurgy and mining operations in the country. And Romania has important domestic energy resources, although it has yet to harness the full potential of the Black Sea's oil and gas reserves, which might well garner the Kremlin's attention in coming years.

The Czech and Montenegrin real estate markets have been particularly attractive for Russian investments, with some of it allegedly serving the purpose of maintaining local political connections. In the Czech Republic, for example, several high-value buildings in Prague are reportedly owned by the Russian embassy and used as headquarters for pro-Russian parties and civic associations.¹² The same buildings allegedly accommodate companies belonging to a former politician close to President Milos Zeman who has business interests in Russia.¹³

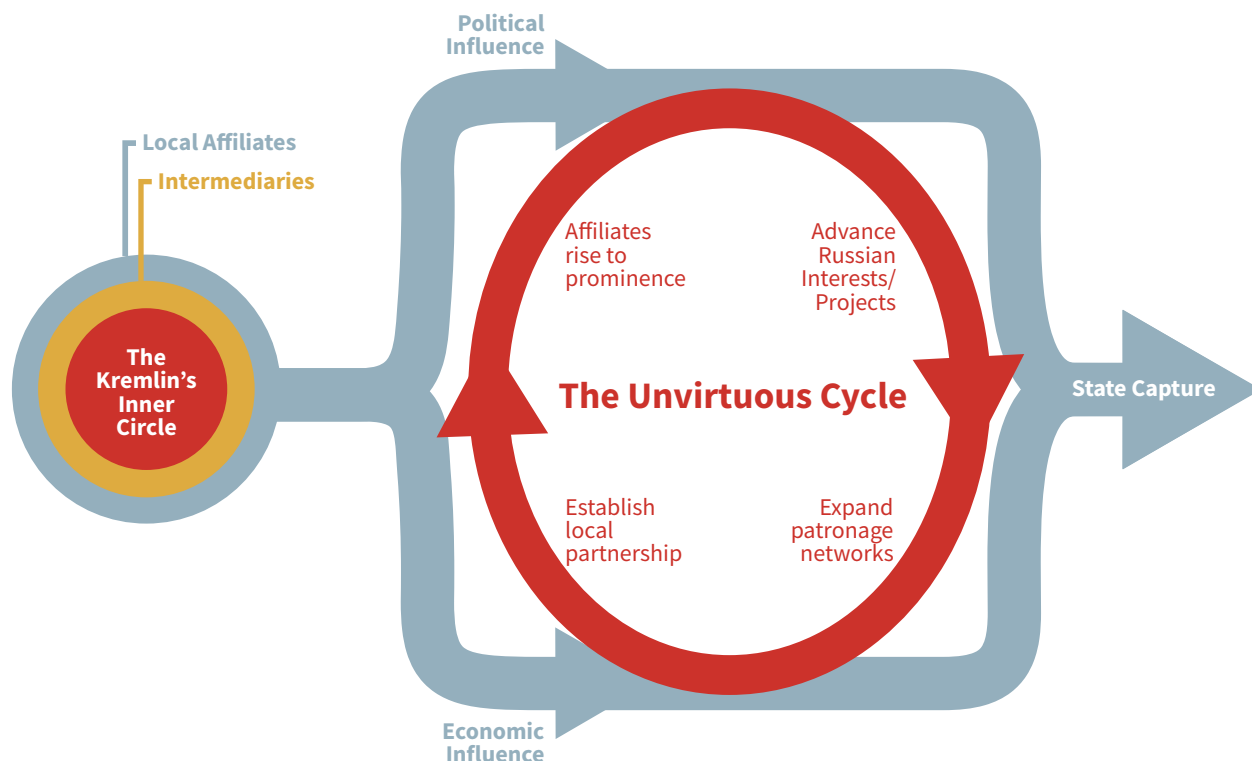
Finally, in the first *Kremlin Playbook*, we observed a shift (and increase in some countries) in the Russian economic footprint around 2008—the time of the global financial crisis and the Russian-Georgian conflict—when seemingly benign investments turned into a deliberate use of economic influence and leverage to shape political outcomes in Central and Eastern Europe. Similar to other Central and Eastern European countries, Romania and Montenegro have been recipients of predatory investments and economic decisions. Russian corporate investments decreased somewhat after 2008, particularly in the aluminum sector, with some plants requiring closure or restructuring, or suffering significant financial losses that negatively affected Russia's economic footprint in those countries. But unfulfilled privatization or merger agreements with Russian economic actors created non-negligible financial harm to the state as well (e.g., lost subsidies, unemployment, lost tax revenue, and lower public confidence). For the Kremlin, even an economic loss can be manipulated into a political win.

11 Eurostat; International Trade Database (Comext).

12 Tomáš Menschik, "Zákulisí Řádu národa. Vůdce z ruské ambasády," Tyden.cz, May 6, 2016, https://www.tyden.cz/rubriky/domaci/zakulisi-radu-naroda-vudce-z-ruske-ambasady_382672.html.

13 Jan Horák, "Prezident není Putinův agent, odpůrci se musí s prohrou smířit, tvrdí Zemanův přítel Zbytek," Lidovky.cz, January 28, 2018, https://www.lidovky.cz/prezident-by-mel-vice-odpocivat-odpurci-se-musi-s-jeho-vyhrou-smirit-mini-zbytek-gpl-/zpravy-domov.aspx?c=A180127_154255_ln_domov_jho.

The Unvirtuous Cycle of Influence



The Kremlin Playbook's unvirtuous cycle of influence remains at play in these three countries, following two tracks: one through economic influence in strategic sectors of a country's economy (in turn providing potential political influence) and the other through political and cultural influence (which typically protects and enhances current and future Russian economic influence). The cycle is fueled by corruption and can lead to state capture.

For Montenegro and the Czech Republic, Russia is effectively using both entry points, sometimes to dangerous effect. Montenegro has an important exposure to Russian economic influence, but it also has a vulnerable cultural link with the Kremlin through the Serbian Orthodox Church, which represents a powerful political force in the country—it can be seen as the strongest opposition force in Montenegro. The Czech Republic is both a recipient (in the nuclear power and financial sectors) and a conduit for Russian economic influence through its financial sector—a hybrid model of sorts. There, the Kremlin can deploy its political influence through the head of state and his closest advisors as well as a still-influential Communist party. Romania has the weakest political and economic ties to Russia in our study, but Russian malign influence can still enter the country through the exploitation of institutional, political, and societal weaknesses (particularly corruption and its politicization).

No matter how much or how little a country is primed for Russian malign economic influence, the Kremlin fully exploits what opportunities are available to it.

Conclusions and Recommendations

The second edition of *The Kremlin Playbook* demonstrates that Russia continues to pursue a multifaceted and adaptative strategy of malign influence in Europe. In its pursuit, the Kremlin has encountered both successes and setbacks. It allegedly meddled in the 2016 Brexit referendum both financially and culturally;¹ this vote has since deeply divided Europe and weakened a major U.S. ally and UN Security Council member. The Kremlin interfered in the 2016 U.S. presidential election and attempted to do so in the 2018 midterm elections.^{2,3} The Kremlin tried to change the government of Montenegro by force in 2016 through an attempted coup and assassination.⁴ It continues to seize terrestrial and maritime space in Ukraine and Georgia while placing intense pressure on Belarus and Moldova. But Moscow has also experienced important setbacks: Montenegro became NATO's newest member and the newly-renamed Republic of North Macedonia has received an invitation to join the alliance. NATO remains unified (thus far), the European Union has maintained its sanctions against Russia for five years (despite loopholes), and U.S. policy toward Russia continues to be resolute (largely due to Congressional action and the active use of sanctions instruments by the Department of Treasury).

Many in the transatlantic community have now openly recognized the threat of Russian malign influence. But the West continues to lack a sense of urgency over and prioritization of the threat and its constituting elements. It also lacks a comprehensive understanding of the institutional deficits that enable this influence and a coherent toolbox to confront and counter the Kremlin's malign efforts. Russia is one of the most integrated actors in the West's economic and financial ecosystem. As such, it is well placed to exploit internal weaknesses as political leaders grapple with the degradation of alliances and democratic systems under the corrosive effect of corruption, illicit financial flows, and state capture. Russia is the clearest threat in this space, but it is not the only malign actor with which the West must concern itself. Other foreign and non-state adversaries are closely studying the Kremlin's tactics and writing their own playbooks, seeking the weakest links, developing patronage networks among the ruling political elites (or nascent political forces that could later become useful), and amplifying structural economic dependencies.

- 1 Patrick Wintour, "Russian bid to influence Brexit vote detailed in new US Senate report," *Guardian*, January 10, 2018, <https://www.theguardian.com/world/2018/jan/10/russian-influence-brexit-vote-detailed-us-senate-report>.
- 2 "Joint Statement from the Department of Homeland Security and Office of the Director of National Intelligence on Election Security," Department of Homeland Security, October 7, 2016, <https://www.dhs.gov/news/2016/10/07/joint-statement-department-homeland-security-and-office-director-national>.
- 3 Lara Seligman, "Mattis Confirms Russia Interfered in U.S. Midterm Elections," *Foreign Policy*, December 1, 2018, <https://foreignpolicy.com/2018/12/01/mattis-confirms-russia-interfered-in-us-midterm-elections-putin-trump/>.
- 4 "Investigation Uncovers Second Russian Montenegro Coup Suspect," *Balkan Insight*, November 22, 2018, <https://balkaninsight.com/2018/11/22/media-investigation-identifies-montenegro-coup-suspect-11-22-2018/>.

One central conclusion of this report is that **Russian malign economic influence and illicit finance are clear and present dangers for the United States and Europe’s national security.** But the West is turning a blind eye to the threat as governments seek to preserve status quo ties between their economies and Russia’s financial and energy flows. Enablers have grown accustomed to the lucrative returns of engaging with and servicing Russian capital and/or state-sponsored projects. Yet, by failing to recognize the gravity and persistence of this threat, to close governance gaps, and to address economic and social disparities at home, the West creates a breeding ground for Russian disinformation and illicit funds to infiltrate public perceptions and its financial system.

Recommendations

It is time for the United States and its European allies to take decisive action to limit Russia’s malign behavior in the transatlantic political, economic, and financial systems. There is a critical need for a renewed focus on deconstructing structural economic dependencies on Russia, with the energy sector being the most obvious target as a central pillar in Russia’s influence infrastructure in Europe. In this respect, the United States has been more vocal in recent years and needs to play a decisively supporting role in completing the European Energy Union through cooperation on specific diversification projects and the design of efficient power and gas markets.

Policymakers have also rightly focused more intensely on anti-money laundering efforts (AML) (e.g., the European Union’s 5th Directive on Money Laundering) and countering tax evasion (an effort driven by the Organisation for Economic Co-operation and Development). The European Union has recently proposed to enlarge its “name and shame” list of countries and territories that contribute to money laundering beyond the current Financial Action Task Force list, which would require financial institutions to be more alert to transactions emanating from and transiting through their country. The U.S. Department of Treasury, through FinCEN, has reissued geographic targeting orders to provide greater transparency on real estate transactions and title insurance companies.⁵

Reports from the Department of Treasury on the U.S. efforts to combat illicit finance relating to Russia—as mandated by the 2017 Countering America’s Adversaries Through Sanctions Act (CAATSA)—are valuable to assess progress on countering this illicit finance risk, and Congress should make sure they are provided every year. In addition, the newly introduced, bipartisan Defending American Security from Kremlin Aggression Act (DASKA) of 2019 proposes a specific requirement for domestic title insurance companies to report information on the beneficial owners of entities that purchase residential real estate in high-value transactions. The European Union should consider a similar legislative effort to counter Russian malign influence along similar lines to CAATSA and DASKA, which would also improve transatlantic sanctions coordination.

5 “FinCEN Reissues Real Estate Geographic Targeting Orders and Expands Coverage to 12 Metropolitan Areas,” Financial Crimes Enforcement Network, November 15, 2018, <https://www.fincen.gov/news/news-releases/fincen-reissues-real-estate-geographic-targeting-orders-and-expands-coverage-12>.

These are important and positive steps, but they are insufficient compared to the scale of the challenge. For example, the European Banking Authority (EBA) currently has only two individuals monitoring money-laundering risks for hundreds of European banks.⁶ The recent U.S. National Illicit Finance Strategy does not mention Russia in its 3-page money laundering threat assessment section and the National Money Laundering Risk Assessment only briefly touches on the risks of Russian transnational organized crime and virtual currency.^{7,8} Like much of the post-9/11 structures of the U.S. national security community, the United States' illicit financing strategy remains nearly exclusively focused on terrorist and proliferation financing and has not grappled enough with the national security implications of Russian illicit financing and corruption. Title 3 of the PATRIOT Act, entitled the International Money Laundering Abatement and Anti-Terrorist Financing Act, places money laundering and terrorist financing on equal footing, but they have not received equal national security or structural attention.

The massive money laundering and tax evasion scandals that have come to light in recent years—from the Panama Papers and Russian Laundromat to the Deutsche Bank and Danske Bank scandals—suggest that we are only beginning to grasp the full scale of the problem. Transparency and scrutiny of financial flows must be elevated as a top priority, particularly scrutiny of transactions that individually may seem innocuous but taken together show a pattern of potential illicit activity. Currently, the application of screening mechanisms at the national level is poor, which allows illicit funding to stream through the system unnoticed.

When EU common banking regulations were devised a decade ago, national security concerns were not part of their legal development. Therefore, the ability of national governments to issue guidance on security matters to banks (and other financial service providers) or regulators was deliberately limited. Although AML responsibilities fall under the supervision of national security agencies, these agencies predominantly focus on countering drug trafficking and terrorist financing. They do not prioritize unassuming business entities that are potentially dependent on or controlled by quasi-sovereign Russian interests.

This reinforces the need for national security agencies and regulators to enhance their cooperation and ensure swift and effective tackling of illicit finance. They should do so by developing international standardization of incorporation and subsidiary formation practices, ultimate beneficial ownership (UBO) laws and disclosures, transfer pricing, and tax avoidance or evasion rules. Despite the passage of the Foreign Account Tax Compliance Act (FATCA) nine years ago, Congress has still not taken steps to guarantee reciprocity with countries that have signed intergovernmental agreements under

6 Francesco Guarascio, "EU states back stronger money laundering monitoring of banks," Reuters, November 13, 2018, <https://www.reuters.com/article/us-eu-banks-moneylaundering/eu-states-back-stronger-money-laundering-monitoring-of-banks-idUSKCN1NI1HJ>.

7 U.S. Department of the Treasury, *National Strategy for Combating Terrorist and Other Illicit Financing* (Washington, D.C.: U.S. Department of the Treasury, 2018).

8 U.S. Department of the Treasury, *National Money Laundering Risk Assessment* (Washington, D.C.: U.S. Department of the Treasury, 2018).

FATCA—reciprocity that would enhance transparency and information sharing. The United States has also not yet approved the OECD’s common reporting standards, which were modeled after FATCA agreements and were meant to improve two-way information sharing on tax avoidance and evasion.⁹

Simply put, if we are at war and illicit financing is a critical battle space, we must reconceptualize our deterrence and offensive tools in this space. One key aspect of this is improving our ability to connect the dots of Russian malign economic influence; faced with complex schemes that are designed to cross many borders and operate just below legal thresholds in some jurisdictions, our law enforcement and financial oversight bodies struggle to get a complete picture. And when one jurisdiction attempts to improve standards, malign actors can easily redirect their networks to other areas that are more conducive to their aims in a never-ending game of whack-a-mole. Illicit finance has reaped the benefits of a globalized financial network, while law enforcement and national security actors have remained bound by national rules and borders. This is compounded by the lack of experience and instruments in tackling corruption and state capture in partner countries, which substantially weakens common efforts.

To address these blind spots and comprehensively target Russian malign influence, we recommend the following lines of effort:

- **Create a transatlantic Intelligence, Surveillance, and Reconnaissance (ISR) system for financial flows** that would provide an integrated database and a common operating picture for national security, financial intelligence, and law enforcement actors. This Financial ISR (FISR) mechanism could alert multiple jurisdictions of potentially suspicious activity or illicit schemes, along the lines of Indications and Warning (I&W) in the military. The aim is for the private sector (e.g., compliance officers at banks) and national authorities to work hand in hand to improve our detection capabilities and proactively react to illicit finance and money laundering risks. Any information sharing would take into account data privacy safeguards in both the United States and Europe.
 - The U.S. Department of Treasury’s Office of Terrorism and Financial Intelligence would manage this system in cooperation with the Treasury’s Financial Crimes Enforcement Network (FinCEN), and the Department of Justice’s National Security and Asset Recovery Divisions. The Department of State would provide input through its Economic and Business Bureau, as would the Director of National Intelligence, the Internal Revenue Service (in cases of tax avoidance or evasion), as well as supervisory authorities and international bodies responsible for anti-money laundering and counter-terrorist financing (e.g., the

9 Laurie Hatten Boyd, “Are Problems Looming for FATCA and the “Reciprocal” IGA?” *The Tax Adviser*, June 1, 2016, <https://www.thetaxadviser.com/issues/2016/jun/problems-looming-for-fat-ca-and-reciprocal-iga.html>.

Bank Secrecy Act Advisory Group and the Financial Action Task Force, or FATF).

- This would build on the capabilities of the Egmont Group of Financial Intelligence Units, whose Secure Web (hosted by FinCEN) already provides a secure information sharing platform and operational capabilities. The Egmont Group would be given operational responsibility for the integrated picture aspect of the FISR.
- CAATSA recommended the creation of a multi-year budget plan to identify the resources necessary to enhance interagency and international cooperation to fight illicit finance (including with the FATF and Egmont Group).¹⁰ These resources could be used to develop this FISR, or a structure similar to it.

The common operating picture built through the FISR would contribute to necessary improvements in and should be complemented by the following:

- **Elevate money laundering as a priority threat to national security** within the Treasury and Justice Departments and encourage European allies to do so in their national jurisdictions.
 - Enable investigative and prosecutorial bodies to pursue money laundering as a standalone crime, in addition to predicate offenses.
- **Better integrate bank supervision in the EU AML monitoring system;** in particular, this supervision should guarantee that no national authority turns a blind eye to transactions and accounts that bring in much needed (or risk-free) income to the banks under their supervision. Supervision should take national security issues into account in addition to the financial health of the banking sector.
- **Reform and considerably strengthen the European Union's AML/Counter-Terrorism Financing system** by ensuring much stronger coordination between EU and national banking and financial supervisors, and EU and national security agencies.¹¹ One possibility is to form an EU-wide AML agency, which has been floated in the past by ECB officials and members of the European Parliament.
 - Reforms should create the ability to thwart risks to the integrity of the entire EU financial system, including non-Eurozone EU countries, and should include mechanisms that require national action when a threat is identified.
 - Efforts should also be made to harmonize tax policy, to track tax evasion, and enhance asset recovery as a crucial part of the AML infrastructure.

¹⁰ *Countering America's Adversaries Through Sanctions Act of 2017*, Public Law 115-44, Title II, Section 262.

¹¹ Joshua Kirschenbaum and Nicolas Veron, *A better European Union architecture to fight money laundering* (Brussels: Bruegel, 2018).

- **Strengthen EU reporting and regulatory requirements for ultimate beneficial ownership (UBO)** by closing disclosure loopholes in a number of tax-treaty jurisdictions. An EU-wide database of corporate ownership (easily accessible to oversight authorities) could assist national tax, financial, and antitrust regulators in the approval process of large public procurement contracts and tenders, strategic mergers and acquisitions, and ahead of the privatization of strategic assets. Energy, banking, telecommunications, and construction should be the most closely watched economic sectors for potential UBO obfuscation.
 - The United States should work with European partners to create international standards for UBO disclosure, limiting the use of nominee directors and standardizing disclosure requirements for foundations and trusts.
- Establish new international standards for suspicious activity reports (SARs) thresholds.
 - Work with the Bank Secrecy Act Advisory Group to balance the needs of national authorities and the burden on private sector entities when adapting the reporting threshold.
 - Because more than 65 percent of all EU SARs in 2014 were flagged in the United Kingdom and the Netherlands alone,¹² the United States should develop a trilateral effort to foster early detection of illicit patterns.

As this report makes clear, authoritarian regimes operate and thrive in the shadows; the West must “fight in the light.”¹³ A relentless pursuit of **transparency and accountability** is the West’s most effective offense against malign economic influence and illicit finance. Information sharing and cooperation between law enforcement bodies and oversight authorities across countries—but also within national jurisdictions—is essential. This transparency must be enhanced in particular for financial and corporate services providers (CSPs) and to prevent sanctions evasion:

- **Elevate the risk level of CSPs in illicit finance and money laundering activities** for both the United States and the European Union.
 - Establish a clear risk profile of CSPs based on the assessments and definitions of the FATF and in collaboration with the OECD. To this aim, expose the use of corporate entities for illicit purposes, including by updating the 2001 report published by the OECD.¹⁴

12 “Global Anti-Money Laundering Framework – Europol Report Reveals Poor Success Rate and Offers Ways to Improve,” Europol, September 5, 2017, <https://www.europol.europa.eu/newsroom/news/global-anti-money-laundering-framework-%E2%80%93-europol-report-reveals-poor-success-rate-and-offers-ways-to-improve>.

13 This term was originally coined by CSIS senior adviser Suzanne Spaulding.

14 Organisation for Economic Co-operation and Development, *Behind the Corporate Veil: Using*

- Enforce customer due diligence (CDD) and know-your-customer (KYC) requirements for financial institutions by increasing penalties for non-compliance.
- Establish strict CDD/KYC requirements for the CSP sector, as well as clear anti-money laundering guidelines.
- **Better align U.S. and European transparency policies on strategic sectors that attract the most significant Russian economic activity and present corruption risks, such as energy, finance, and real estate.** Pragmatic solutions to enable market transparency and data-driven policy action across the Atlantic must be identified to reduce the scope for Russian malign activities.
 - Public procurement and privatization contracts should be made publicly accessible, including annexes and updates in the agreements.
 - The European Union should restart the publication of a biannual Anti-Corruption Report, following the format of their 2014 report. Its findings should inform the planned EU rule-of-law instrument, which foresees the freezing of EU development funds for member states that fail to live up to the highest anti-corruption and rule of law standards.¹⁵
 - The European Union should considerably strengthen and, in some member states, begin implementing the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions.¹⁶
 - These efforts should be complemented by a more systematic implementation of innovative diagnostic instruments that provide insights into sector-level monopoly power concentration and corruption vulnerabilities, such as the State Capture Assessment Diagnostics (SCAD).¹⁷
- **Use disclosure (“name and shame”) to increase the reputational damage of harboring Russian illicit funds** or helping malign actors shift profits abroad, while acknowledging legitimate reasons for moving assets out of Russia.
 - Better target oligarchic networks that have used the Western finan-

Corporate Entities for Illicit Purposes (Paris, France: OECD, 2001).

15 European Commission, “Proposal for a Regulation of the European Parliament and of the Council on the protection of the Union’s budget in case of generalised deficiencies as regards the rule of law in the Member States,” May 2, 2018, https://ec.europa.eu/commission/sites/beta-political/files/protection-union-budget-rule-law-may2018_en.pdf.

16 “OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions,” OECD, <http://www.oecd.org/corruption/oecdantibriberyconvention.htm>.

17 Center for the Study of Democracy, *State Capture Diagnostics Roadmap*, Working Paper (Sofia, Bulgaria: Center for the Study of Democracy, August 2016); Center for the Study of Democracy, *State Capture Assessment Diagnostics* (Sofia, Bulgaria: Center for the Study of Democracy, 2019).

cial system as well as their subsidiaries to circumvent sanctions, including through asset freezes in key European centers of Russian economic activity.

- **Adopt and rigorously implement the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017 in EU member states** to make the approved intracompany pricing methodology consistent with general market levels. National law enforcement and tax inspection bodies should recognize the role of grey economy practices such as layering, unregulated transfer pricing mechanisms, and contraband energy flows in destabilizing the financial system and financing grand corruption schemes.
- **Address the key risks and loopholes allowing the evasion of sanctions.** Remove bilateral exemptions and loopholes that have exempted grandfathered deals from the sanctions regime, particularly in the European Union, and understand how joint projects between European and Russian companies have created potential gaps in the sanctions regime. It is vital to understand, track, and limit the use of subsidiaries to evade sanctions.
- **Harness the potential of the Global Magnitsky Act** in targeting kleptocrats, as well as nominees for and people who assist these perpetrators.¹⁸
 - EU member states and the United States should harmonize their use of the Act as well as the provisions contained in each national law, particularly on the matter of asset freezes. The European Council and the European Parliament should speed up the development of the EU Global Human Rights Sanctions Regime (an EU-wide Magnitsky Act) that was proposed by the Netherlands and approved by EU foreign ministers in December 2018.¹⁹
- **Use the U.S. Foreign Corrupt Practices Act**, if applicable, and leverage visa instruments to target companies in the European Union, as well as influential oligarchs and corrupt politicians, that do business with sanctioned firms and individuals in Russia.
- **End the use of the so-called golden visas in the European Union.** In parallel, the United States must increase the transparency of its invest-

18 U.S. Congress, Senate, *Global Magnitsky Human Rights Accountability Act*, S. 284, 114th Cong. 2nd Sess., referred in House April 16, 2018, <https://www.congress.gov/114/bills/s284/BILLS-114s284r-fh.pdf>. Specifically Section 3(a)(3) and (4): sanctions can be imposed on any foreign person determined to be “a government official, or a senior associate of such an official, that is responsible for, or complicit in, ordering, controlling, or otherwise directing, acts of significant corruption, [. . .] bribery, or the facilitation or transfer of the proceeds of corruption to foreign jurisdictions; or (4) has materially assisted, sponsored, or provided financial, material, or technological support for, or goods or services in support of, an activity described in paragraph (3).”

19 Ewelina U. Ochab, “The Magnitsky Law Is Taking Over The European Union,” *Forbes*, December 10, 2018, <https://www.forbes.com/sites/ewelinaochab/2018/12/10/the-magnitsky-law-is-taking-over-the-european-union/>.

ment visas. Oligarchs and kleptocrats have used our systems and courts to keep their money safe, but they should accept that the rule of law cuts both ways.

If it is suggested that “democracy dies in darkness,”²⁰ then it must be that it thrives in the light. Transparency and accountability are essential elements that rebuild and sustain trust in democratic institutions. Enforcement of this transparency ensures an enduring trust in this unique system. In this fight, democracies must never surrender.

20 Paul Farhi, “The Washington Post’s new slogan turns out to be an old saying,” *Washington Post*, February 24, 2017, https://www.washingtonpost.com/lifestyle/style/the-washington-posts-new-slogan-turns-out-to-be-an-old-saying/2017/02/23/cb199cda-fa02-11e6-be05-1a3817ac21a5_story.html.

Case Study

Austria

Like Russia, Austria has historically viewed itself as neither East nor West. It was annexed by Germany prior to the Second World War in the *Anschluss*, and following Germany's defeat—and at the onset of the Cold War—Austria pledged neutrality after Allied and Soviet troops pulled out of the country in 1955. Since then, Austria has leveraged and marketed itself as a neutral and favorable “space in between” East and West and a hub for Central and Eastern Europe. Its position has allowed it to encourage first Soviet and then Russian economic activity while at the same time fly under the geopolitical radar for U.S. and European policymakers. Austria was the first European country to import pipeline gas from the USSR in 1968 and to create early financial connections that would later make it an integral part of the opening and economic transformation of the former communist countries in Europe. After the collapse of the Soviet Union in 1991 and Austria's accession to the European Union in 1995, the country strengthened its position as a diplomatic and economic hub between East and West, particularly with post-Soviet countries and their leading oligarchs. It has been a favorite vacation spot for Russian politicians and business leaders (for example, Vladimir Putin began vacationing in the Alps in the 1990s). But the relationship building has been a two-way street, as Austrian leaders have made numerous trips to Russia, and prominent Russian politicians have traveled to Vienna even after the invasion of Ukraine in 2014.

Austria's “in between” status is perfectly reflected in its political and business culture, which serves as an attractive environment for Russian businesses and funds. While Austria ranks high as a country that protects democratic rights and civil liberties, it has a very uneven, if not outright lax, approach to combatting corruption as well as official and banking secrecy. Austria's Corruption Perception Index score worsened between 2009 and 2013 and has only slowly improved since.¹ A 2012 report by the Austrian Green Party parliamentary group estimated that corruption reduced Austria's economic output by 5 percent, or €17 billion.²

Several structural reasons make Austria an attractive venue for malign Russian economic influence. First, Austria has a legacy of corporatism, whereby the country's large corporate interests have shaped major institutional structures over the decades, and major social and interest groups (employers' federations, trade unions, and business chambers) are closely tied to governmental decision-making processes and institutions. These corporate interests (dominated by large, state-owned firms) are not always ideologically sorted, as they are well-connected with both of Austria's main

1 “Corruption Perceptions Index 2017,” Transparency International, February 21, 2018, https://www.transparency.org/news/feature/corruption_perceptions_index_2017.

2 “Freedom in the World – Austria,” Freedom House, June 20, 2014, <https://freedomhouse.org/report/freedom-world/2014/austria>.

political parties—the center-left Social Democrats (SPO) and the center-right Conservatives (OVP)—and they share long-standing ties with Russian companies and oligarchs. Thus, corporate interests propel the political parties to allocate resources and nominate public officeholders that can protect their interests. The main political parties, in turn, become invested in the well-being of these corporate interests to maintain their power. But whose interests are being served? The distinction becomes so blurred that one can no longer discern where corporate interest ends and public governance begins (or vice versa). This is why Austria is particularly susceptible to political corruption scandals, fostered by transparency-adverse corporate-government entanglements.

It is therefore not surprising that Austria went through a spate of political corruption scandals in the early 2010s involving high-level individuals including a former minister of the interior and a deputy governor of the central bank. Former Austrian chancellor Werner Faymann was implicated in a corruption scandal as well, but the parliamentary inquiry did not yield concrete results—though its head, Green MP Gabriela Moser, resigned after complaining that both SPO and OVP were blocking her investigation.³

Second, Austria has one of the weakest legal frameworks in the world in terms of access to information; its constitution still protects official secrecy,⁴ and a law on freedom of information has been stalled in parliament for years.⁵ It lacks transparency in the public procurement sector as well, creating a permissive environment for lobbying and for illicit activities such as corruption, bribes, tax evasion, and money laundering, domestic or otherwise. According to the Financial Action Task Force (FATF), Austria “does not pursue [money laundering] as a priority and in line with its profile as an international financial center,” and it is vulnerable to illicit funds (proceeds from international or foreign crimes) transiting through the country, including through Austrian bank accounts of companies established offshore.⁶ Beyond the banking sector, corporate service providers (CSPs), or Designated Non-Financial Businesses and Professions (DNFBPs) such as lawyers and accountants, are not regulated as stringently as financial actors despite their key role in the economic and financial system.⁷ Yet these CSPs could enable the conduct of illicit activity without oversight and greater transparency.

Diplomatic pressure from the United States and European partners has facilitated the removal of some Austrian banking secrecy provisions (e.g., anonymous accounts) in the aftermath of September 11 and counterterrorism financing efforts. But structures and legal provisions such as private foundations (*Privatstiftung*) continue to protect

3 “Freedom in the World – Austria,” Freedom House, January 9, 2013, <https://freedomhouse.org/report/freedom-world/2013/austria>.

4 “Austria,” Global Right to Information Rating, June 2016, <https://www.rti-rating.org/country-data/Austria/>.

5 “Freedom in the World – Austria,” Freedom House, January 4, 2018, <https://freedomhouse.org/report/freedom-world/2018/austria>.

6 Financial Action Task Force, *Anti-money laundering and counter-terrorist financing measures – Austria, Fourth Round Mutual Evaluation Report* (Paris, France: Financial Action Task Force, 2016), 3.

7 Ibid., 9.

anonymity for beneficial owners and offer important tax exemptions. Banking secrecy laws still shelter many individuals from banks regularly sharing information with investigative authorities.⁸ The legal threshold for freezing bank accounts in the context of investigations is also high, sometimes preventing the suspension of assets in potential money-laundering investigations.⁹

Finally, Austria also has relatively weak counterintelligence services, despite its position as a major financial center and the seat of several international organizations in which many diplomatic accreditations can hide an intelligence actor. The intelligence penetration of businesses in the energy, financial, and infrastructure sectors is reportedly high.¹⁰ Legally, spying is only a crime if it is directed against the Austrian state, making Vienna an ideal location for intelligence operations. For example, in 2011, an Austrian master sergeant was sentenced by German authorities for espionage on technical documentation concerning German combat helicopters, which the sergeant provided to the SVR, the Russian foreign intelligence service. The individual was not prosecuted in Austria, as Austrian state secrets were not involved in the leak.¹¹

While Russia is not a major player in Austria's foreign trade, it is the second-largest investor in Austria, reaching more than €26 billion in FDI in 2017. *Russian investments in Austria have risen since the crisis over Ukraine began in 2014 and accounted for over 16 percent of inbound FDI stocks in 2017* (up from around 8 percent in 2013).¹² The value of Russian company assets in Austria has substantially increased from €3.7 billion in 2007 to €17.7 billion in 2015.¹³ Meanwhile, the Russian direct and indirect corporate footprint is estimated at 5.7 percent of the total corporate revenues in the economy.¹⁴ Given Russia's limited corporate footprint and the lack of tangible projects that would necessitate these investments, it appears Austria is used mostly as a hub or throughput for Russian investments across Europe and as a point of repatriation of capital from Russian subsidiaries in Europe.¹⁵ Austria is one of the three largest foreign direct investors in Central and Eastern Europe and the Western Balkans, especially in the services sector (principal-

8 Kurt Bayer, "Bankgeheimnis für wen?" Kurt Bayer's Commentary, April 11, 2013, <https://kurt-bayer.wordpress.com/2013/04/11/bankgeheimnis-fur-wen/#more-1052>.

9 *Anti-money laundering*, FATF, 7.

10 "Verfassungsschutzbericht 2017," Office for the Protection of the Constitution and Counterterrorism, Ministry of the Interior, 2017, <https://www.bvt.gv.at/401/files/Verfassungsschutzbericht2017.pdf>.

11 "Bewährung für den Spion in Uniform," *Focus Online*, March 1, 2011, https://www.focus.de/politik/deutschland/prozesse-bewaehrung-fuer-den-spion-in-uniform_aid_604641.html.

12 Authors' calculations based on data from the National Bank of Austria.

13 Authors' calculations based on data from the national statistical institute, commercial registries, and corporate databases.

14 Among the indirectly controlled Russian companies present in Austria is also Strabag, one of the largest construction companies in Europe, which has among its shareholders a Cypriot offshore firm (25 percent stake) with Oleg Deripaska (the U.S.-sanctioned Russian businessman) as ultimate beneficial owner.

15 Austrian bank accounts were involved in the Russian Laundromat scandal in 2017.

ly banking and insurance). These structural factors, combined with Austria's substantial economic network in the region, can amplify Austria's role in enabling Russian malign influence and as a prime banking and business hub for Russia.

One key area of investment is the energy sector. As with many countries in Europe, energy is a critical factor shaping bilateral trade between Austria and Russia and an influential vehicle for business and political ties. Austria is dependent on Russia for close to 80 percent of its natural gas consumption, and its main imports (in goods) from Russia are fossil fuels.¹⁶ Gazprom chose Vienna as its operational hub in the early 2000s to expand into Western Europe, and it established several Gazprom subsidiaries and private funds; in 2012, Gazprom Next Trading—registered in Vienna—had an annual turnover of €11.5 billion but only employed 52 people.¹⁷

Founded in 1956, OMV, Austria's formerly state-owned oil and gas company, employs over 20,000 people throughout its extensive downstream portfolio and network of subsidiaries in Europe, and its total assets were worth €31.5 billion in 2017.¹⁸ OMV was the company that first imported gas from the Soviet Union into Western Europe in 1968, and it has bought stakes in several gas fields in Siberia. It joined the Nord Stream 2 project in 2015, was a partner in the defunct South Stream project, has discussed extending the TurkStream pipeline to Austria, and has concluded asset swaps with Gazprom that provided the latter with stakes in European companies that it would otherwise not have access to due to sanctions and limits on financing.¹⁹

Beyond its long-time strategic partnership with Gazprom, OMV also enjoys close ties with the OVP (the leading party in the current Austrian government). OMV's CEO Rainer Seele—who is also the former president of the German-Russian Chamber of Commerce—has openly expressed his willingness to increase OMV's share in Russian production, considering it a safe upstream reserve.²⁰ Several high-level politicians, including successive Austrian chancellors and foreign ministers, have publicly supported both South Stream and Nord Stream 2. Austria has opposed the application of EU market rules on the offshore section of the Nord Stream 2 pipeline and some experts have noted it is likely one of the member states that has refused to give the Commission a mandate to negotiate with

16 EU statistics on natural gas supply, imports, and consumption are provided by the electronic database of EUROSTAT. See E-Control, Statistikbroschüre, 2017, <https://www.e-control.at/documents/20903/388512/e-control-statistikbroschuere-2017.pdf/93acb38b-6653-420b-7985-08d3d341732b>, 21. Note that gas from Russia is noted as imports from Slovakia because the pipeline runs through Slovakia. E-Control is the national gas and electricity market control authority.

17 Florian Horcicka, "Gazprom – Das unheimliche Imperium," *Trend*, April 21, 2012, <https://www.trend.at/wirtschaft/business/gazprom-das-imperium-325489>.

18 OMV, *Annual Report 2017* (Vienna, Austria: OMV, 2018), https://www.omv.com/pbd_download/52/413/2018_04_annual_report_2017_de.pdf.

19 Rauf Mammadov, "Putin's Visit to Austria: Implications for Energy Diplomacy in Europe," *Eurasia Daily Monitor* 15, no. 89 (June 2018), <https://jamestown.org/program/putins-visit-to-austria-implications-for-energy-diplomacy-in-europe/>.

20 "OMV-Chef: Kerosin und Tankstellen sichern Raffinerie ab," *Energy News Magazine*, October 19, 2016, https://energynewsmagazine.at/de/omv-chef+kerosin+und+tankstellen+sichern+raffinerie+ab_n9382.

Gazprom.²¹ And in 2011, the European Commission blocked Gazprom's acquisition of a 50 percent stake in the Central European Gas Hub at Baumgarten (an OMV subsidiary) because of the decoupling of supply and distribution mandated by EU energy regulations.²²

Another important sector for Russian economic presence in Austria is banking and insurance. Austrian banks' exposure in Russia rose from 3 percent in 2014 to 11 percent in 2018. The total Austrian bank credit exposure in Russia reached €14.6 billion in 2018, increasing Austrian financial vulnerability to Russia. Austria has been the only Western European country in which total banking exposure to Russia increased following the imposition of Ukraine-related sanctions. The international arm of Raiffeisen Bank, the second-largest Austrian banking group, made an eye-catching 78 percent of its corporate profits in Russia in 2014 and operates an insurance franchise in Russia along with UNIQA, the largest Austrian insurance group.²³ Vienna Insurance Group was the first Austrian insurance company to enter the Russian market in 2006. Bank-Austria (currently owned by Italy's UniCredit)—the largest foreign bank in Russia in terms of volume of activity (it controlled more than €18 billion in assets in Russia in 2017)—made close to 25 percent of its corporate profits in Russia before the Ukraine crisis.²⁴

In 2014, Austria maintained its attractive investment position after EU members exempted EU-based affiliates of state-owned Russian from EU sanctions. These included VTB Bank (Europe) and Sberbank Europe, which at the time were headquartered in Vienna and have combined assets of over \$26 billion.²⁵ Sberbank had also acquired Volksbanken International in 2011, gaining a foothold in Europe and allowing it to tap the Central and Eastern European market. The two banks still operate in seven EU member states including Austria, Czech Republic, France, Germany, Slovakia, Hungary, and Cyprus. By exempting these banks' EU affiliates from sanctions, the European Union allowed them to continue transferring profits or make loans to their Russian owners.²⁶

Another example of the many inroads of Russian influence in Austria is Meisl Bank AG. It is part of the Austrian Meisl business empire. In the 1990s, Julius Meisl V trans-

21 Agata Loskot-Strachota, Rafal Bajczuk, and Szymon Kardas, "Nord Stream 2 divides the West," Centre for Eastern Studies (OSW), June 18, 2018, <https://www.osw.waw.pl/en/publikacje/osw-commentary/2018-06-18/nord-stream-2-divides-west>; "European Commission throws book at Russia's Nord Stream 2 natural gas link," S&P Global Platts, November 1, 2017, <https://blogs.platts.com/2017/11/01/ec-russia-nord-stream-2-gas-link/>.

22 "EU Commission Blocks OMV's Deal with Gazprom," *Vindobona*, June 20, 2011, <https://www.vindobona.org/article/eu-commission-blocks-omv-s-deal-with-gazprom>.

23 Raiffeisen Bank International, *Annual Report 2017* (Vienna, Austria: Raiffeisen Bank International, 2018); Raiffeisen Bank International, *Annual Report 2014* (Vienna, Austria: Raiffeisen Bank International, 2015).

24 "Österreicher stark in Russland engagiert," *Der Standard*, March 24, 2014, <https://derstandard.at/1395363068222/Oesterreicher-stark-in-Russland-engagiert>.

25 David Enrich, Gabriele Steinhäuser, and Matthew Dalton, "Loopholes Blunt Impact of U.S., EU Sanctions Over Ukraine," *The Wall Street Journal*, July 30, 2014, <https://www.wsj.com/articles/eu-units-of-russian-banks-exempt-from-sanctions-1406714101>.

26 Ibid.

formed the business and the family-run bank into a financial services provider.²⁷ Meinel is not the largest Austrian financial player in Russia, but it concentrates on providing services to wealthy investors, among which many are oligarchs.²⁸ Over the years, Meinel has been involved in several alleged fraud cases and allegations of breach-of-trust that included the use of offshore companies.²⁹ It had an alleged role in the laundering of almost \$2 billion from Ukraine through correspondent accounts registered at Meinel,³⁰ and in 2017, Austrian prosecutors started to investigate the case (investigations are still ongoing).³¹ In 2017, reports surfaced that Meinel Bank was allegedly implicated in the “Russian Laundromat” scandal, whereby more than \$20 billion had been stolen from the Russian government through organized crime activity or corrupt officials.³² Between 2012 and 2014, 17 Austrian banks were reportedly involved in the laundering machine, including Meinel Bank, which processed a little over €300,000 in suspicious transactions.³³ While bank accounts at the bank were reportedly used for these transfers, the institution has not been accused of any wrongdoing.

The interlinkage between Austrian corporate interests and Austria’s political leaders is clearly apparent when it comes to preserving Russian policy and economic interests. These political leaders have argued that EU sanctions weigh heavily on Austrian businesses although empirically, Russian investment flows in Austria have risen since 2014. Political leaders across Austria’s political spectrum advocate for better relations with Russia, particularly in light of their long-standing relationships with Moscow, as well as to protect Austrian investments in Russia. Both the SPO and the OVP have, at best, a non-confrontational policy toward Russia—which is apparent in party members’ statements on EU sanctions and the political and business ties that exist between the two countries. In some of the more problematic instances, politicians-turned-lobbyists or businessmen have leveraged their political connections in support of Russian interests.

- 27 Josh Kovensky, “Did Austria’s Meinel Bank help launder \$2 billion?” *Kyiv Post*, April 21, 2017, <https://www.kyivpost.com/business/austrias-meinel-bank-help-laundry-2-billion.html>.
- 28 “Die Meinel Bank zieht es nach Russland,” *Die Presse*, October 27, 2009, <https://diepresse.com/home/wirtschaft/meinelbankinformiert/517544/Die-Meinel-Bank-zieht-es-nach-Russland>.
- 29 “Julius Meinel V faces breach-of-trust charges,” *The Local*, January 1, 2015, <https://www.thelocal.at/20150101/julius-meinel-faces-dishonesty-charges>. See also: “Pulling the wool,” *The Economist*, July 21, 2008, <https://www.economist.com/node/11848791>. See also: “Ermittlungen gegen Meinel Bank in Gorilla-Affäre,” *Der Standard*, March 9, 2012, <https://derstandard.at/1331206875759/SlowakeiOesterreich-Ermittlungen-gegen-Meinel-Bank-in-Gorilla-Affaere>.
- 30 Josh Kovensky, “Did Austria’s Meinel Bank help launder \$2 billion?”; Kateryna Kapliuk, “As Yanukovych Fell, Regime-connected Bank Sent Millions Offshore,” Organized Crime and Corruption Reporting Project, December 7, 2017, <https://www.occrp.org/en/investigations/7373-as-yanukovych-fell-regime-connected-bank-sent-millions-offshore>.
- 31 Andreas Schnauder, “Offshoredeals: Justiz ermittelt gegen Meinel-Banker,” *Der Standard*, February 27, 2017, <https://derstandard.at/2000053272672/Offshore-Deals-Ermittlungen-der-Justiz-gegen-Meinel-Banker>.
- 32 Peter Sim, Georg Eckelsberger, and Florian Skrabal, “Transit Bauernmarkt,” *Dossier*, March 22, 2017, <https://www.dossier.at/dossiers/geldwaesche/transit-bauernmarkt>.
- 33 Ibid.

The use of Russian affinity and cultural organizations such as the Dialogue of Civilization Research Institute as well as the Austrian-Russian Friendship Society, under the leadership of Ludwig Scharinger (a former head of the Upper Austrian branch of Raiffeisen Bank), connect the Austrian political and business elite with Russian business and political circles.³⁴ Alfred Gusenbauer, a former SPO leader and Austrian chancellor, currently serves on the supervisory board of Vladimir Yakunin's Dialogue of Civilization Research Institute.³⁵ Several MPs are members of the Friendship Society, stemming from the OVP, SPO, and the far-right Freedom Party (FPÖ). On the far-right fringe, the Identitarian Movement (a youth organization) and the Suworow Institute help foster ideological and peer-to-peer connections between Austrian far-right and some Russian nationalist forces.³⁶

Alfred Gusenbauer was also reportedly engaged in a lobbying campaign in favor of former Ukrainian president Viktor Yanukovich and is believed to be one of the former European officials cited in the Paul Manafort indictments as part of the "Hapsburg group."³⁷ Ukrainian connections in Austria also extend to Dmytro Firtash, a Ukrainian oligarch close to Yanukovich who is under prosecution in the United States for bribery and has in the past been associated with Russian organized crime figure Semion Mogilevich.³⁸ Firtash is currently under house arrest in Vienna and has been fighting extradition to the United States for years.³⁹ Another former Austrian chancellor, Wolfgang Schüssel (ÖVP), is a member of the board of Russian telecommunications firm MTS, while former ÖVP finance minister Hans Jörg Schelling became a consultant for Gazprom. These connections are potentially attractive entry points for Russian malign influence and provide protection for Russian economic and political interests.

But by far the most visible and outspoken ally for Moscow in the Austrian political sphere is the FPÖ, which is currently part of the Austrian government. Far-right groups in Austria have historically been anti-Russian due to their anti-Soviet roots, despite some common anti-American views. But in the mid-2000s, the FPÖ moved away from its pro-NATO, anti-clerical stance to a more positive view of Russia under the leadership of current party leader and now Vice-Chancellor Heinz-Christian Strache. As the FPÖ slowly gained national popularity, it aligned itself with the Kremlin's agenda in its opposition

34 Bernhard Weidinger, Fabian Schmid, and Peter Kreko, *Russian Connections of the Austrian Far-Right* (Budapest, Hungary: Political Capital, 2017).

35 "Alfred Gusenbauer," DOC Research Institute, <https://doc-research.org/author/alfred-gusenbauer/>.

36 Weidinger, Schmid, and Kreko, *Russian Connections*, 23.

37 Adam Taylor, "The Mueller indictment mentioned the 'Hapsburg group.' Now European ex-politicians are under scrutiny." *Washington Post*, February 24, 2018, https://www.washingtonpost.com/news/worldviews/wp/2018/02/24/after-hapsburg-group-disclosure-in-mueller-indictment-former-european-politicians-come-under-scrutiny/?utm_term=.09bc36b47e92.

38 Tom Winter, "DOJ: Ex-Manafort Associate Firtash Is Top-Tier Comrade of Russian Mobsters," NBC News, July 26, 2017, <https://www.nbcnews.com/news/us-news/doj-ex-manafort-associate-firtash-top-tier-comrade-russian-mobsters-n786806>.

39 Kim Janssen, "On-again, off-again extradition of Ukrainian oligarch on again – maybe," *Chicago Tribune*, March 16, 2018, <https://www.chicagotribune.com/news/chicago-inc/ct-met-dmitry-firtash-chicago-inc-20180316-story.html>.

to Western “moral decay” and to the European Union. By 2014, the party began actively supporting pro-Russian positions, including strong opposition to sanctions. Several FPO members, including the vice-mayor of Vienna, Johann Gudenus, visited Crimea (Gudenus, who studied in Russia and is a member of the executive board of the Austrian-Russian Friendship Society, also traveled as an election “observer” for the illegal Crimea independence referendum). Strache has reportedly stated that he had received information on migrant flows from Russian intelligence services.⁴⁰ By December 2016, the FPO and Kremlin-backed political party United Russia had signed a cooperative agreement in which they agreed to meet regularly and exchange information on a wide range of issues.⁴¹ The United Russia signatory, Deputy Secretary Sergei Zheleznyak, has been barred from entry into the United States as part of the Crimea-related sanctions.

Although there has not been any indication that Russia has contributed financially to the FPO, the political and diplomatic investments made by the Kremlin in the party have seen some impressive political returns. In October 2017, the FPO became the third-largest party in Austria (only 0.9 percent behind the second-largest party, the SPÖ). The ÖVP’s Sebastian Kurz agreed to form a coalition with the FPO in a repeat of a governing coalition that was formed in 2000. But unlike then, in 2017 the European Union did not place sanctions against the Austrian government for including far-right forces in a coalition. Most importantly, the FPO gained control of critically important ministries, including Interior, Defense, and the Vice Chancellery.

A few months into its term, Austrian institutions were challenged by this new government. In February 2018, a section of the Viennese organized crime police raided the headquarters of Austria’s domestic intelligence service, taking away stacks of documents. Interior minister and leading FPO official, Herbert Kickl, abruptly dismissed three senior intelligence officials, although their positions were reinstated by the courts. The official reason for the raid was to confiscate material collected on a Viennese lawyer suspected of working for foreign intelligence,⁴² but there was speculation that the true motivation behind Minister Kickl’s dismissal was to prevent these individuals from monitoring right-wing extremism.⁴³ Following these dismissals, other European intelligence

40 Fabian Schmid and Markus Sulzbacher, “Moscheeschändung: Rechtsextremes Netzwerk mit Kontakt zur FPÖ-Spitze,” *Der Standard*, December 4, 2017, <https://derstandard.at/2000068873477/Moscheeschaendung-Rechtsextremes-Netzwerk-mit-Kontakt-zur-FPOe-Spitze>.

41 Alison Smale, “Austria’s Far Right Signs a Cooperation Pact With Putin’s Party,” *New York Times*, December 19, 2016, <https://www.nytimes.com/2016/12/19/world/europe/austrias-far-right-signs-a-cooperation-pact-with-putins-party.html>.

42 Fabia Schmid and Maria Sterkl, “Kickls Generalsekretär im BVT-Ausschuss voller Widersprüche: ‘Das habe ich anders in Erinnerung,’” *Der Standard*, November 6, 2018, <https://derstandard.at/2000090770850/Kickls-Generalsekretaer-voller-Widersprueche-Das-habe-ich-anders-in-Erinnerung>.

43 Souad Mekhennet and Griff Witte, “Austria’s far-right ordered a raid on its own intelligence service. Now allies are freezing the country out,” *Washington Post*, August 17, 2018, https://www.washingtonpost.com/world/national-security/austrias-far-right-government-ordered-a-raid-on-its-own-intelligence-service-now-allies-are-freezing-the-country-out/2018/08/17/d20090fc-9985-11e8-b55e-5002300ef004_story.html?utm_term=.c7eae62aef92.

services expressed concerns that information shared with Austria could no longer be protected. It is interesting to note that Austria did not expel any Russian diplomats after the Skripal poisoning case in 2018,⁴⁴ although it is believed that the Russian Embassy in Vienna is quite large with an estimated 870 embassy officials and employees, many of which are assumed to be part of the intelligence services.⁴⁵

Austria, by cultivating its posture as a space between East and West, has exploited its unique position to make itself a crucial hub for Russian investments in Europe over the past fifteen years. It has attracted the presence and riches of many of the former Soviet Union party and secret service apparatchiks-turned-businessmen. Under the current chancellor, Sebastian Kurz, the Austrian government has protected and grown its economic relationship with Moscow. Chancellor Kurz visited Moscow in March 2018, and Vladimir Putin made his first post-reelection European visit to Vienna in June of the same year. The FPÖ's rise to power is the clearest example of a long-term personal investment by the Kremlin. Importantly, in Austria it has invested politically not only in far-right political movements but also across the Austrian political spectrum at some of the highest levels of power. Under current terms, Austria can protect its favorable economic position and Russia can access Austria's extensive network of banks and corporate entities in Central and Eastern Europe and the Western Balkans to further spread its malign influence under the guise of economic pursuits—a “win-win” situation for Austria and Russia, but at the expense of European security.

44 In June 2014, then-president Heinz Fischer (SPO) invited Putin to Vienna a few months after the annexation of Crimea and publicly stated that sanctions benefitted no one.

45 Damien McElroy, “Vienna named as global spying hub in new book,” *Telegraph*, July 31, 2014, <https://www.telegraph.co.uk/news/worldnews/europe/austria/11003898/Vienna-named-as-global-spying-hub-in-new-book.html>. See also: Francois Murphy, “Austria says it will not expel any Russians over spy case,” Reuters, November 14, 2018, <https://www.reuters.com/article/us-austria-russia-spy/austria-says-it-will-not-expel-any-russians-over-spy-case-idUSKCN1NJ23G>.

Case Study

Italy

For the past 75 years, Italy and Russia have enjoyed positive economic and political relations due in large measure to Moscow's ties with one of Europe's strongest communist parties, the Italian Communist Party. These "ideological sympathies" paralleled Italy's growing dependency on Russian energy. Italian firms such as Fiat (now Fiat-Chrysler) and state-controlled Italian energy firm ENI were early European investors in the Soviet Union. Italy's foreign and trade policy toward the Soviet Union and then Russia was designed to first and foremost protect Italian business interests. These established relationships have only strengthened since the collapse of the Soviet Union as Russia has reinforced its strategic partnerships with important Italian economic and political players.

Today, Italy is Russia's third-largest commercial partner in Europe and its fourth in the world. Trade flows have doubled since 2005, peaking in 2013 before falling slightly due to sanctions and the negative impact of lower energy prices on bilateral flows (though oil and gas prices have recovered since 2017).¹ Italian companies have important economic interests in Russia: from 2005 to 2013, exports to Russia grew from €6 billion to almost €11 billion, and outward FDI stocks to Russia went from €1.7 billion in 2007 to €11 billion in 2016. These investments come from some of the structurally most important Italian businesses, from ENI (oil and gas) and ENEL (electricity generator) to Pirelli (tires).² Entities like Pirelli and ENI have reportedly attempted to shape the Italian government's policies indirectly in relation to the imposition and rollover of EU sanctions on Russia by underscoring the risk of retaliatory sanctions and their impact on the companies' bottom lines.³

But while Russian economic ties with Italy have grown, Italy's economic situation has stagnated and its governance standards, institutional malaise, and chronic corruption—already lagging behind other EU member states—have grown even more sclerotic. Italy, which is at the intersection of strong economic and political ties to Russia on the one hand and weak and opaque institutional processes on the other, is in an optimal position to enable Russian malign influence as it protects and even enhances Russia's strategic interests in Europe. In that way, the country should be viewed as a microcosm of a larger enabling ecosystem in which Russian malign influence can prosper and grow.

1 Ministero dello Sviluppo Economico, <https://www.sviluppoeconomico.gov.it/index.php/it/>; Italian National Institute of Statistics (ISTAT), <http://dati.istat.it/?lang=en>.

2 Rosneft became Pirelli's largest shareholder in 2014, and Igor Sechin, a close ally of Vladimir Putin, was appointed to its board. See Rachel Sanderson and Christian Oliver, "Italy accused of blocking tougher sanctions on Russia," *Financial Times*, July 13, 2014, <https://www.ft.com/content/ad743cae-0a8a-11e4-be06-00144feabdc0>.

3 Ibid.

Italy's economy is substantially impacted by the risk of corruption and organized crime.⁴ It ranks considerably lower than its Western European counterparts on Transparency International's Corruption Perception Index, in 53rd place out of 180.⁵ The country was the only founding EU member state singled out by the European Commission when it received specific country recommendations to address corruption in the EU Anti-Corruption Report.^{6,7} The risk of corruption in public procurement and tax administration is deemed high,⁸ the latter sector also presenting significant money-laundering risks along with organized crime and the luxury market. Indeed, tax-related crimes account for 75 percent of illegal proceeds in Italy.⁹ Italy does have a strong money-laundering legal framework, law enforcement capacity, and understanding of risks when it comes to money laundering, but the judicial system lacks the resources to prosecute many of those crimes in a timely manner.¹⁰ And while banks have generally followed their due-diligence and anti-money laundering reporting requirements, the Designated Non-Financial Businesses and Professions (DNFBPs) or non-financial sector (trust services, notaries, accountants, etc.) rely too heavily on banks' assessments instead of developing their own and lack awareness of the money-laundering risks in their own field.¹¹

This enabling economic environment is combined with political receptivity to malign influence. The Italian political scene is fragmented, and players often balance many interests in unstable coalitions. Italian political parties are reliant on private donations, which have limited transparency, and are increasingly moving away from direct donations to foundations and think tanks that have less stringent reporting requirements.¹² Previous Italian governments have been reluctant to support the continuation of EU

4 Philip Gounev and Tihomir Bezlov, *Examining the Links between Organised Crime and Corruption* (Sofia, Bulgaria: Center for the Study of Democracy, 2010).

5 As a comparison, the Netherlands ranks 8th, Austria 14th, and even the Czech Republic presents a cleaner image in 38th place. See "Corruption Perceptions Index 2018," Transparency International, January 29, 2019, <https://www.transparency.org/cpi2018>.

6 Council of the European Union, *Council Recommendation of 12 July 2016 on the 2016 National Reform Program of Italy and Delivering a Council Opinion on the 2016 Stability Program of Italy*, C 299/01, Brussels, 2016, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.C_.2016.299.01.0001.01.ENG&toc=OJ%3AC%3A2016%3A299%3ATOC.

7 European Commission, *Report from the Commission to the Council and the European Parliament: EU Anti-Corruption Report* (Brussels: European Commission, 2014), https://ec.europa.eu/home-affairs/what-we-do/policies/organized-crime-and-human-trafficking/corruption/anti-corruption-report_en.

8 "Italy Corruption Report," GAN Business Anti-Corruption Portal, December 2017, <https://www.business-anti-corruption.com/country-profiles/italy/>.

9 Financial Action Task Force, *Anti-money laundering and counter-terrorist financing measures – Italy, Fourth Round Mutual Evaluation Report* (Paris, France: Financial Action Task Force, 2016).

10 Ibid.

11 Ibid. See also: "Financial Secrecy Index 2018: Narrative Report on Italy," Tax Justice Network, 2018, <https://www.financialsecrecyindex.com/PDF/Italy.pdf>.

12 Alessandro Sardo, "Finanziamenti alla politica "ancora poco trasparenti." Con donazioni anonime ai singoli candidati tramite fondazioni," *il Fatto Quotidiano*, January 23, 2018, <https://www.>

sanctions against Russia, and one can easily understand how this political financing framework could cloud policy decisions.¹³

Over the 2005–2017 study period, Italy's governance standards have generally worsened, particularly during former prime minister Silvio Berlusconi's tenure. Domestic corruption has remained a serious issue, though positive developments followed Berlusconi's departure from government, particularly in Italy's application of the OECD's Anti-Bribery Convention through active enforcement against foreign corruption.¹⁴

In many ways, Mr. Berlusconi's tenure perfectly embodied the comingling of business and political interests: he tried to use his parliamentary majority to change the rules several times in order to protect himself from prosecution (for example, in 2009, when his party proposed changing the length of the statute of limitations and trial duration, though the law was ultimately ruled unconstitutional).¹⁵ He also made economic decisions that benefitted him and his business associates.¹⁶ Mr. Berlusconi has also had repeated encounters with law enforcement related to tax evasion, bribery, mafia association, and embezzlement and was convicted for tax evasion in 2013, temporarily barring him from political office.¹⁷ Despite Mr. Berlusconi's departure from government in 2011, Italy has not substantially improved its governance standards, and its political landscape has become even more unstable.

While in power, Silvio Berlusconi was not only a great proponent of a close Italian-Russian bilateral relationship, but he was also a personal friend of Russian president Vladimir Putin, which helped to propel new bilateral energy links between the two countries (imports of oil and gas from Russia steadily rose between 2008 and 2013, and Russia is by far the largest natural gas supplier in Italy, covering over 30 percent of the annual consumption in 2017).¹⁸ The two men's personal friendship has remained

ilfattoquotidiano.it/2018/01/23/finanziamenti-alla-politica-ancora-poco-trasparenti-con-donazioni-anonime-ai-singoli-candidati-tramite-fondazioni/4108448/.

- 13 In 2009, U.S. Ambassador to Italy Ronald P. Spogli explained in a leaked cable that the “combination of . . . factors [driving Italy and Russia's relationship such as ideological sympathies and energy dependence] creates a strong tendency for Italy's foreign policy to be highly receptive to Russian efforts to gain greater political influence in the EU and to support Russia's efforts to dilute American security interests in Europe.” See “Italy-Russia Relations: The View from Rome (C-RE8-02675),” WikiLeaks, January 26, 2009, https://wikileaks.org/plusd/cables/09ROME97_a.html.
- 14 Gillian Dell and Andrew McDevitt, *Exporting Corruption. Progress report 2018: Assessing enforcement of the OECD Anti-Bribery Convention*, (Berlin, Germany: Transparency International, 2018) https://www.transparency.org/whatwedo/publication/exporting_corruption_2018.
- 15 Nick Squires, “Silvio Berlusconi accused of changing laws to his advantage,” *Telegraph*, November 10, 2009, <https://www.telegraph.co.uk/news/worldnews/europe/italy/6538660/Silvio-Berlusconi-accused-of-changing-laws-to-his-advantage.html>.
- 16 Rachel Sanderson, “Berlusconi study sheds light on politics and profits,” *Financial Times*, January 4, 2017, <https://www.ft.com/content/eb86eb6c-d284-11e6-9341-7393bb2e1b51>.
- 17 Iliaria Polleschi, “Italy court bans Berlusconi from public office for two years,” Reuters, October 19, 2013, <https://www.reuters.com/article/us-italy-berlusconi/italy-court-bans-berlusconi-from-public-office-for-two-years-idUSBRE99I01T20131019>.
- 18 “Natural gas supply statistics,” Eurostat, July 2018, https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Natural_gas_supply_statistics&oldid=401136.

vibrant even after Mr. Berlusconi resigned from office in 2011. He recently joined Vladimir Putin on a trip to Crimea in 2015, for which Ukrainian authorities opened criminal proceedings against him for unauthorized travel.¹⁹

It has been alleged that Mr. Berlusconi received a portion of the proceeds from the energy deals Italy struck with Russia during his tenure.²⁰ At the time, a number of Mr. Berlusconi's close advisers had relationships with Russian state-owned energy companies and financial institutions. Such is the case for Bruno Mentasti-Granelli, who owned 33 percent of Central Energy Italian Gas Holding (CEIGH), a gas distribution company that was initially involved in an ENI-Gazprom deal signed in 2005 for sales on the domestic market. Gazprom held 25 percent of CEIGH through ZMB, the German-registered subsidiary of Gazpromexport, while Vienna-based Centrex Europe Energy and Gas AG (also ultimately owned by Gazprom) held 41.6 percent. The Italian antitrust authority initially blocked the agreement as it was deemed too restrictive of competition in the energy market, but CEIGH was later dissolved and replaced, and the agreement ultimately went through without the company.²¹

Energy has been the most visible strategic sector in which Italy and Russia have had important exchanges. Russia is Italy's largest energy source, and energy is the largest trading sector between the two countries. Between 2013 and 2016, Italy received approximately 40 percent of its natural gas needs from Russia (though this amount declined in 2017).²² While ENI already invested in the Soviet Union during the Cold War, the formation of the strategic partnership between the Italian company and Gazprom truly took off in 1999, when the two formed a special-purpose joint venture (registered in the Netherlands) to build the Blue Stream gas pipeline on the Black Sea seabed, in which ENI retains a 50 percent stake.²³ Building on this relationship, both firms signed a new memorandum of understanding in 2007 to construct the South Stream gas pipeline across Central and Southeastern Europe and through the Western Balkans. In addition, in 2012, ENI signed additional energy deals with the Russian state-owned oil behemoth Rosneft for an agreement to explore and produce in Egypt's Zohr offshore field, in the Black Sea, and in the Barents Sea in the Arctic. The Black Sea exploration project is currently on hold due to

- 19 Damien Sharkov, "Ukraine Launches Criminal Case Against Italy's Berlusconi for Crimea Visit," *Newsweek*, October 30, 2015, <https://www.newsweek.com/ukraine-berlusconiukraine-criminal-caseukraine-criminal-proceedingslegal-597853>.
- 20 Rob Evans, Luke Harding, and John Hooper, "WikiLeaks cables: Berlusconi 'profited from secret deals' with Putin," *Guardian*, December 2, 2010, <https://www.theguardian.com/world/2010/dec/02/wikileaks-cables-berlusconi-putin>.
- 21 Roman Kupchinsky, "Berlusconi, Centrex, Hexagon 1 and 2 and Gazprom," *Eurasia Daily Monitor* 5, no. 228 (December 2008), <https://jamestown.org/program/berlusconi-centrex-hexagon-1-and-2-and-gazprom/>. See also: Barbara Ciolli, "Acqua minerale con gas," *Lettera 43*, December 8, 2010, <https://www.lettera43.it/it/articoli/economia/2010/12/08/acqua-minerale-con-gas/2380/>.
- 22 "Natural gas supply statistics," Eurostat.
- 23 "Blue Stream," ENI, September 25, 2018, https://www.eni.com/en_RU/eni-russia/partners-projects/gazprom/bluestream/bluestream.shtml.

sanctions and economic reasons,²⁴ but ENI is still involved in the Zohr and Barents Sea explorations. Important engineering firms like Leonardo (30 percent of which is owned by the Italian state) have also contributed to important oil and gas projects in Russia through the supply of transport material, including after the 2014 imposition of sanctions and U.S. warnings over supporting the Russian industry.^{25,26}

In the oil sector, in 2008, Russian energy firm Lukoil acquired 49 percent of ISAB, the third-largest refinery in Europe located in Sicily. Lukoil has since increased its stake to 80 percent, giving it control over a strategically-located refinery in the Mediterranean that employs over 1,000 people and providing vital investment in a region where unemployment is 21.5 percent and the GDP per capita is only 62 percent of the national level.^{27,28} This gives Lukoil an outsize economic role in the region. In September 2017, there were rumors that Lukoil was planning on selling the plant—which would have had a profound effect on the regional economy—but these rumors have not yet materialized.

And though not all Russian energy partnerships are successful, they do not seem to ever fully go away. For example, in December 2014 the Russian government withdrew from the South Stream project, leaving a number of Western Balkan and Central European countries empty handed after governments had spent large amounts of political capital on trying to get the pipeline built (such as Austria or Italy).²⁹ The shelving of the project created tensions in the ENI-Gazprom partnership as the Italian company's engineering subsidiary, Saipem, lost one of its biggest pipe-laying contracts. As a result, the company filed a €679 million claim against Gazprom, though the latter refused all demands and announced its intention to start a counterclaim for €541 million.³⁰ Saipem

24 Nastassia Astrasheuskaya, Henry Foy, and Miles Johnson, "Rosneft hunts for projects to keep Eni in Russia," *Financial Times*, October 28, 2018, <https://www.ft.com/content/06a455b8-d91f-11e8-a854-33d6f82e62f8>.

25 Tom Kington, "Leonardo could get shut out of joint EU defense programs — but backs them anyway," *DefenseNews*, October 27, 2017, <https://www.defensenews.com/global/europe/2017/10/27/leonardo-could-get-shut-out-of-joint-eu-defense-programs-but-backs-them-anyway/>.

26 At a 2017 Italian-Russian business conference in Verona, Leonardo's CEO stated that his company was "present in force" in Russia, but that they "work in a heavily regulated environment, political guidance is key, and it is clear that we must find areas for co-operation." Henry Foy, Rachel Sanderson, and James Politi, "The ties that bind Italy and Russia," *Financial Times*, October 29, 2017, <https://www.ft.com/content/ffbe03c0-b976-11e7-8c12-5661783e5589>; "Sakhalin Energy Signs AW189 Contract for Modern Long Range Helicopter Transport Supporting Oil&Gas Industry in Russia," Leonardo, December 20, 2018, <https://www.leonardocompany.com/en/-/oil-gas-aw189-sakhalin-energy>.

27 Ron Bousso and Dmitry Zhdannikov, "Russia's Lukoil puts Italian refinery up for sale – sources," *Reuters*, September 20, 2017, <https://www.reuters.com/article/lukoil-refinery/russias-lukoil-puts-italian-refinery-up-for-sale-sources-idUSL5N1LZ4YS>.

28 DG Growth, "Sicily," European Commission, December 18, 2018, <https://ec.europa.eu/growth/tools-databases/regional-innovation-monitor/base-profile/sicily>.

29 Judy Dempsey, "Europe's Energy Strategy and South Stream's Demise," *Carnegie Europe*, December 4, 2014, <https://carnegieeurope.eu/strategieurope/57386/>.

30 Francesca Gerosa, "Saipem, Gazprom presenta contro-ricorso per South Stream," *Milano Finanza*, April 7, 2017, <https://www.milanofinanza.it/news/saipem-gazprom-presenta-contro-ricor>

CEO Stefano Cao has stated that he “does not expect resolution of South Stream arbitration” before 2020.³¹ Saipem, however, won a pipe-laying contract for Gazprom’s other major pipeline project in Europe, Nord Stream 2.

Despite the failure of the South Stream project, Gazprom immediately launched a new strategic gas pipeline project in early 2015 that followed a similar route as South Stream through the Black Sea, but it would arrive in Turkey, transport the gas through the country, and reach into Central Europe. Dubbed TurkStream, the offshore part of the pipeline was completed in November 2018. Governments in the region have supported this project despite its lack of economic feasibility and the corruption risks it carries. Both Bulgaria and Serbia have already begun working on large-scale gas pipeline expansion projects that would serve as outlets for TurkStream. Although ENI is not directly involved in the project, Gazprom has contracted Saipem to conduct engineering and feasibility studies for the Serbian pipeline extension. Saipem was also the first company to be selected to build the Black Sea offshore section of TurkStream before it was replaced by a Swiss contractor (Allseas) in December 2016.³² Meanwhile, ENI and Gazprom have continued their cooperation on the development of the southern corridor for gas supplies (from Russia to European countries) despite sanctions and continued geopolitical tensions.³³

The other key strategic sector for Russia in Italy is the banking industry. Unlike most other European countries’ banks, the share of Italian bank loans in all foreign bank loans in Russia has grown from 11 percent in 2014 to 18 percent in 2018—though it should be noted that financial exposure is nominally lower today than in 2018, and the share increase is due to a decrease in the total amount of claims.³⁴ Italy’s banks also have the second-largest financial exposure to Russia (behind Switzerland) with claims worth almost \$23 billion.³⁵ The fragility of the Italian banking sector and the volume of non-performing loans (14.4 percent of total gross loans in 2017, or €224.2 billion) reinforces the need for Italian banks to protect their business activities (though they have not doubled down on investments) in Russia despite the risks involved.³⁶ This is happening at the same time these banks are receiving considerable support from the European Union and the European Central Bank (ECB), with a €17 billion plan approved by the Commission in 2017 to save Banca Popolare di Vicenza

[so-per-south-stream-201704071624414136](https://www.reuters.com/finance/stocks/SPMI.MI/key-developments/article/3780350).

31 Reuters, “Saipem does not expect resolution of South Stream arbitration before 2020,” March 6, 2018, <https://www.reuters.com/finance/stocks/SPMI.MI/key-developments/article/3780350>.

32 Angelo Scorza, “Allseas grasps the deal that Saipem awaited for on the Turkish Stream,” Ship2Shore, December 12, 2016, http://www.ship2shore.it/en/shipping/allseas-grasps-the-deal-that-saipem-awaited-for-on-the-turkish-stream_63139.htm.

33 “Partnership with Gazprom and Rosneft,” ENI, October 8, 2018, https://www.eni.com/en_RU/eni-russia/partners-projects/partners-projects.shtml.

34 “Consolidated banking statistics,” Bank of International Settlements, <https://www.bis.org/statistics/consstats.htm>.

35 Ibid.

36 World Bank data, <https://data.worldbank.org/>.

and Veneto Banca. The ECB also held €341 billion worth of Italian sovereign debt at the end of April 2018.³⁷

UniCredit, Italy's largest banking group based on total assets, is the largest foreign bank in Russia in terms of volume of activities.³⁸ In 2015, the bank advised Gazprom, the steel company Evraz, and the mining company Norilsk Nickel on previous Eurobond deals worth €2.7 billion. UniCredit's exposure to the Russian market reached 30 percent of its tangible book value in 2017, creating risks of a credit selloff in case of economic instability in Russia or a worsening of relations between Russia and the West.³⁹ But unlike Austria's Raiffeisen Bank, for example, UniCredit has not closed branches or reduced its loan portfolio in Russia. The head of the Central and Eastern Europe division, Carlo Vivaldi, has publicly recognized Russia as a "key market" and mentioned UniCredit has been "in discussions and had good communication with the [Russian] Ministry of Finance."⁴⁰ In December 2018, the largest private Russian bank, Alfa, reportedly approached UniCredit alongside Russian state-owned bank VTB to discuss a possible sale of Alfa Bank.⁴¹ In 2016, UniCredit sold its Ukrainian business (Ukrsotsbank) to Alfa Bank in exchange for a 9.9 percent share in the Russian banking holding.⁴²

Italy's second-largest bank, Intesa Sanpaolo, is also heavily invested in Russia, and its president for Russia, Antonio Fallico, has called sanctions "illegal and . . . imposed due to ideological reasons."⁴³ Intesa Sanpaolo's relations with Russia date back to the Soviet era when its predecessor Banca Commerciale Italiana invested in several projects in the USSR in the 1960s and 1970s; it was then one of the top five foreign banks in

37 Thomas Hale, "Italian banks and the problem of tightly knit politics," *Financial Times*, August 13, 2018, <https://ftalphaville.ft.com/2018/08/13/1534151830000/Italian-banks-and-the-problem-of-tightly-knit-politics>. See also: Eric Maurice, "EU approves rescue of Italian banks," *EUobserver*, June 26, 2017, <https://euobserver.com/economic/138345>. See also: Balazs Koranyi, "Explainer – Italian debt held by the ECB in focus as populists sign governing pact," *Reuters*, May 18, 2018, <https://uk.reuters.com/article/uk-italy-politics-ecb-explainer/explainer-italian-debt-held-by-the-ecb-in-focus-as-populists-sign-governing-pact-idUKKCN1IJ166>.

38 Info MercatiEsteri, Farnesina, Ministero degli Affari Esteri e della Cooperazione Internazionale, http://www.infomercatiesteri.it/accesso_credito.php?id_paesi=88.

39 UniCredit, *2017 Consolidated Reports and Accounts* (Milan, Italy: UniCredit, 2018).

40 Jason Corcoran, "No Retreating from Russia, says UniCredit's Vivaldi," *bne Intellinews*, May 19, 2016, <http://www.intellinews.com/no-retreating-from-russia-says-unicredit-s-vivaldi-97795/>.

41 Max Seddon, "Alfa-Bank owners discuss sale with VTB and UniCredit, sources say," *Financial Times*, December 11, 2018, <https://www.ft.com/content/29b62d34-e2ab-11e8-a6e5-792428919cee>.

42 "UniCredit Group completes sale of Ukrsotsbank to Alfa Group's ABH Holdings," UniCredit, October 31, 2016, <https://www.unicreditgroup.eu/en/press-media/press-releases-price-sensitive/2016/unicredit-group-completa-la-vendita-di-ukrsotsbank-a-abh-holding.html>.

43 Foy et al., "Ties that bind." Fallico received the Order of Friendship from Russia in 2008 and last year received an award from President Putin for facilitating the sale of a stake in Rosneft in 2016. See Giuseppe D'Avanzo, Andrea Greco, and Federico Rampini, "Berlusconi, Putin e quel biglietto la vera storia del gas di Mosca," *La Repubblica*, December 8, 2010, https://www.repubblica.it/esteri/2010/12/08/news/wikileaks_berlusconi_putin-9950307/.

the Soviet Union in terms of loan portfolio.⁴⁴ Today, Intesa serves “more than half of the foreign trade operations between Russia and Italy,”⁴⁵ reinforcing the interdependence of banks and businesses and their dependence on Russia.

There is also a troubling interaction (and potential reinforcement) between these two Russian-dominated strategic sectors—energy and finance—as Intesa has been an important financial partner in large Russian energy infrastructure projects in Russia and abroad. For example, the bank became an investor in Blue Stream in 2000 and financed part of the first Nord Stream project. In 2017, it signed an agreement with Russian oil producer Independent Petroleum Company to raise funds for a new drilling project (the company has been sanctioned by the United States for violating North Korea sanctions).^{46,47} Intesa Sanpaolo also provided a €5.2 billion loan to Glencore and Qatar Investment Authority in 2017 to finance their acquisition of a stake in Rosneft after its privatization, which was an effort by the Kremlin to raise capital amid sanctions (a Chinese conglomerate later agreed to buy part of that stake and Intesa will thus be reimbursed sooner than planned).⁴⁸

SACE, the Italian export credit agency (providing insurance for the risks to which Italian companies are exposed in their international transactions and investments), also has a significant presence in and exposure to Russia. Its operations in Russia and the Commonwealth of Independent States stretch over several decades, with an in-country presence since 2006. Russia is SACE’s third-largest market, with a total exposure of around €5 billion.⁴⁹ The Italian agency is currently studying several projects in Russia—mainly in the oil and gas and metallurgical industries—worth around €1 billion in potential commitments. In the last decade, SACE has developed a solid partnership in strategic sectors with the Russian development bank, Vnesheconombank (VEB, which is currently under U.S. sanctions). In 2011, SACE and VEB, together with the French company Coface, signed an agreement to support the sales of the Sukhoi Superjet 100 (SSJ100), an aircraft developed with Russian, Italian, and French technologies.

Over the research period, real estate and telecommunications have become particularly attractive for Russian investors and have emerged as strategic sectors. Italy is now the third most favored destination for Russian real estate investments, particularly

44 “Intesa Sanpaolo Activities in Russia,” Banca Intesa, <https://www.bancaintesa.ru/en/about/intesa/1/>.

45 Ibid.

46 Foy et al., “Ties that bind.”

47 “Russia Sanctions Tracker,” Center for Strategic and International Studies, <https://russiasanctionsracker.csis.org>.

48 Gianluca Semeraro and Stephen Jewkes, “Intesa Sanpaolo not concerned about Glencore loan for Rosneft,” Reuters, April 27, 2018, <https://www.reuters.com/article/us-intesasanpaolo-rosneft-glencore-cefc/intesa-sanpaolo-not-concerned-about-glencore-loan-for-rosneft-idUSKBN1HY2IW>.

49 “SACE e Vnesheconombank firmano accordo di cooperazione,” SACE, June 16, 2016, <https://www.sace.it/media/comunicati-stampa/dettaglio/sace-e-vnesheconombank-firmano-accordo-di-cooperazione>.

among high-ranking Russian government officials and oligarchs such as Roman Abramovich, Dmitri Medvedev, and Viktor Vekselberg, who own luxury properties in Italy.⁵⁰ Tuscany's Versilia region has been a focal point for Russian investments in hotels.⁵¹ This level of concentration of Russian investments in real estate is important as it can skew the local tax base and directly impact local politics, given real estate's vital role as a source of revenue for towns and regions.

There has also been a substantial increase in Russian purchases of important telecommunication firms. In 2011, VEON (formerly VimpelCom) acquired the third-largest mobile operator in Italy, Wind S.p.A., which boasts a 22.9 percent market share.⁵² VEON's largest shareholder is Mikhail Friedman's Alfa Group (through a company called LetterOne, which is registered in the Netherlands).⁵³ Wind S.p.A. later merged with Tre Italia to form Wind Tre S.p.A., which is now the largest mobile operator in Italy with a 32.7 percent market share (other shareholders in Wind Tre include Chinese and American companies).⁵⁴ Today, the Italian market is VEON's second-largest revenue source.⁵⁵

While Italian and Russian companies have important ties in some specific sectors, Russia's economic footprint in Italy is also concentrated in specific locations. This is the case in Northern and Central Italy, where most Russian-owned businesses are located (specifically Lombardy, Emilia-Romagna, Tuscany, and Marche). Along the Adriatic coast, Emilia-Romagna and Marche have the highest density of retail, food, and hospitality businesses with Russian ownership. The Romagna coast has recently seen an increase in Russian tourism, with a 25 percent increase in visits in 2017 compared to 2016.⁵⁶ Lombardy, in particular, ranks first in the number of Russian companies present in the region (173) and the density of Russian presence (1.81 Russian companies per 10,000 Italian ones); Milan princi-

50 "I Russi Comprano Casa in Italia," Luxury Villa Italy, http://www.luxuryvillaitaly.com/russi-comprano_casa_italia.aspx.

51 Niccolo Gramigni, "I russi rimettono piede in Versilia, gli americani continuano a comprare," Il Sole 24 Ore, March 6, 2018, <http://www.ilssole24ore.com/art/impresa-e-territori/2018-03-06/i-russi-rimettono-piede-versilia-americani-continuano-comprare-121049.shtml?uclid=AEsO3s9D>.

52 "Vimpelcom, sì all'acquisizione di Wind. Nasce il 5° colosso della telefonia mobile," *La Repubblica*, March 17, 2011, http://www.repubblica.it/economia/2011/03/17/news/vimpelcom-wind_via_libera_a_fusione-13719580.

53 "Share ownership," VEON, <https://veon.com/investor-relations/Share-information/Share-ownership>. Alfa Group owns Alfa Bank, which owns Amsterdam Trade Bank, a bank involved in money laundering scandals. ATB was accused by the U.S. Department of Justice of paying bribes on behalf of VEON in Uzbekistan. Fridman cofounded LetterOne, which created the Dutch "foundation" (*stichting*) that owns 8.3 percent of VEON (exempt from corporate tax).

54 "Osservatorio sulle comunicazioni," Autorita per le Garanzie nelle Comunicazioni, Servizio Economico Statistico, 2017, <https://www.agcom.it/documents/10179/8144896/Studio-Ricerca+20-07-2017/d784816b-708d-471b-adc3-82337ce08b98?version=1.2>.

55 Interfax, "Altimo может потратить \$1,5 млрд на увеличение доли в Vimpelcom Ltd." Comnews, April 26, 2012, <http://www.comnews.ru/node/63601>.

56 "Il turismo in Emilia-Romagna Gennaio-Settembre 2017," Osservatorio sul turismo dell'Emilia-Romagna, September 1, 2017, <http://www.ucer.camcom.it/osservatori-regionali/os-turistico/pdf17/turismo-er-01-09-2017.pdf>.

pally accounts for this density, being the city with the highest number of Russian-controlled companies in the country (121) such as Wind Tre S.p.A. and Centrex Italia S.p.A.⁵⁷

This concentration of Russian activity in Italy has exposed a new nexus between Russian and Italian economic, political, and societal interests (e.g., anti-immigrant, culturally conservative, and Euroskeptic forces), reinforcing the unvirtuous circle of Russian influence. This geographic concentration of investments from Russia also coincides with Italian political figures from those regions opposing sanctions.⁵⁸ These places and figures have developed cultural ties with Russia, creating full-spectrum connections: Lombardy hosts the Lombardy-Russia Cultural Association, an organization founded by League-affiliated individuals that takes a strongly pro-Kremlin line. It is headed by Gianluca Savoini, a close advisor to the current Italian Deputy Prime Minister and Interior Minister Matteo Salvini and someone who sees Russia as a “fundamental geopolitical, military, as well as economic ally.”⁵⁹ The Association’s honorary president is Aleksey Komov, better known for his role as Russian representative of the World Congress of Families—an ultra-conservative organization defending “Christian values” against the social and moral decadence of the West.⁶⁰

Undoubtedly, there has always been strong political support of Italian-Russian relations under previous Italian prime ministers, who viewed Russia as an important economic partner and a partner in foreign policy that shared similar security concerns in Italy’s neighborhood (e.g., instability in North Africa and the Middle East).⁶¹ However, it

57 CSD calculations based on commercial corporate databases.

58 In 2016, the local parliaments of Veneto, Lombardy, and Liguria passed resolutions opposing sanctions against Russia. Veneto called the annexation of Crimea an act of self-determination. See “Sanzioni alla Russia: Assessore Marcato, Danni per Miliardi di Euro, “Il Veneto Mette in Campo la Diplomazia Regionale – Ecco le Proposte del Comitato Tecnico,” Regione del Veneto, June 30, 2017, https://www.regione.veneto.it/web/guest/comunicati-stampa/dettaglio-comunicati?_spp_detailId=3125316. See also: “Russia, Maroni: intensificare rapporti e stop sanzioni,” Regione Lombardia, February 16, 2017, <http://www.regione.lombardia.it/wps/portal/istituzionale/HP/lombardia-notizie/DettaglioNews/2017/02-febbraio/13-19/russia-maroni-intensificare-rapporti-e-stop-sanzioni>. See also: ANSA, “Regione Liguria, stop sanzioni a Russia,” June 29, 2016, http://www.ansa.it/liguria/notizie/consiglioregionale/2016/06/30/regione-liguria-stop-sanzioni-a-russia_0cc62556-34bb-41ed-bb6b-346f685168aa.html.

59 Savoini also reportedly has ties to paramilitary groups that have sent people to fight in occupied areas of Ukraine. Alina Polyakova et al., *The Kremlin’s Trojan Horses 2*, (Washington, D.C.: Atlantic Council, 2017): 14. See also: Alberto Nardelli and Olga Tokariuk, “Here’s A Totally Incredible Story About Pro-Russian Mercenaries And A Close Aide To Italy’s De Facto Leader,” BuzzFeed News, September 13, 2018, <https://www.buzzfeednews.com/article/albertonardelli/matteo-salvini-russia-gianluca-savoini>.

60 Komov participated in the League’s party congress in 2013, during which Salvini was elected party leader. The Southern Poverty Law Center has designated the World Congress of Families as a hate group. WCF has also served as a way to connect right-wing, conservative forces across Europe and leverage them for Russia’s geopolitical goals. See “World Congress of Families,” Southern Poverty Law Center, <https://www.splcenter.org/fighting-hate/extremist-files/group/world-congress-families>.

61 As recently as May 2017, then-prime minister Paolo Gentiloni visited Sochi for a meeting with Vladimir Putin during which they discussed economic difficulties for both countries and how to improve the bilateral relationship. See Dario Cristiani, “Italy and Russia: Between Economic

is the rise of nativist and anti-establishment forces in recent years that has strengthened the country's alignment with Russia's geopolitical interests, as these forces have fed on and fueled citizens' rising frustration with "the system" that produces anemic economic growth and offers little optimism for positive change.

Some political parties and figures have participated in this shift more than others. Under the leadership of Matteo Salvini, the far-right League (formerly Northern League) has rapidly evolved from a regionalist party to a national force, which is now the most popular political party in Italy and a staunch ally of the Kremlin's. The party's northern Italian constituency includes Italy's main exporters, who partly drive opposition to EU sanctions against Russia to protect their economic ties. The League has gradually altered its position on NATO operations and is now more vocally opposed to the Alliance's efforts, including troop deployments to Eastern Europe. The party has denounced the placing of NATO forces as an act of war against Russia while pro-Russian outlets spread messages of fear of impending conflict and retaliation against Italy.⁶² Political contacts between the League and Russian officials have intensified since the illegal annexation of Crimea in 2014. In March 2014, League members even traveled to Crimea as election "observers" during the Russian-controlled "independence referendum." In 2015, the League was reportedly in discussions with the Kremlin-affiliated party United Russia, although the agreement was only signed in March 2017.⁶³

Ahead of the parliamentary elections in 2018, reports surfaced and the government acknowledged that there had been attempts by Russia to influence the public and the election. Italian officials warned that Russia was behind a sustained cyberattack on the Ministry of Foreign Affairs that lasted for several months in 2016, hacking into emails but not infiltrating encrypted communications.⁶⁴ In November 2017, misinformation efforts ahead of the election surfaced, principally targeted at the center-left incumbent Democratic Party (PD), with tampered images and videos slandering PD candidates. Fringe media outlets also spread nationalist and anti-immigrant messages online, including through Facebook pages.⁶⁵ The League and another anti-establishment party, the Five Star Movement (M5S), went on to form a governing coalition after the election.

Cooperation and Mediterranean Problems," *Eurasia Daily Monitor* 14, no. 78 (June 2017), <https://jamestown.org/program/italy-russia-economic-cooperation-mediterranean-problems/>.

62 Polyakova et al., *Trojan Horses*, 15.

63 Eugenio Fatigante, "Analisi. La rete fra la Lega e Putin dietro l'Italia giallo-verde," *L'Avvenire*, May 31, 2018, <https://www.avvenire.it/economia/pagine/la-rete-fra-la-lega-e-putin-dietro-litalia-gialloverde>.

64 Robert Hackwill, "Italy accuses Russia of huge hack of its foreign ministry outposts," Euronews, August 14, 2017, <http://www.euronews.com/2017/08/14/italy-accuses-russia-of-huge-hack-of-its-foreign-ministry-outposts>.

65 Ibid. See also: Alberto Nardelli and Craig Silverman, "One of the Biggest Alternative Media Networks In Italy Is Spreading Anti-Immigrant News and Misinformation on Facebook," BuzzFeed News, November 21, 2017, https://www.buzzfeed.com/albertonardelli/one-of-the-biggest-alternative-media-networks-in-italy-is?utm_term=.lrZe8GmNp#.hddb7AXRr.

The League's accession to and increasing grasp on power has placed a strong pro-Kremlin voice at the helm of a founding EU and NATO member, a host to important NATO bases, and the third-largest eurozone economy. The League-M5S coalition agreement of May 2018 lists the lifting of sanctions against Russia as an objective, notes the importance of Russia as an economic partner to Italy, and defends the need for Italy to work closely with Russia as a strategic partner to resolve crises in Syria, Libya, and Yemen.⁶⁶

The other coalition partner in the current government, M5S, published a foreign policy platform in 2017 that officially called for an end to EU sanctions and for removing funding for the European Union's strategic communications task force as it spread "anti-Russian propaganda."⁶⁷ This represented a significant shift in the party's views from 2014 when it criticized Russia's positions on social issues (e.g., LGBTQ rights) and its media crackdown. By mid-2015, it had adopted a much more pro-Kremlin and anti-NATO stance. In late 2015, a delegation of M5S members was reportedly set to visit Russia and Crimea, though it is unclear whether this plan ever materialized.⁶⁸ M5S-aligned outlets have since echoed and sourced Russian outlets and defended Kremlin views such as blaming the United States and the European Union for the instability in the Middle East and North Africa.⁶⁹ M5S has also encouraged increased intelligence cooperation between Italy and Russia on counterterrorism.

Italy continues to be fertile ground for Russian malign influence, as its openly pro-Kremlin government confronts economic stagnation, public discontent against the European Union, and anti-immigration sentiment. Yet despite the significant policy changes of both political parties and coalition government members in Moscow's favor, a year into its term the government's policy positions have been surprisingly less pro-Russian than previous governments. This may suggest that Italian civil servants and government authorities are seeking to counteract the pro-Russian attitudes of the ruling parties. Nevertheless, the country's economic, financial, geographic (including its strategic access to the Mediterranean), and energy centrality to Europe make Italy an especially attractive hub for Russian influence, compounded by its permissive governance and political environment. This influence could jeopardize European and transatlantic unity in the future.

66 Virginia Piccolillo, "M5S-Lega, ecco il contratto definitivo," *Corriere Della Serra*, May 18, 2018, https://www.corriere.it/politica/18_maggio_18/m5s-lega-ecco-contratto-definitivo-c85cd80a-5a7c-11e8-be88-f6b7fb45ecc.shtml?refresh_ce-cp.

67 Polyakova et al., *Trojan Horses*, 18.

68 "Duma russa: Delegazione M5S si prepara a sbarcare in Crimea," *Askanews*, November 12, 2015, http://www.askanews.it/politica/2015/11/12/duma-russa-delegazione-m5s-si-prepara-a-sbarcare-in-crimea-pn_20151112_00341/.

69 Polyakova et al., *Trojan Horses*.

Case Study

The Netherlands

The Netherlands might not come to mind as the most obvious candidate for a study on Russian influence in Europe. A founding NATO and EU member, it actively participates in NATO military operations and maintains a strong stance on sanctions against Russia. It has suffered greatly at the hands of Russian actions, from the tragic shootdown of flight MH17 that killed 193 Dutch citizens in July 2014 to a cyberattack in April 2018 against the Organization for the Prohibition of Chemical Weapons (OPCW) based in The Hague. Notwithstanding these recent developments, the Netherlands' commercial relationship with Russia dates back to the nineteenth century when "Dutch entrepreneurs were willing to invest in Russian ventures and part of foreign Russian gold reserve was kept in the Netherlands. By January 1, 1914, Russian foreign investments in the Netherlands had amounted to 8 million gold roubles."¹ A century later, the bilateral economic relationship serves the same purpose, making the Netherlands a largely unnoticed, unappreciated, and therefore underestimated enabler for Russian influence and its oligarchs, particularly in the provision of services on tax avoidance through incorporation. Dutch central bank members of a special committee of the International Monetary Fund have indeed highlighted the country's prominent role in international corporate tax avoidance.²

The Netherlands is a free and open democracy with an independent judiciary and a strong legal framework for anti-corruption. It is vocal on the deterioration of human rights and civil society in Russia. It is consistently ranked one of the "cleanest" countries in Transparency International's Corruption Perception Index, though its score has decreased slightly since 2009.³ However, when it does occur, corruption is not heavily prosecuted in the Netherlands and the penalties in the legislation for corruption do not act as a strong deterrent. There also appears to be a gap between the legislation on and the enforcement of anti-corruption and anti-money laundering measures. A recent survey of business owners in the Netherlands shows that 23 percent believe bribery and corrupt business practices occur widely in the country.⁴ In addition, the OECD has repeatedly

- 1 "Russian-Dutch relations before 1917 – History of the Russian-Dutch relations," Embassy of the Russian Federation in the Netherlands, https://netherlands.mid.ru/web/netherlands-en/russian-dutch-history/-/asset_publisher/b3L1jei38qRk/content/russian-dutch-relations-before-1917?redirect=%2Fweb%2Fnetherlands-en%2Frussian-dutch-history&inheritRedirect=true.
- 2 Pim Claassen and Gerrit van den Dool, "The effects of including SPEs on BoP and FDI statistics" (paper presented at meeting of IMF Committee on Balance of Payments Statistics, Muscat, Oman, October 28–30, 2013), <https://www.imf.org/external/pubs/ft/bop/2013/13-15.pdf>.
- 3 "Corruption Perceptions Index 2017," Transparency International, February 21, 2018, https://www.transparency.org/news/feature/corruption_perceptions_index_2017#table.
- 4 "Corruption perception by country," EY EMEA Fraud Survey, 2017, <https://fraudsurveys.ey.com/emeia-fraud-survey-2017/detailed-results/corruption-perception-by-country/>.

noted that Dutch authorities have been lenient in their approach to prosecuting foreign bribery and holding corporates accountable for wrong-doing abroad.⁵

The Netherlands ranks as the 14th largest contributor to global financial secrecy (partially due to its lack of transparency on beneficial ownership in trusts and limited partnerships), a significant drop from 2015 when it ranked 41st.⁶ It is the largest conduit for tax haven funds in the world, with 23 percent of all offshore investments flowing through the country in 2017.⁷ And this profile is exactly what makes it so attractive to companies and wealthy individuals in the world—in particular Russia—and has attracted so much investment in recent years. The Netherlands is Russia's second-largest investment market, and Russian companies' assets in the country grew from €13.8 billion in 2007 to €96 billion in 2017, or 13 percent of nominal Dutch GDP.⁸

The Netherlands has flexible company laws and an attractive tax regime that offers an appealing combination for investors looking to decrease (or avoid) their tax burden or adapt (or obscure) their ownership structure. The Netherlands is a hub for incorporation and registration, including for Russian companies operating across Europe—an observation we noted in the first *Kremlin Playbook*, where many energy companies involved in Central and Eastern Europe had Dutch incorporation. Lukoil, Rosneft, Gunvor, and Novatek (among others) all have subsidiaries registered in the Netherlands that operate across Europe.⁹ Gazprom alone has 25 subsidiaries registered in the country. Many multinational corporations also go through the Netherlands to invest in Russia (e.g., ExxonMobil, Royal Dutch Shell, Chevron), and some of the largest Russian firms own tens of billions of assets in the Netherlands, such as Gazprom and Rosneft.

Incorporation is typically done through a particular type of company—nicknamed letterbox companies—that serves as a conduit to park assets or transfer funds from one place to another (usually a tax haven). Though they are incorporated in the Netherlands, the bulk of these companies' activity is usually concentrated outside of the country. In 2017, there were an estimated 14,000 letterbox companies registered in the Netherlands. In 2013, 83 percent of all incoming and 78 percent of all outgoing fo-

5 OECD Working Group on Bribery, *The Netherlands: Follow-up to the Phase 3 Report & Recommendations* (Paris, France: Organization for Economic Co-operation and Development, 2015).

6 As a reference, Switzerland ranks first, the United States second, and the Cayman Islands third in this measurement. "Financial Secrecy Index – 2018 Results," Tax Justice Network, January 30, 2018, <https://www.financialsecrecyindex.com/introduction/fsi-2018-results>.

7 Javier Garcia-Bernardo, Jan Fichtner, Frank W. Takes, and Eelke M. Heemskerk, "Uncovering Offshore Financial Centers: Conduits and Sinks in the Global Corporate Ownership Network," *Scientific Reports* 7, no. 6246 (July 2017): 6. See also: Daniel Boffey, "Netherlands and UK are biggest channels for corporate tax avoidance," *The Guardian*, July 25, 2017, <https://www.theguardian.com/world/2017/jul/25/netherlands-and-uk-are-biggest-channels-for-corporate-tax-avoidance>.

8 Boffey, "Netherlands and UK are biggest channels."

9 Interestingly, the Netherlands appears as the largest foreign investor in Bulgaria. However, upon closer inspection, Russian companies are ultimately responsible for between 50 and 60 percent (on average) of these transactions—they just happen to be made from subsidiaries registered in the Netherlands.

reign investments circulated through this type of company.¹⁰ More than \$4 trillion in FDI stocks are held in the Netherlands today—twice the amount recorded in 2008—partly through these letterbox companies. A 2012 OECD report faulted the Netherlands for not proactively investigating and prosecuting these companies, which are often the subject of foreign bribery allegations.¹¹ A 2015 follow-on report recognized positive reforms, but also noted a lack of proactive detection efforts regarding letterbox companies and their involvement in possible money laundering operations.¹²

Although the Netherlands does not fit the definition of a classic tax haven,¹³ it is probably the biggest tax treaty jurisdiction in the world and functions as a de-facto conduit offshore financial center.¹⁴ A combination of no withholding taxes on outgoing interest, dividends, and royalty payments as well as a network of double taxation treaties with special exemptions can reduce the tax burden for foreign multinationals. The Dutch corporate income tax rate¹⁵ is not abnormal when compared with other European countries. However, the Netherlands has a system of individual tax rulings that allow corporations to negotiate their own tax deals. This system is a potential pathway for tax avoidance that can harm fiscal conditions in another country.¹⁶ The companies using the Dutch incorporation system and letterbox companies also benefit from a participation exemption in the tax code that treats parent companies and subsidiaries as separate entities and exempts them from reporting profits in two different locations. Some of the large companies whose subsidiaries are registered in the Netherlands can therefore choose to be taxed there, where corporate taxes are lower—and can be negotiated with the government—and avoid being taxed again in their home country (for example, in Russia).

Incorporation laws and tax regulations, in turn, allow foreign companies to conduct mergers and acquisitions under attractive tax conditions, with access to international capital markets and opportunities to obscure the ultimate beneficiary of the mergers and acquisition—which can be useful if facing sanctions. Recent murky acquisitions by Russian companies in Central and Eastern Europe (including the Czech Republic, Bulgaria, and Montenegro), as well as the money-laundering scandals of Danske Bank and ING, show the

10 Esme Berkhout, *Nederland Belastingparadijs* (The Hague, Netherlands: Oxfam Novib, 2016), 15.

11 “Netherlands must significantly step up its foreign bribery enforcement, says OECD,” Organization for Economic Co-operation and Development, January 8, 2013, <http://www.oecd.org/daf/anti-bribery/netherlandsmustsignificantlystepupitsforeignbriberyenforcementsaysoecd.htm>.

12 OECD Working Group on Bribery, *The Netherlands*.

13 Such as the British Virgin Islands, Panama, Bermuda, Belize, and others. These tax havens have zero or very low corporate income tax and have no withholding taxes. There is very low transparency into corporate accounts, potentially allowing for tax evasion to remain unnoticed.

14 Through the conduit arrangement, companies registered in the Netherlands are used to route transactions from another jurisdiction in order to reduce the tax burden in that other jurisdiction.

15 20 percent on generated profit under €200,000 and 25 percent for profit over €200,000. “Corporation tax,” Government of the Netherlands, <https://www.government.nl/topics/taxation-and-businesses/corporation-tax>.

16 Michael van Dijk, Francis Weyzig, and Richard Murphy, *The Netherlands: A Tax Haven?* (Amsterdam, Netherlands: Centre for Research on Multinational Corporations [SOMO], 2006), 62.

continued lack of capacity of oversight authorities. Widespread complacency has allowed enormous suspicious financial flows to transit in and out of the European financial system.

Foreign firms are also able to retain important assets in the Netherlands while using it as a hub for investments throughout Europe (e.g., Lukoil), a conduit for funds that are ultimately headed for offshore tax havens, or for round-tripping (the channeling of local funds abroad to repatriate some or all of them, a tactic sometimes used in money-laundering activities).¹⁷ Many of these investments are funds that flow between subsidiaries and headquarters or between special purpose entities (conducting share buybacks and swaps) rather than physical or “brick-and-mortar” investments in the Netherlands. It is therefore not surprising that the Netherlands became the number one private equity market by deal value in 2018 (reaching a total value of £23.5 billion).¹⁸

As complex structures have proliferated and monetary flows increased, there has been a higher demand for corporate service providers (CSPs; e.g., incorporation agents, accountants, and lawyers), which service and support incorporation and investment structures. Today, the CSP sector in the Netherlands includes 14,000 letterbox companies, through which an approximate \$4.2 trillion transit each year.¹⁹ Most of these shell companies are in turn managed by trusts (approximately 240 in 2016). The average size of trusts has grown, prompting calls by the central bank for more instruments to control and regulate them.²⁰ A 2018 draft law has proposed to regulate the CSP industry by requiring more extensive background checks on clients, though this risks pushing business into the shadow CSP sector (now potentially larger than the official sector, though there are no official statistics on this).²¹ Though Dutch CSPs manage trillions of dollars, they do not appear to be well aware of the potential for illicit financing or of their money-laundering risks (especially through limited partnerships).²²

While the size of investments circulating through the Dutch economy and its shell companies is staggering, the rewards for the state do not seem to match those le-

17 Round-tripping: “The practice of earning profit by borrowing on overdraft and relending in the money markets; (later also) the practice of investing capital abroad and then reinvesting it in its country of origin, in order to take advantage of favourable tax rates, etc., given to foreign investors.” “Round-tripping,” English Oxford Living Dictionaries, <https://en.oxforddictionaries.com/definition/round-tripping>.

18 Javier Espinoza, “UK toppled as Europe’s biggest private equity market,” *Financial Times*, December 16, 2018, <https://www.ft.com/content/72ef5dbe-ff88-11e8-aebf-99e208d3e521>.

19 Rodrigo Fernandez, “Dutch efforts to combat letterbox companies have no effect,” SOMO, March 29, 2018, <https://www.somo.nl/dutch-efforts-combat-letterbox-companies-no-effect/>. See also: Bart Meijer, “Tax treaties create \$4.2 trillion cash flow through Netherlands,” Reuters, December 13, 2018, <https://uk.reuters.com/article/us-netherlands-tax/tax-treaties-create-4-2-trillion-cash-flow-through-netherlands-idUKKBN1OC28C>

20 Fernandez, “Dutch efforts to combat letterbox companies.”

21 Bram Logger and Parcival Weijnen, “Witwassen in een flexkantoor,” *De Groene Amsterdammer*, June 6, 2018, <https://www.groene.nl/artikel/witwassen-in-een-flexkantoor>.

22 The Dutch Central Bank has highlighted the financial risks (money laundering, lack of information on beneficial ownership) associated with limited partnerships as “exceptionally high.” Tax Justice Network, *Narrative Report on the Netherlands* (Tax Justice Network, 2018), 3.

vels. Though trillions of dollars circulate through companies each year, the Dutch state only received around \$1 billion in tax revenue from these flows. In 2013, revenue from investment flows reached around €4 billion, or 0.7 percent of GDP.²³ But the desire to remain an investment destination appears to outweigh the state's desire for higher tax revenues. In late 2017, the Dutch government abolished the tax on dividends at a cost of approximately €1.4 billion for the Dutch budget.²⁴

Investments represent the bulk of the bilateral economic relationship between the Netherlands and Russia, and this relationship is so important it bears repeating: the Netherlands is Russia's second-largest trading partner and is the second-largest investment market for Russia (though inward FDI has decreased since 2014). It is also important to note that outgoing FDI stocks from the Netherlands to Russia have grown from €20 billion in 2006 to close to €100 billion in 2017, which could be partly explained by the repatriation of capital from Russian companies' Dutch subsidiaries.

More traditional strategic sectors are also part of the bilateral economic relationship (trade turnover reached around \$32 billion, or almost 5 percent of Russia's total trade volume, in 2017), particularly concentrated in the energy sector—where most of the Russian economic footprint is focused. The Netherlands has sought to become a major oil and gas distribution hub in Europe and requires important energy reserves to preserve this position.²⁵ Gazprom is a crucial ally in this task—particularly as Dutch energy production has fallen and European countries have pledged to move away from fossil fuels toward renewable energy. Despite the significant increase in tensions with Russia since the introduction of sanctions over Crimea, Dutch gas imports from Russia rose from 6.4 billion cubic meters (bcm) in 2014 to 14 bcm in 2016, or around a third of the country's gas consumption (before falling sharply to below 5 bcm in 2017).

On average, Russian gas has made up only around 14 percent of the Netherlands' consumption through the Nord Stream pipeline and Germany. However, the ongoing decline of Dutch domestic natural gas production would make the Netherlands much more dependent on foreign suppliers in the near future (including through the planned Nord Stream 2 pipeline). Gazprom is also trying to stake out a higher domestic gas market share in the Netherlands; the company has stated that it wants to obtain a 15 percent market share in the Netherlands in the next few years.²⁶

23 Arjan Lejour and Maarten van't Riet, *Bilaterale belastingverdragen en buitenlandse investeringen* (The Hague, Netherlands: CPB Netherlands Bureau for Economic Policy Analysis, 2013).

24 Robert Giebels, "De dividendbelasting is afgeschaft, maar niemand in Den Haag weet waarom," *de Volkskrant*, November 3, 2017, <https://www.volkskrant.nl/nieuws-achtergrond/de-dividendbelasting-is-afgeschaft-maar-niemand-in-den-haag-weet-waarom~b4693074/>.

25 Dutch businesses have increasingly complained to the government and the European Union about the prolongation of the economic sanctions against Russia. See Caroline de Gruyter, "View from The Hague: An eternal balancing act," European Council on Foreign Relations, October 14, 2016, https://www.ecfr.eu/article/commentary_view_from_the_hague_an_eternal_balancing_act7146.

26 David Bremmer, "Nederlander wil niet langer Russisch gas," *Algemeen Dagblad*, July 25, 2014, <https://www.ad.nl/buitenland/nederlander-wil-niet-langer-russisch-gas~aeb6c4e5/>.

Gazprom also has important ties to energy giant Royal Dutch Shell and state-owned gas distributor Gasunie, Europe's biggest gas distribution company (accounting for 25 percent of the total gas sales in Europe).²⁷ Shell has lobbied U.S. and EU policymakers for their support for the Nord Stream projects (transporting Russian gas through the Baltic Sea to Germany and thus bypassing Ukraine and Central Europe).²⁸ Gasunie and Gazprom signed a memorandum of understanding on strategic cooperation in 2013. Marcel Kramer, Gasunie's former CEO, sits on the board of Gazprom and was in charge of the now-defunct South Stream project (although this project is being revitalized through TurkStream, which sends Russian gas to Turkey and bypasses Ukraine).

Russian gas also makes up 9 percent of the trading portfolio of Gasunie's former subsidiary, GasTerra, which is now 50 percent owned by the state, 25 percent by Shell, and 25 percent by ExxonMobil. If domestic output in the Netherlands continues to fall, especially from the giant Groningen field,²⁹ Gasunie and GasTerra would become increasingly dependent on trading Russian gas. In addition, they would directly benefit from Nord Stream 2's new gas supplies in Northwestern Europe as they currently operate the biggest networks of pipelines in Germany, Belgium, and the Netherlands. This would also directly benefit the Dutch public finances as Gasunie allocates an annual dividend, which in 2017 alone was €259 million (down from €362 million in 2014). The Netherlands will thus likely attempt to preserve its position as the most liquid gas hub in continental Europe, and Gazprom can help them do so.

The Anglo-Dutch oil major Royal Dutch Shell is the most closely intertwined with Russia. In 2017, the company celebrated 125 years of doing business in Russia, prompting Russian Prime Minister Medvedev to release a letter stating, "Shell is firmly integrated into our national economy and is one of our biggest foreign investors."³⁰ Shell is heavily invested in the Russian gas exploration and production sector, specifically the \$22 billion Sakhalin-2 project that was completed in 2009, a large infrastructure plan comprising gas fields, offshore platforms, pipelines, and an LNG plant in Siberia. Interestingly, Shell has furthered its investments in Russia despite being forced by the Russian government in 2007 to reduce its majority stake

27 Gasunie holds a 9 percent stake in Nord Stream while Shell owns a 10 percent stake in the planned Nord Stream 2.

28 "Polish Briefing: Nord Stream 2 lobbyists spent almost \$1,5 million in the US," *Biznes Alert*, August 1, 2018, <http://biznesalert.com/polish-briefing-nord-stream-2-lobbyists-spent-almost-15-million-in-the-us/>. See also: Andrew Rettman, "Nord Stream 2: Business unusual," *EUobserver*, June 7, 2016, <https://euobserver.com/business/133720>.

29 Due to earthquakes and damage to houses and infrastructure, production is being lowered at the Groningen field, first lowering annual extraction from 21 bcm/yr to 12 bcm/yr and then to zero in the coming years.

30 John Donovan, "Shell Company Firmly Integrated in Russian Economy, PM Medvedev Says," Royal Dutch Shell Group, June 22, 2017, <http://royaldutchshellgroup.com/2017/06/22/shell-company-firmly-integrated-in-russian-economy-pm-medvedev-says/>.

in Sakhalin-2 from 55 to 27.5 percent, allegedly for environmental concerns and after threats of having its license to operate in Russia revoked. Shell transferred part of its stake to Gazprom.^{31,32}

While the Netherlands' energy relationship with Gazprom is most visible in these large investments, Gazprom's ties to Dutch municipalities may not be as well understood and could have an outsized impact: 30 out of 380 local municipalities have their own separate gas supply contracts with Gazprom (municipal authorities are free to negotiate independently of the central government), creating potential local dependencies on Russian energy. In turn, local politicians could pressure the central government not to jeopardize this relationship with Gazprom, and by extension, the Kremlin.³³

Though natural gas has been the main economic tool Russia has used for political influence in Europe, the biggest energy export revenue comes from the sale of crude oil; despite a gradual shift to Asia, more than 70 percent of Russia's crude goes to Europe.³⁴ The Netherlands is the biggest European importer of Russian oil (accounting for almost 20 percent of EU oil imports from Russia in 2017) because Dutch oil terminals on the North Sea serve as Russia's biggest oil reexporting hubs. Before the sanctions imposed in 2014, Russia traded most of its crude oil via two companies, Gunvor (partially owned by Genadii Timchenko, who is under U.S. sanctions and allegedly close to Vladimir Putin) and Lukoil's subsidiary Litasco, both headquartered in Switzerland. Gunvor is connected to the Netherlands through two subsidiaries: Gunvor International B.V., which appears to be set up for tax optimization, and Gunvor Petroleum Rotterdam B.V., which runs its refinery operation in the port of Rotterdam.³⁵

Russia has also increased its business with the Dutch-registered energy trader Vitol, which in 2015 posted a profit of \$1.6 billion and traded 6.5 percent of the world's oil, making it the largest independent trader in the world.³⁶ Vitol, together with Glencore, has

31 "Baltic LNG: Natural gas liquefaction plant in the Leningrad Region," Gazprom, <http://www.gazprom.com/about/production/projects/lng/baltic-lng/>.

32 Abrahm Lustgarten, "Shell shakedown," *Fortune*, February 1, 2007, http://archive.fortune.com/magazines/fortune/fortune_archive/2007/02/05/8399125/index.htm.

33 Daniel van Harmelen, "Apeldoorn buys gas from Russian Gazprom," *ApeldoornDirect*, January 4, 2018, <https://www.apeldoorndirect.nl/stad/apeldoorn-koopt-gas-van-russische-gazprom-20180104/>.

34 "Russia exports most of its crude oil production, mainly to Europe," U.S. Energy Information Administration, November 14, 2017, <https://www.eia.gov/todayinenergy/detail.php?id=33732>.

35 According to the U.S. Department of Treasury, Putin has investments in Gunvor, and he "may have access to Gunvor funds." See "Treasury Sanctions Russian Officials, Members Of The Russian Leadership's Inner Circle, And An Entity For Involvement In The Situation In Ukraine," U.S. Department of the Treasury, March 20, 2014, <https://www.treasury.gov/press-center/press-releases/Pages/jl23331.aspx>.

36 Javier Blas and Andy Hoffman, "Inside Vitol: How the World's Largest Oil Trader Makes Billions," *Bloomberg*, June 1, 2016, <https://www.bloomberg.com/news/features/2016-06-01/giant-oil-trader-vitol-makes-billions-in-volatile-times>. Despite Dutch incorporation, Vitol is owned through two Luxembourg letterbox companies. In 2013, it paid zero dollars in taxes despite posting a profit of \$837 million; in 2017, Vitol reported a revenue of \$181 billion USD.

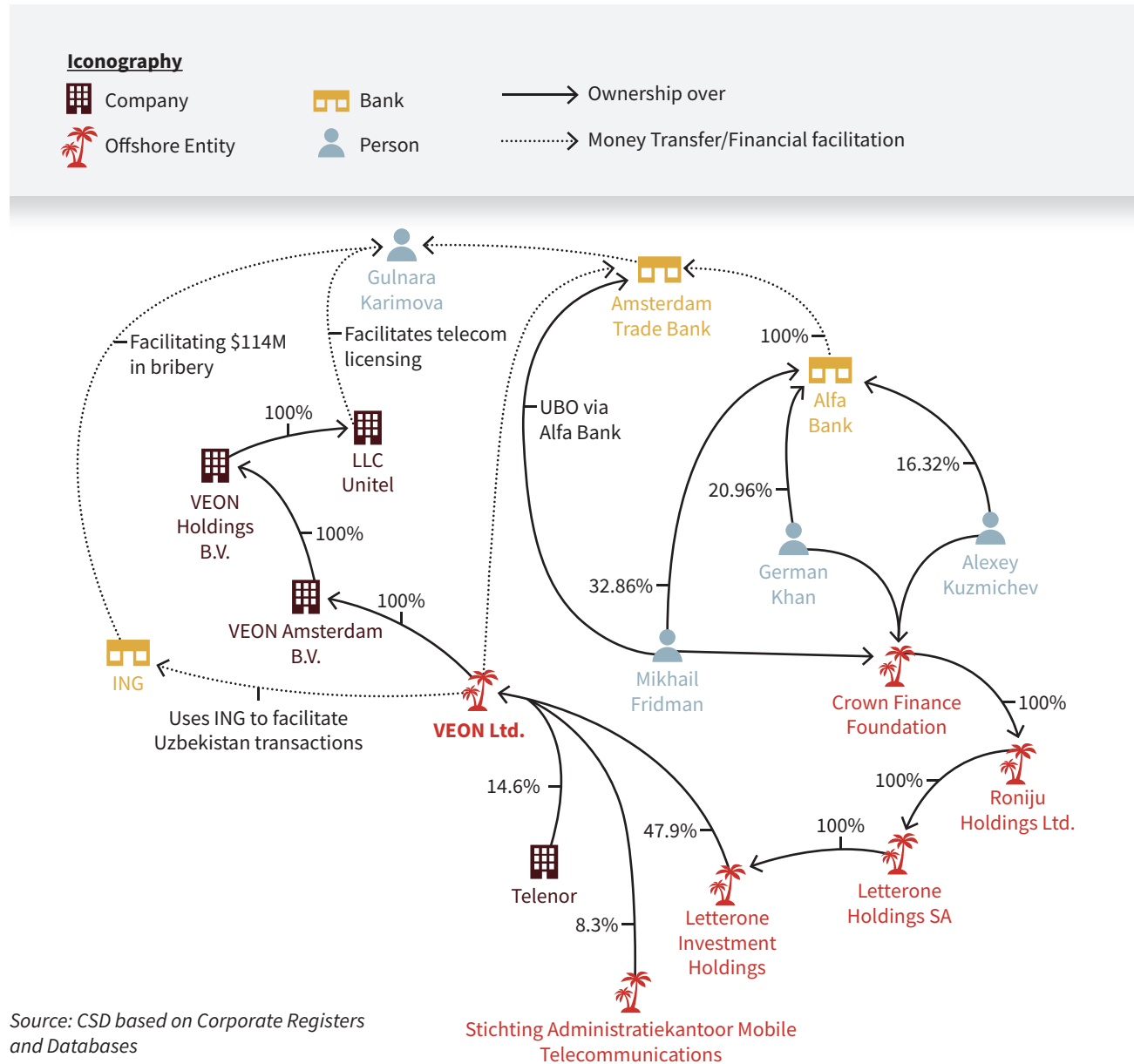
been bankrolling Russia's largest oil producer Rosneft under long-term cash-for-oil deals (whereby traders provide liquidity to cash-strapped state-owned companies in return for future long-term deliveries). Rosneft raised \$40 billion through similar deals between 2012 and 2015, making them an important fundraising tool for the company.³⁷ Over the years, Vitol has signed similar deals with Kazakhstan and Iraq and has been accused of circumventing sanctions on Iran and Iraq.³⁸ In April 2017, the company signed a long-term deal for the shipment of 300,000 metric tons (400 million cubic meters) of liquified natural gas (LNG) from Gazprom starting in 2018.³⁹ Although marginal in terms of volume, this move signals that Russia could use a network of dependent oil and gas traders to mask its future expansion on the European LNG market, hence challenging alternative suppliers.

The Russian economic footprint in the Netherlands has also expanded to the telecommunications sector, a pattern previously seen in other countries in Europe such as Italy. One of the most important players has been the Russian firm VEON (previously VimpelCom), which established headquarters in Amsterdam in 2010.⁴⁰ Globally, VEON is the sixth largest mobile network operator with 214 million customers, 80 percent of which are located in Russia and Italy. Like other Russian firms, VEON benefits from the Netherlands's lucrative tax model: 8.3 percent of the company is owned by the Stichting Administratiekantoor Mobile Telecommunications, a vehicle resembling a foundation that can operate as a trust, is exempt from corporate tax, and is headed by a Board of Directors to which the owners of the assets transfer full authority over the shares.⁴¹ LetterOne, an entity co-founded by Russian oligarch Mikhail Fridman in 2016, transferred 8.31 percent of the shares to the Stichting Administratiekantoor Mobile Telecommunications trust.⁴² LetterOne management claims the trust will be fully independent, but according to experts and given that those trusts act as reserve funds that become untaxable, it is possible that the main purpose of the transaction is to ensure that Fridman and his business partners retain full control over the company without breaking anti-monopoly laws. It is also possible it serves as a way for Fridman to protect his assets.

The Norwegian telecom giant, Telenor, also owns a 14.6 percent stake in VEON, and the two partners have worked together in emerging markets including Uzbekistan,

- 37 Sheppard, David, "Vitol extends cash-for-crude deal with Kazakhstan to \$5bn," *Financial Times*, September 18, 2017, <https://www.ft.com/content/6fc02f7c-9a19-11e7-a652-cde3f882dd7b>
- 38 Michael Stothard, "Total and Vitol fined in Iraq corruption case," *Financial Times*, February 26, 2016, <https://www.ft.com/content/c46bb45a-dc7a-11e5-98fd-06d75973fe09>.
- 39 Muhsin Tiryakioglu, "Swiss-Dutch Vitol to receive LNG from Gazprom from 2018," AA Energy, April 21, 2017, <https://www.aa.com.tr/en/energy/natural-gas/swiss-dutch-vitol-to-receive-lng-from-gazprom-from-2018/2723>.
- 40 VEON offers digital and connectivity products such as communications and network infrastructure, mobile operations, and cloud services. See: "Operations," VEON, <https://veon.com/whoweare/Operations/>.
- 41 Igor Korolev, "Владельцы «Альфа-групп» спрятали свои акции «Билайна»," Cnews.ru, February 4, 2016, http://www.cnews.ru/news/top/2016-04-02_vladeltsy_alfagrupp_spryatali_svoi_aktcii_bilajna.
- 42 Ibid.

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where a major corruption scandal involving VEON led to the firing of two Telenor executives and a gradual divestment by the Norwegian company from VEON. VEON (then still VimpelCom) settled court cases worth \$835 million with the Dutch state and the U.S. Department of Justice over the Uzbekistani bribery scandal.⁴³

The VEON example also offers a window into the importance of a country's financial sector as a conduit to further Russian influence and interests. Amsterdam Trade Bank (a small bank making over 40 percent of its total profits in Russia), which is owned by Fridman's Alfa Group and registered in the Netherlands, was also involved

43 Agence France-Presse, "VimpelCom pays \$835m to US and Dutch over Uzbekistan telecoms bribes," *Guardian*, February 19, 2016, <https://www.theguardian.com/world/2016/feb/19/vimpel-com-pays-835m-to-us-and-dutch-over-uzbekistan-telecoms-bribes>.

in the Uzbekistan scandal as the alleged executor of the bribes on behalf of VEON.⁴⁴ Amsterdam Trade Bank has also been implicated in one of the largest money-laundering scandals in recent years known as the Russian Laundromat, a complex criminal financial operation that moved huge amounts of funds out of Russia through over a hundred bank accounts throughout Europe.⁴⁵ The bank allegedly helped Russian-owned companies channel funds from Moldova and Latvia to safe havens in Western Europe.⁴⁶ It is believed that companies and individuals in the Netherlands received over \$68 million of the illicit funds implicated in the scandal.⁴⁷ In December 2017, the Dutch financial crimes prosecutor (FIOD) opened an investigation into possible money laundering committed by Amsterdam Trade Bank.⁴⁸ FIOD claims that the bank withheld information about unusual transactions by clients and did not conduct sufficient background checks. The bank has said that this “investigation focuses on a client portfolio that ceased to be part of the bank’s business some years ago” and it has since “completely” shifted its strategy.⁴⁹

The largest Dutch financial institution, ING, also settled for its involvement in the Uzbek case for not identifying or reporting the suspicious transactions made from ING accounts, including a \$55 million transfer to Gulnara Karimova, the daughter of the former president. The bank agreed to pay a €775 million fine in 2018 as part of a larger case accusing ING of violating laws on anti-money laundering and financing terrorism “structurally and for years.”^{50,51}

It thus appears the Dutch financial sector may be susceptible to illicit transactions and is an attractive location for Russian companies and funds. Between 2006 and 2014, 31 percent of all suspicious transaction reports sent to national financial intelligence units (FIUs) in the European Union originated in the Netherlands.⁵² This high number can be partly explained by the fact that all transactions of over €2,000 must be reported to the Dutch FIU, which then assesses whether the transactions constitute

44 Aleya Begum Lonsetteig, “Amsterdam Trade Bank under new money laundering investigation,” *Global Trade Review*, December 20, 2017, <https://www.gtreview.com/news/europe/amsterdam-trade-bank-under-new-money-laundering-investigation/>.

45 “The Russian Laundromat Exposed,” *Organized Crime and Corruption Reporting Project*, March 20, 2017, <https://www.occrp.org/en/laundromat/the-russian-laundromat-exposed/>.

46 Ibid.

47 Ibid.

48 Aleya Begum Lonsetteig, “Amsterdam Trade Bank under new money laundering investigation.”

49 Ibid.

50 Toby Sterling and Bart H. Meijer, “Dutch bank ING fines \$900 million for failing to spot money laundering,” *Reuters*, September 4, 2018, <https://www.reuters.com/article/us-ing-groep-settlement-money-laundering/dutch-bank-ing-fined-900-million-for-failing-to-spot-money-laundering-idUSKCN1LK0PE>.

51 Ibid.

52 However, it is unclear what share of these transactions is related to Russian individuals or companies. Financial Intelligence Group, *From Suspicion to Action: Converting financial intelligence into greater operational impact* (Luxembourg: European Union Agency for Law Enforcement Cooperation, 2017).

suspicious transaction reports (STRs). Only 15 percent of unusual transfers are classified as STRs by the FIU, leading to a very small number of money-laundering investigations.⁵³ While not all suspicious transactions are illicit, it suggests that the Netherlands holds a high concentration of activity that necessitates greater scrutiny.

With such a significant Russian economic presence in the Netherlands, one could anticipate substantial Russian political influence in the Netherlands. However, Russian political influence is not particularly visible in the country on a daily basis, but it can be detected at specific moments in which political pressure is helpful to the Kremlin's agenda. For example, the far-right Party for Freedom (PVV, which holds 20 out of 150 seats in the Dutch House of Representatives) is not actively pro-Russian but can serve Moscow's interests as it aims to erode confidence and support in the European Union. The Dutch Socialist Party is a more visible pro-Kremlin voice (though it holds only 14 seats in parliament), having opposed both the EU Constitution in 2005 (the Netherlands voted against it in a referendum) and the EU-Ukraine Association Agreement in 2016 (it was also defeated in a referendum).

Other Dutch political parties, however, have been more resolute on Russia and the European Union's sanctions regime since 2014 (even the PVV has not called for the lifting of sanctions), though most have concentrated their efforts on preserving the Netherlands as a prime investment destination.⁵⁴ This is in spite of the Netherlands becoming a target of Russian hybrid attacks, including attempted cyberattacks on the Dutch Safety Board after it concluded Russia was at fault for the downing of flight MH17 in 2015 and most recently, on the OPCW after it concluded that Russian agents had used the nerve agent Novichok in the United Kingdom in 2018.^{55,56}

A high-profile influence operation took place in 2016 around the Dutch referendum to approve the European Union's Association Agreement with Ukraine, when a group of "Ukrainian immigrants" launched a public campaign (i.e., public meetings, television appearances, etc.) to oppose the agreement. The group worked in collaboration with Harry van Bommel, a former Dutch Socialist party member and foreign affairs spokesperson, but it was later discovered the individuals were Russian and not Ukrainian or from Russian-controlled separatists regions in Eastern Ukraine.⁵⁷ Dutch intelli-

53 The Dutch authorities also do not report the size of the STRs, making it difficult to estimate the impact of money laundering on the overall economy.

54 Caroline de Gruyter, "View from The Hague: An eternal balancing act," European Council on Foreign Relations, October 14, 2016, https://www.ecfr.eu/article/commentary_view_from_the_hague_an_eternal_balancing_act7146.

55 "Hackers target Dutch Safety Board website, may be Russian link," *DutchNews.nl*, October 23, 2015, <https://www.dutchnews.nl/news/2015/10/hackers-target-dutch-safety-board-website-may-be-russian-link/>.

56 "How the Dutch foiled Russian 'cyber-attack' on OPCW," BBC, October 4, 2018, <https://www.bbc.com/news/world-europe-45747472>.

57 Andrew Higgins, "Fake News, Fake Ukrainians: How a Group of Russians Tilted a Dutch Vote," *New York Times*, February 16, 2017, <https://www.nytimes.com/2017/02/16/world/europe/russia-ukraine-fake-news-dutch-vote.html>.

gence officials also warned that foreign countries, including Russia, had tried to hack into government computer systems ahead of the 2017 elections.⁵⁸

In the past few years, the Netherlands has become increasingly aware of its role in large, complex financial flows that are ripe for abuse and transit to offshore centers. The government has announced plans to introduce a withholding tax on interest and royalty outflows to low-tax jurisdictions. It has strengthened oversight and due diligence requirements for trust services and plans to create a public register for ultimate beneficial ownership of all corporations.⁵⁹ These are welcome developments. But the Netherlands' proactive policy approach toward Russia's acts of aggression and violations of international law—the country has itself been on the receiving end of the most deadly and virulent attacks against its citizens and its democratic institutions—is only just a first step, and the economic environment continues to serve Russian financial interests. This dichotomy is difficult to understand. Funds originating from Russia but facilitated by the Dutch financial and CSP sectors could be used to inflict material damage onto Dutch citizens (financing influence campaigns, for example) but also to reduce the revenue available to the state. This is the true paradox of the enabler: in pursuit of economic gains, self-harm awaits.

58 Janene Pieters, "Russia Hacking Dutch Election a Warm-Up for Germany, France Interference: Report," *NL Times*, March 10, 2017, <https://nltimes.nl/2017/03/10/russia-hacking-dutch-election-warm-germany-france-interference-report>.

59 "Nader rapport Wet toezicht trustkantoren 2018," Rijksoverheid, March 16, 2018, <https://www.rijksoverheid.nl/onderwerpen/financiele-sector/documenten/kamerstukken/2018/03/16/nader-rapport-wet-toezicht-trustkantoren-2018>.

Case Study

Czech Republic

Since the fourteenth century, the Czech Republic has been an important intersection between East and West. The country's relationship with Russia dates back to the emergence of the pan-Slavic movement in the mid-nineteenth century, but these ties frayed in the early twentieth century following the collapse of the Russian Empire and Czechoslovakia's independence in 1918. At the end of the Second World War, a Soviet-supported communist coup in 1948 led to Czechoslovakia's incorporation into the COMECON, an economic association of former Communist states, and the Warsaw Pact. The country remained a Soviet satellite until the 1989 Velvet Revolution (despite a brief and tragic period of reform in 1968, the Prague Spring, which was brutally repressed by the Soviet military). Following the fall of the Berlin Wall, the Czech Republic separated peacefully from the Slovak Republic in 1993. The country ultimately joined NATO in 1999 and the European Union in 2004, cementing its Euro-Atlantic orientation.

Yet, despite its almost half-century struggle against communism and aspiration for reform, the Czech Republic remains divided today: the government espouses a pro-Western foreign and security policy, while the country retains an active Communist Party and has elected successive Czech presidents who have been reluctant to embrace Euro-Atlantic institutions and values. This, in turn, has made the Czech Republic a target-rich environment for Russian malign influence. This paradox has shaped Prague's cautious and hesitant regional policy approach, such as its initial reluctance to recognize Kosovo's independence in 2008 (Social Democrats and Communists were firmly opposed to it) or its generally ambivalent position on EU-imposed sanctions against Russia.¹

The Czech Republic's governance standards have not substantially improved since its accession to EU membership, apart from the strengthening of judicial independence and transparency. State capture risks persist, allowing the commingling of oligarchic and political interests in decision-making. Corruption has worsened in recent years, fueled by clientelism, while media freedom has suffered from the concentration of ownership in a few hands and the spread of disinformation. The increasingly fragmented political landscape has enabled the decline in governance standards and encouraged political instability in the country: there have been eight prime ministers since 2005, two of which resigned after financial scandals, two suffered no-confidence votes in

1 Jan Richter, "Czech Government Hesitates to Recognize Kosovo," Radio Praha, February 19, 2008, <https://www.radio.cz/en/section/curaffrs/czech-government-hesitates-to-recognize-kosovo>.

parliament, and only one finished his full four-year term.^{2,3,4,5,6} Governing majorities have grown thinner in recent elections, contributing to this political fragility and limiting the country's ability to tackle tough policy challenges (the most recent election yielded a coalition of 93 seats out of 200, with the tacit support of the Communists' 15 seats creating a narrow total of 108).⁷ Popular disillusionment with politics has given rise to populist and nationalist voices as well as increasing Euroskepticism, providing entry points for Russian malign influence in a country that was at the vanguard of post-Communist democratization and pro-Europeanism in the 1990s.

Though much of the governance failings are internally driven and the public remains generally wary of close ties with Russia, Moscow's presence in the Czech Republic remains visible at the economic and political levels. The country offers a central geographic location, strong regional linkages, and perhaps most importantly for Russian interests, lackluster enforcement of anti-corruption laws.⁸ It provides a lucrative target for Russian malign influence through its public procurement contracts (in energy, transportation, and infrastructure) and a gateway for illicit funds through its banking system and telecommunications. Its nuclear and automotive industries are well integrated into Western technological and value-added chains.

The local level—which has seen several corruption scandals in the past ten years—is an additional potential point of entry for malign economic influence. Because of the decentralized government structure in public funding, the local level is still responsible for many procurement contracts in transportation, infrastructure, and forestry that can be abused. For example, in 2012 the governor of Central Bohemia, David Rath, was arrested on charges of bribery (kickbacks worth millions of Czech crowns) and fraud related to an alleged manipulated tender.⁹ This is particularly worrying as the Supreme

- 2 Luke Harding, "Czech PM resigns after home loan scandal and waning support," *Guardian*, April 10, 2005, <https://www.theguardian.com/world/2005/apr/11/lukeharding>.
- 3 Kilian Kirchgessner, "Czech PM Petr Necas resigns over major corruption scandal," *Deutsche Welle*, June 17, 2013, <https://www.dw.com/en/czech-pm-petr-necas-resigns-over-major-corruption-scandal/a-16887266>.
- 4 Andrew Gardner, "Topolánek toppled: loses vote of no confidence," *Politico*, March 24, 2009, <https://www.politico.eu/article/topolane-toppled-loses-vote-of-no-confidence>.
- 5 "New cabinet under Rusnok loses confidence vote in Czech Republic," *Deutsche Welle*, August 7, 2013, <https://www.dw.com/en/new-cabinet-under-rusnok-loses-confidence-vote-in-czech-republic/a-17004874>.
- 6 Robert Muller and Jason Hovet, "Czech PM quits as party leader but remains head of government," *Reuters*, June 14, 2017, <https://www.reuters.com/article/us-czech-politics/czech-pm-quits-as-party-leader-but-remains-head-of-government-idUSKBN1952LS>.
- 7 Jan Lopatka and Robert Muller, "Czech center-left party approves joining coalition, new government close," *Reuters*, June 14, 2018, <https://www.reuters.com/article/us-czech-politics/czech-centre-left-party-approves-joining-coalition-new-government-close-idUSKBN1JB05C>.
- 8 "Czech Republic Corruption Report," *Business Anti-Corruption Portal*, November 2017, <https://www.business-anti-corruption.com/country-profiles/czech-republic>.
- 9 Jeremy Druker, *Nations in Transit*, Czech Republic (Washington, D.C.: Freedom House, 2013), <https://freedomhouse.org/report/nations-transit/2013/czech-republic>.

Audit Office has no enforcement power and limited oversight competences at the local level, leaving the decentralized procurement structure vulnerable to abuse.

As early as 2005, the country's Security Information Service (intelligence services, BIS) warned that "Russia strives to use economic instruments for influence on the Czech Republic."¹⁰ BIS has noted this influence risk in all its reports since 2005 and observed that the Russian embassy in Prague is abnormally large for the size of the country (implying that there is a large presence of Russian agents under diplomatic cover). In 2014, the U.S. Department of State also warned the Czech Republic was vulnerable to money laundering and its financial institutions were targeted by criminal groups (particularly from former Soviet republics) for laundering purposes.¹¹ This makes the Czech Republic a sort of hybrid model of malign Russian economic influence: halfway between a more typical Central European recipient of such influence and an enabler of influence through its financial, telecommunications, and industrial sectors.

Russia's economic footprint in the Czech Republic has increased since 2006, principally through rising inward stocks of foreign direct investments (from €90 million in 2006 to €718 million in 2016), though these investments remain low at 1.3 percent of total inward FDI stocks. Czech exports to Russia saw a substantial rise before Ukraine-related sanctions went into force, but the country still runs around a €300 million trade deficit due to oil and gas imports from Russia (though this trade balance tilted in Prague's favor in 2016 with a surplus for the first time since 1989). Although Russia's corporate footprint has remained marginal (around 1 percent of the economy), the Czech Republic seems to play an important role in facilitating and transmitting Russian economic influence in Europe.

Out of the 86,000 companies directly owned or controlled by foreigners in the Czech Republic, Russian firms make up the largest share with over 13,000 registered entities (though this number has decreased slightly since 2015). The majority of these companies serve as shell entities with no or only minimal economic activity, and until 2009, some were used as vehicles to purchase real estate.¹² A significant number of companies in the Czech Republic have unclear ownership and many of them are suspected to be under Russian control; estimates from the Bisnode corporate data provider range from hundreds to several thousands of such companies.¹³ As an indicator, only around 100 of the Russian-owned companies operating in the Czech Republic declare over €1 million in annual revenues.¹⁴ Apart from these directly-owned companies, Russian business

10 Security Information Service, *Annual report of the Security Information Service (BIS) for 2005* (Prague, Czech Republic: Security Information Service, 2006), 8.

11 Bureau of International Narcotics and Law Enforcement Affairs, "Countries/Jurisdictions of Primary Concern – Czech Republic," U.S. Department of State, 2014, <https://www.state.gov/j/inl/rls/nrcrpt/2014/supplemental/227766.htm>.

12 "Conditions for foreigners when buying real estate in the Czech Republic," Central Group, <http://www.central-group.cz/page.aspx?page=titul-03&jv=3>.

13 Robert Břešťan, "Ruský byznys v Česku. TOP 10 ruských firem podle tržeb a kapitálu. Kdo vede?," *Hlidacipes.org*, September 14, 2015, <https://hlidacipes.org/rusky-byznys-v-cesku-top-10-rusky-ch-firem-podle-trzeb-a-kapitalu-kdo-vede/>.

14 CSD based on national and international corporate databases.

interests can be represented in other companies in the Czech Republic via proxy owners. Since regulation of the transparency of beneficial owners is weak in the Czech Republic, many large companies, including those significantly involved in public tenders, are not forced to disclose their ownership structure and/or ultimate beneficial owners.¹⁵

As in nearly all the case study countries, Russia's economic presence in the Czech Republic is most visible in the energy sector; around 66 percent of all imports from Russia are made up of oil and gas. In 2016, 55 percent of oil imports and 61 percent of gas imports came from Russia.¹⁶ BIS also warned in 2014 that Russian intelligence services were beginning to focus on power engineering and nuclear power in the Czech Republic as a way to expand their influence in Central Europe.¹⁷ The Czech Republic's two nuclear power plants, Dukovany and Temelin, are operated by the state entity, CEZ. They were built with Soviet technology, and all of their nuclear fuel needs are met by Russia's TVEL.¹⁸ In recent years, the government has looked at options to replace the aging nuclear plants, with the costs of new reactors for Dukovany estimated at 300 to 400 billion Czech koruna (or between €11 and €15 billion)—a potentially lucrative contract.¹⁹ Russia's Rosatom has been actively involved in the tender process for the modernization and expansion of Dukovany, though U.S. and Chinese investors have looked at those prospects as well.²⁰ The government may decide to simply extend the life of the Dukovany reactors to buy time before it makes a decision on this large project.

The government's approach to this procurement has been at odds with Czech president Milos Zeman's, who has publicly advocated for the contract to go to Rosatom along similar (non-competitive) conditions as Hungary's Paks power plant.²¹ Kirill Komarov, one

- 15 Eliška Hradilková Bártová, "Nejvíce v Česku investují firmy s německými majiteli a s vlastníky z daňových rájů. Čína se v žebříčku propadá," *Hlidacipes.org*, July 24, 2017, <https://hlidacipes.org/nejvice-cesku-investuji-firmy-nemeckymi-majiteli-vlastniky-danovych-raj-u-cina-se-ze-bricku-propada/>.
- 16 "Do České republiky proudí nejvíce ropy z Ruska," *Statistikaamy.cz*, November 2016, <http://www.statistikaamy.cz/2016/10/do-ceske-republiky-proudi-nejvice-ropy-z-ruska/>; See also: David Tramba, "Česko snižuje závislost na ruské ropě. U plynu a jaderného paliva to ale neplatí," *Euro.cz*, April 23, 2017, <https://www.euro.cz/byznys/cesko-snizuje-zavislost-na-ruske-rope-u-plynu-a-jaderneho-paliva-to-ale-neplati-1342892>.
- 17 Security Information Service, *Annual report of the Security Information Service (BIS) for 2014* (Prague, Czech Republic: Security Information Service, 2015), 10.
- 18 Jan Žižka, "Na palivo pro Dukovany získali monopol Rusové," *E15.cz*, December 6, 2011, <https://www.e15.cz/byznys/prumysl-a-energetika/na-palivo-pro-dukovany-ziskali-monopol-rusove-723511>.
- 19 James Shotter, "Prague weighs replacement options for nuclear plants," *Financial Times*, November 21, 2018, <https://www.ft.com/content/26cced6c-c8be-11e8-86e6-19f5b7134d1c>.
- 20 Jan Brož, "Jsme ochotni v Česku zafinancovat nové jaderné reaktory, nabízí Rusové," *Idnes.cz*, January 29, 2017, https://ekonomika.idnes.cz/rozhovor-s-kirillem-komarovem-dzk-ekonomika.aspx?c=A170129_140709_ekonomika_ozr; See also: "Ruský Rosatom projevil zájem postavit nový jaderný blok v Česku," *Novinky.cz*, November 1, 2016, <https://www.novinky.cz/ekonomika/419292-rusky-rosatom-projevil-zajem-postavit-novy-jaderny-blok-v-cesku.html>.
- 21 Dalibor Rohac, "Murky Nuclear Business in New Europe," *American Interest*, November 12, 2018, <https://www.the-american-interest.com/2018/11/12/murky-nuclear-business-in-new-europe/>.

of Rosatom's directors and its chief negotiator in the Czech Republic, reiterated that Russia would be the financial guarantor of the contract, providing credit up to the full amount of construction costs. He suggested that a direct intergovernmental contract, reflecting Rosatom's previous experience in Paks, Hungary, would be more effective than a public tender.²²

The banking, engineering, and real estate sectors have also attracted Russian investments, some of which raised concerns within the government as early as 2008.²³ State-owned bank Vneshekonombank (VEB)—under EU and U.S. sanctions since 2014—owns one of the two largest suppliers of heavy vehicle parts in the Czech nuclear energy industry (Pilsen Toll) and rescued another engineering company operating in the Czech Republic, Pilsen Steel, from bankruptcy in 2012.^{24,25} Skoda JS, another large supplier of heavy vehicle parts, is owned by Russia's OMZ Holding. It is currently under U.S. sanctions for attempts to circumvent Ukraine-related sanctions on Russia.²⁶ In 2017, Škoda JS representatives were involved in the corruption investigation of former Ukrainian MP and Prime Minister Arseniy Yatsenyuk's advisor, Mykola Martynenko. Skoda JS's director, Miroslav Fiala, sent 30 million Swiss francs (around €25 million) from the company's bank account to Bradcrest Investment, a consulting company based in Panama, the beneficial owner of which is believed to be Martynenko. While Škoda JS claims that the sum was a consultation fee, Martynenko is under investigation in Ukraine for accepting a bribe and Skoda JS is under investigation in the Czech Republic for tax evasion in connection with the money transfer.^{27,28}

Scientific and technical sectors also provide important EU funds that Russia can tap into through Czech "middlemen," according to the Czech security services.²⁹ While Russian economic presence is not nefarious in and of itself, it seems to be concentrated in lucrative fields that either involve large public tenders (which have been the locus of corruption and bribes in the past) or poorly-regulated fields like real estate.

- 22 Jan Brož, "Tendr na jaderné bloky není efektivní. Je to ale možnost, říká šéf Rosatomu," iDnes.cz, February 4, 2017, https://ekonomika.idnes.cz/kirill-komarov-rosatom-rozhovor-jaderne-reaktory-dostavba-pq0/ekonomika.aspx?c=A170130_2302287_ekonomika_rts.
- 23 Former prime minister Topolánek was worried about Russian investments in the energy and media sectors. "The Czech Republic and A Resurgent Russia," WikiLeaks, September 22, 2008, https://wikileaks.org/plusd/cables/08PRAGUE623_a.html.
- 24 "Company Overview of Pilsen Toll S.R.O.," Bloomberg, <https://www.bloomberg.com/research/stocks/private/snapshot.asp?privcapId=276943948>; Pilsen Toll s.r.o., <http://www.pilsensteel.cz/en/pilsen-toll/>.
- 25 Lucie Sýkorová, "Pilsen Steel? To je nešťastný případ, takový vřed kraje," Neovlivni.cz, March 29, 2016, <https://neovlivni.cz/pilsen-steel-to-je-nestastny-pripad-takovy-vred-kraje/>.
- 26 "Treasury Sanctions Individuals and Entities for Sanctions Evasion and Activities Related to the Conflict in Ukraine," U.S. Department of the Treasury, September 1, 2016, <https://www.treasury.gov/press-center/press-releases/Pages/jl5048.aspx>.
- 27 Aneta Ščotková, "Uplácení Škoda JS ukrajinského politika? Vyšetřování se vleče, brzy má ale nastat průlom," E15.cz, July 30, 2017, <http://zpravy.e15.cz/domaci/udalosti/uplacen-skoda-js-ukrajinskeho-politika-vysetrovani-se-vlece-brzy-ma-ale-nastat-prulom-1335264>.
- 28 Sabina Slonková, "Česká policie řeší korupci v blízkosti ukrajinského premiéra," Neovlivni.cz, January 21, 2016, <http://neovlivni.cz/uplacen-cesko-ruska-firma-na-ukrajine-policie-rozjela-vysetrovani/>.
- 29 Security Information Service, *Annual report 2014*, 11.

Czech intelligence services and journalists have highlighted the risks of Russian-owned companies using Czech banks and shell companies for money-laundering purposes. The Czech Republic was indeed prominently featured in the Russian Laundromat, where 17 of the 21 main shell companies involved in the scheme sent money to Czech bank accounts.³⁰ These accounts appear to function as a pass-through to offshore accounts rather than be the actual recipient of funds. Large commercial lenders like PPF Bank (owned by Petr Kellner, an ally of Czech president Milos Zeman) and Raiffeisenbank reportedly hosted some of the Russian Laundromat accounts used for these transfers.^{31,32} The banks collaborated with Czech financial investigators and did report these transactions as non-standard.³³

Russian-linked banking entities also offer a foothold into the wider European market. Notably, in 2014, the now-defunct First Czech-Russian Bank, owned by Russian businessman Roman Popov, extended a €9 million loan to France's far-right National Front (now called National Rally) after it failed to secure other sources of funding.³⁴ Popov's other bank, the European-Russian Bank (ERB), was the first Russian-owned bank to acquire a banking license in an EU member state after it opened in Prague in 2008. However, the Czech National Bank stripped the ERB of its license in 2016 for poor risk management and the lack of systems to prevent money laundering.³⁵ The bank's resulting insolvency left it owing €120 million to the Czech Deposit Insurance Fund.³⁶ The second largest bank on the Czech market with 100 percent Russian ownership is Expobank CZ, which is owned by Igor Kim, a Russian-Kazakh banker with alleged ties to Vladimir Putin.³⁷ In 2017, Expobank CZ expanded to Serbia, where it acquired Marfin Bank a.d. Beograd.³⁸ In 2017, Expobank reported 25.5 billion Czech korunas in total assets (€980 million), which is about 0.3 percent of all assets held in the Czech banking sector.

30 "Ceska spojka v ruske pracce," Investigace.cz, March 20, 2017, <https://www.investigace.cz/ceska-spojka-v-ruske-pracce/>.

31 "CEE's Top Business Leaders: Central Europe," bne Intellinews, May 12, 2017, <http://www.intellinews.com/cee-s-top-business-leaders-central-europe-121404/>.

32 "Ceska spojka v ruske pracce."

33 Ibid.

34 Damien Sharkov, "France's Front National Accepts €9M Loan from Russian Bank," *Newsweek*, November 25, 2014, <https://www.newsweek.com/frances-front-national-accepts-eu9m-loan-russian-bank-286999>.

35 Jason Hovet and Jan Lopatka, "Russian-owned Czech lender ERB loses banking license," Reuters, October 24, 2016, <https://www.reuters.com/article/us-czech-erb/russian-owned-czech-lender-erb-loses-banking-license-idUSKCN12O114>.

36 Daniel Novak, "Banka ERB skončila v insolvenční. Garančnímu fondu dluží přes tři miliardy," E15.cz, October 30, 2017, <https://www.e15.cz/byznys/finance-a-bankovnictvi/banka-erb-skonci-la-v-insolvenци-garancnimu-fondu-dluzi-pres-tri-miliardy-1339160>.

37 "Igor Kim preparing offer for purchase of Marfin Bank Serbia," Ekapija.com, September 28, 2016, <https://www.ekapija.com/en/news/1556115/igor-kim-preparing-offer-for-purchase-of-marfin-bank-serbia>.

38 "Historie společnosti," Expobank, 2018, <https://www.expobank.cz/domu/o-expobank/#profile>.

In addition to Russian economic activity in the Czech Republic, one must also understand the Czech economic presence in Russia as a potential tool of influence and leverage. An interesting pattern emerges when looking at the reverse flow of the Czech-Russian trading relationship. Before EU sanctions were imposed in 2014, Czech exports to Russia had been rising since 2005 before stagnating to around €4.7 billion in 2012 (primarily automotive parts and data processing systems).³⁹ The Czech business community is active in Russia: a delegation accompanied President Zeman to Russia in 2017 to the Czech-Russian Business Forum, and 19 companies signed contracts worth €750 million with Russian counterparts.⁴⁰ PPF Group, PPF Bank's parent company and the largest Czech investment firm, has been active on the Russian market for twenty years; it owns the consumer finance company Home Credit, which is PPF's highest-priced asset in Russia (€2.8 billion).⁴¹ The group has been officially based in the Netherlands since 2001, and in 2017, the reported value of its assets was €38 billion, about 17 percent of which are located in Russia.⁴²

Czech exports and foreign ventures in Russia present political or commercial risks, which are protected by the Export Guarantee and Insurance Corporation (EGAP), a state-run credit insurance corporation. In 2017, EGAP's highest indemnity payments by far were in Russia after the failure of multiple insured projects, totaling close to €75 million.⁴³ By the end of 2017, Russia remained the country where EGAP has its largest gross outstanding insurance exposure—close to €1.4 billion.⁴⁴ The Czech Export Bank (CEB) and EGAP—together forming the Export Credit Agency (ECA)—have recently come under scrutiny for a string of badly managed projects,⁴⁵ including an unfinished gas-fired power plant in Poljarnaja, Russia, for which the CEB had loaned Czech company PSG around €330 million.⁴⁶ These risky investments, some of which are in collaboration with dubious Russian companies and local oligarchs, weigh on the Czech state's finances while potentially enriching Russian companies and oligarchs and their Czech partners at the expense of Czech taxpayers.

Beyond the economic interest of Czech firms, leading Czech businessmen with economic ties to Russia gravitate around high political circles, particularly Czech presidents.

39 Eurostat.

40 "Czech Presidents' visit to Russia: IIB partakes in a dialogue between businessmen from both countries," International Investment Bank, November 23, 2017, <https://iib.int/en/articles/print/vizit-prezidenta-chehii-v-rossiyu-mib-uchastvuet-v-dialoge-biznesmenov-dvuh-stran>.

41 "Richest Czech pursues new investment venture in Russia," *Aktualne.cz*, May 18, 2011, <https://zpravy.aktualne.cz/richest-czech-pursues-new-investment-venture-in-russia/r-i:article:700692/>.

42 "PPF Group Annual Accounts 2017," PPF Group, <https://www.ppf.eu/cs/financni-vykazy>.

43 Export Guarantee and Insurance Corporation, *Vyrocni zprava Annual Report 2017* (Prague, Czech Republic: Export Guarantee and Insurance Corporation, 2018).

44 Ibid.

45 Dan Heuer, "Lack of transparency hindering Czech export agency," Bankwatch Network, February 15, 2017, <https://bankwatch.org/blog/lack-of-transparency-hindering-czech-export-agency>.

46 Chris Johnstone, "Czech Building Company PSG Withdraws from Major Russian Contract," *Radio Praha*, August 31, 2015, <https://www.radio.cz/en/section/business/czech-building-company-psg-withdraws-from-major-russian-contract>.

PPF owner Peter Kellner has at times praised Vladimir Putin, has donated millions to former Czech president Vaclav Klaus's think-tanks (which are supportive of the Kremlin), and has in the past claimed that U.S. military presence in the Czech Republic would hurt Czech business interests in Russia.^{47,48,49} Martin Nejedlý, who is now an economic advisor to President Zeman and was his campaign financial manager in 2013, is another notable individual close to the presidency. Nejedlý was the founder of a joint-stock investment company, ENE Investment, and later became the general manager for Lukoil Aviation Czech, a subsidiary of Russian energy firm Lukoil, between 2007 and 2016. Nejedlý, who was a car dealer in the 1990s, is believed to have spent years working in Russia during that time.⁵⁰ In 2014, Lukoil Aviation Czech was fined 27 million Czech korunas (€1.03 million) for an emergency kerosene supply procurement that was not properly carried out (the company supplied less fuel than initially agreed).⁵¹ In a positive sign, President Zeman threatened to fire Nejedlý if he did not take care of the issue, which was resolved when Lukoil paid the fine in full in 2016.⁵² Nejedlý today retains his position as a close confidant and adviser to President Zeman, despite the fact that he is not formally on the government payroll.⁵³

Close to Nejedlý is František Koníček, a former member of the Czech Communist Party who also has ties to President Zeman and is an adviser to Prime Minister Andrej Babiš. He was reportedly in the running for minister of trade and industry in the current government, where he would have had influence over some of his own businesses.⁵⁴ Indeed, his company, ICB Prague, has supplied valves for the Dukovany and Temelin nuclear power plants and is part of the Alliance of Czech Energy, which signed a memorandum of cooperation with Rosatom in 2017. The memorandum stated the Alliance was “ready to assist in obtaining export finance for Czech companies to be able to take part in the projects” despite EGAP and ECA incurring losses for similar projects in the past.⁵⁵

47 In 2012, Kellner noted that PPF welcomed Putin's reelection. István Léko, “Kellner o korupci, Klausovi, Ficovi a Putinovi,” *Česká pozice*, April 10, 2012, http://ceskapozice.lidovky.cz/kellner-o-korupci-klausovi-ficovi-a-putinovi-fnr-/tema.aspx?c=A120410_105530_pozice_63317.

48 Christian Falvey, “Kellner Donates Tens of Millions to Vaclav Klaus Institute,” *Radio Praha*, April 10, 2012, <https://www.radio.cz/en/section/news/kellner-donates-tens-of-millions-to-vaclav-klaus-institute>.

49 “The Czech Republic and A Resurgent Russia,” WikiLeaks.

50 Daniel McLaughlin, “Czechs launch anti-propaganda unit with close eye on Russia,” *Irish Times*, January 1, 2017, <https://www.irishtimes.com/news/world/europe/czechs-launch-anti-propaganda-unit-with-close-eye-on-russia-1.2922787>.

51 Jan Kalal, “Zeman navštíví Sobotkovu vládu. Dluhy Nejedlého budou tabu,” *Echo24.cz*, July 15, 2014, <https://echo24.cz/a/wLxGU/zeman-navstivi-sobotkovu-vladu-dluhy-nejedleho-budou-tabu>.

52 Neil MacFarquhar, “How Russians Pay to Play in Other Countries,” *New York Times*, December 30, 2016, <https://www.nytimes.com/2016/12/30/world/europe/czech-republic-russia-milos-zeman.html>.

53 Ibid.

54 Matej Slavík, “Ministrem průmyslu má být muž blízký Hradu. František Koníček v minulosti kandidoval za Zemanovce a seděl v Rusnokově úřednické vládě,” *Hospodarske Noviny*, June 13, 2018, <https://domaci.ihned.cz/c1-66167880-ministrem-prumyslu-ma-byt-muz-blizky-hradu-frantisek-kmonicek-v-minulosti-kandidoval-za-zemanovce-a-sedel-v-rusnokove-urednicke-vlade>.

55 “ROSATOM and Czech Power Industry Alliance Sign Memorandum of Understanding,” Rosatom, June 20, 2017, <http://www.rosatom.ru/en/press-centre/news/rosatom-and-czech-power-indus->

President Zeman has made no secret of his support for positive relations with Moscow and has repeatedly called for an end to sanctions against Russia,⁵⁶ calling the annexation of Crimea a “fait accompli.”⁵⁷ He is a close friend of Vladimir Yakunin, the former head of Russian Railways, who is under U.S. sanctions for his support of Russia’s annexation of Crimea and aggressive behavior in eastern Ukraine.⁵⁸ Former Czech president Vaclav Klaus has voiced similar opinions on Crimea and in 2008 advocated for a tempered reaction to the Russian invasion of Georgia, even going as far as blaming Georgia for the conflict.^{59, 60} President Klaus grew increasingly Euroskeptic during his tenure (2003–2013) and remains an active pro-Russian voice in the Czech Republic.

Some Czech political parties, like the far-right Freedom and Direct Democracy (SPD) party and the Communists (KSCM), pursue pro-Russian, anti-NATO, and Euroskeptic policies. The SPD, formed only in 2015 after splitting from another far-right party, came in fourth place in the 2017 parliamentary elections. Following those elections, SPD obtained the chairmanship of the security committee in the Chamber of Deputies,⁶¹ an influential role that could threaten security cooperation with NATO should SPD misuse information obtained in the committee.⁶² SPD leader Tomio Okamura has ties to the pro-Russian Institute for Slavic Strategic Studies, an organization founded in 2013 that organizes seminars in the Czech Parliament promoting pro-Russian policies and criticizing U.S. and European policies.⁶³

For the first time since 1989, Prime Minister Andrej Babis formed a government that relies on the support of KSCM in parliament, after failing to secure the support of enough deputies from moderate parties. Although no KSCM member has received a ministerial position, they now have the means to exert pressure on government policy. This was already visible during coalition negotiations in June 2018, when the Commu-

try-alliance-sign-memorandum-of-understanding/.

56 Jan Richter, “President Zeman Calls for Lifting of Russia Sanctions at Event Organized by Putin Associate,” Radio Praha, September 29, 2014, <https://www.radio.cz/en/section/curaffrs/president-zeman-calls-for-lifting-of-russia-sanctions-at-event-organized-by-putin-associate>.

57 “Czech President, PM Clash Over Russia Sanctions For Crimea Annexation,” Radio Free Europe/Radio Liberty, October 10, 2017, <https://www.rferl.org/a/czech-president-zeman-crimea-sanctions-russia-sobotka/28785176.html>.

58 Leonid Ragozin, “The Putin adoration society,” Politico, October 11, 2015, <https://www.politico.eu/article/the-putin-adoration-society/>.

59 Gregory Feifer and Brian Whitmore, “The Velvet Surrender,” *New Republic*, September 17, 2010, <https://newrepublic.com/article/77397/russian-aggression-the-velvet-surrender-vladimir-putin-vaclav-klaus-czech-republic>.

60 Ramesh Jaura, “CZECH REPUBLIC: Georgia Sets Off an Old Debate,” Inter Press Service, August 23, 2008, <http://www.ipsnews.net/2008/08/czech-republic-georgia-sets-off-an-old-debate/>.

61 “Radek Koten,” Parliament of the Czech Republic, <http://www.psp.cz/en/sqw/detail.sqw?id=6508&o=8>.

62 “LN: Voices warn against pro-Russia SPD in Czech security body,” *Prague Daily Monitor*, November 2, 2017, <http://praguemonitor.com/2017/11/02/ln-voices-warn-against-pro-russia-spd-czech-security-body>.

63 Petra Vejvodova, Jakub Janda, and Veronika Vichova, *The Russian Connections of Far-Right and Paramilitary Organizations in the Czech Republic* (Budapest, Hungary: Political Capital, 2017), 21–25.

nists and President Zeman opposed the appointment of Miroslav Poche as minister of foreign affairs—and ultimately won, as Poche was seen as too pro-immigration and openly supported President Zeman’s opponent in the 2018 presidential election.⁶⁴ This move has elevated the stature and leverage of KSCM’s Chairman, Vojtech Filip, who has close ties with Moscow and has advocated for a Czech withdrawal from NATO. He visited the Russian Duma in November 2014—months after the invasion of Ukraine—and met with United Russia’s Deputy Secretary Sergei Zheleznyak.⁶⁵ President Zeman has maintained good relations with KSCM; he spoke at both KSCM’s and SPD’s party congresses in 2017 and 2018, the first time since 1990 that a Czech president attended the Communist party’s conference.⁶⁶ Both Tomio Okamura and Vojtech Filip are currently vice-presidents of the Czech Chamber of Deputies.

Russian economic, political, and societal influences in the Czech Republic blend together in the media sector, though Russian investments themselves have remained subdued. Due to lax ownership restrictions on media companies, many media firms are foreign-owned and media consolidation has increased in recent years.⁶⁷ Communist voters and supporters of President Zeman tend to read more pro-Russian media, and Russia has used the internet and other channels of information to support its interests.⁶⁸ The presence and prevalence of pro-Russian Czech-language media have increased since the annexation of Crimea in 2014 and was actively used in 2015, when a U.S. armored convoy was set to drive through the Czech Republic as part of a military exercise.⁶⁹ Ahead of the tour, opposition groups appeared on social media, and pro-Russian outlets like Sputnik reported large protests were being organized against the convoy. KCSM called for protests and distributed signs with anti-U.S. slogans. Ultimately, the size of the protests was dwarfed by the number of supporters who came to cheer on the U.S. military (still fondly remembered for the liberation of Pilzen in the Second World War). However, many of the websites used to rally protesters remain online and continue to publish distinctly pro-Russian articles, as well as push a negative line against Ukraine in particular. Some of the Facebook groups that opposed the convoy still convey anti-U.S.

64 “Miroslav Poche v 10 bodech: Kdo je politik ČSSD, proč ho Zeman a komunisté odmítají a co má za sebou,” Reflex, June 20, 2018, <https://www.reflex.cz/miroslav-poche-cssd>.

65 Dominik Jun, “Czech Parliament Declares Opposition to Vojtech Filip Russia Trip,” Radio Praha, November 6, 2014, <https://www.radio.cz/en/section/curaffrs/czech-parliament-declares-opposition-to-vojtech-filip-russia-trip>.

66 “Babis aims for Czech administration with Communist ‘tolerance,’” bne Intellinews, February 22, 2018, <http://www.intellinews.com/babis-aims-for-czech-administration-with-communist-tolerance-137215/>.

67 Lubomír Kopeček, *Nations in Transit 2016, Czech Republic* (Washington, D.C.: Freedom House, 2016), <https://freedomhouse.org/report/nations-transit/2016/czech-republic>.

68 Pavel Štrunc, “Zeman a Klaus jsou součástí ruské mašinérie, pro Kreml jsme cenní jako Francie, říká analytik Šlerka,” Info.cz, August 16, 2017, <https://video.info.cz/strunc/zeman-a-klaus-jsou-soucast-ruske-masinerie-pro-kreml-jsme-cenni-jako-francie-rika-analytik-slerka-14406.html>; See also: Miriam Faltová, “Ruská propaganda v českých médiích,” Master’s Thesis, Univerzita Karlova, 2017, <https://is.cuni.cz/webapps/zzp/detail/165673/>.

69 *Nations in Transit 2016*, Freedom House.

and anti-NATO opinions.⁷⁰ Questionable civil society organizations have been formed over these topics, some of which helped organize protests and allegedly received funding from Russia.⁷¹

The Czech Republic is both a target of Russian malign economic influence and an emerging enabler due to its geographic centrality and growing economic weight in Europe. Some have gone so far as to suggest that the Czech Republic has “become a hub for Russian operations in broader Central Europe.”⁷² The country’s unstable political environment—a hardened Communist party and far-right elements, weak governing standards, and general public skepticism over the benefits of the European Union—offers fertile soil to grow Russian malign influence. This allows the Kremlin to successfully exploit Czech weaknesses such as its banking sector’s exposure to Russian finance, its connections to individuals who have ties to senior Czech officials, and societal divisions. Fortunately, elements within the Czech government fully recognize their vulnerabilities and are clear-eyed about Russian intentions. In its 2017 annual report, BIS underscored that Russian activities “have continuously focused primarily on influence operations and exploitation of Czech sources” to fulfill the Kremlin’s long-term aim to influence public opinion and turn it against the European Union and NATO.⁷³ Recognition of the problem is the first step, but the Czech Republic must undertake concrete actions to shield itself and its allies from Russia’s malign efforts.

- 70 Daisy Sindelar, “U.S. Convoy: in Czech Republic, Real-Life Supporters Outnumber Virtual Opponents,” Radio Free Europe/Radio Liberty, March 30, 2015, <https://www.rferl.org/a/us-convoy-czech-republic-supporters-virtual-opponents/26928346.html>.
- 71 Vit Novotny et al., *The Bear in Sheep’s Clothing: Russia’s Government-Funded Organisations in the EU*, (Brussels, Belgium: Wilfried Martens Centre for European Studies, 2016), 23.
- 72 Daniela Lazarova, “Political Scientist: Prague Has Become a Hub for Russian Operations in Broader Central Europe,” Radio Praha, March 19, 2018, <https://www.radio.cz/en/section/curraffrs/political-scientist-prague-has-become-a-hub-for-russian-operations-in-broader-central-europe>.
- 73 Brian Kenety, “Analyst: Czech Intelligence Report Notable for Direct Accusations Against Russian, Chinese Actors,” Radio Praha, April 12, 2018, <https://www.radio.cz/en/section/curraffrs/analyst-czech-intelligence-report-notable-for-direct-accusations-against-russian-chinese-actors>.

Case Study

Montenegro

Of the six case study countries assessed in this report, Montenegro is the most visible and recent victim of high-risk, high-profile Russian malign influence. The Western Balkans country, with its strategic coastline on the Adriatic Sea, was the stage of an attempted coup—allegedly backed by Russian intelligence and Serbian operatives—on the eve of elections in October 2016 and ahead of its NATO accession.¹ Montenegro’s long-standing relationship with Russia dates back to the nineteenth century when the Russian Empire presented itself as the defender of the people of Montenegro from the Ottoman Empire. Ties frayed between the Soviet Union and Communist Yugoslavia (of which Montenegro was a constituent republic) at the beginning of the Cold War when Yugoslavia refused to accept the Soviet Union’s supreme authority over all communist nations. Despite improved relations after Stalin’s death in 1953, Yugoslavia kept its distance and retained an independent foreign policy from the USSR. After the breakup of Yugoslavia in 1992, Serbia and Montenegro formed the Federal Republic of Yugoslavia until Montenegro’s independence vote in 2006.²

Throughout this turbulent history, the political and cultural forces of pan-Slavism along with a common Christian orthodox faith have united Russian and Balkan communities, serving the Kremlin’s interest in its posturing as the historical defender of all Slavic peoples. Ethnic Serbs in Montenegro, who represent close to 30 percent of the population, remain inspired by the mythological vision of a Greater Serbia that would unite all ethnic Serbs under Russia’s protection.³ Russia also has a larger economic footprint in Montenegro than all other Central and Eastern European case study countries. Montenegro’s NATO accession—and its broader pursuit of Euro-Atlantic integration—severs that historical narrative and instead gives Slavic peoples freedom to join the West, thwarting Moscow’s ambitions in the region and prompting its rebuke.⁴

Yet, despite becoming a member of NATO in 2016 and being on a rapid path toward EU accession since 2010, Montenegro’s overall democracy score and the inde-

- 1 Dusica Tomovic, “Investigation Uncovers Second Russian Montenegro Coup Suspect,” *Balkan Insight*, November 22, 2018, <http://www.balkaninsight.com/en/article/media-investigation-identifies-montenegro-coup-suspect-11-22-2018>.
- 2 Reuf Bajrovic, Vesko Garcevic, and Richard Kraemer, “Hanging by a Thread: Russia’s Strategy of Destabilization in Montenegro,” *Foreign Policy Research Institute*, July 3, 2018, <https://www.fpri.org/article/2018/07/hanging-by-a-thread-russias-strategy-of-destabilization-in-montenegro/>.
- 3 “Census 2011 data – Montenegro,” *MONSTAT*, <http://www.monstat.org/eng/page.php?id=393&pageid=57>.
- 4 Dusica Tomovic, “Serbian Church Urges Montenegro NATO Referendum,” *Balkan Insight*, January 5, 2016, <http://www.balkaninsight.com/en/article/serbian-church-urges-montenegro-to-hold-referendum-on-nato-01-04-2016>; See also: “Rogozin: Crna Gora će zažaliti zbog odluke da pristupi u NATO,” *Vijesti*, January 12, 2016, <http://www.vijesti.me/vijesti/rogozin-crna-gora-ce-zazali-ti-zbog-odluke-da-pristupi-u-nato-869751> (cache-based source).

pendence of its media have worsened since its independence in 2006.⁵ Anti-corruption efforts have stagnated in the past 10 years.⁶ Although there have been some cases of successful prosecution of corruption and non-transparent acquisitions, Montenegro ranks lower than Romania in Transparency International's Corruption Perception Index,⁷ and its governance standards have barely improved in the past decade.⁸ Investigative resources are insufficient and institutions are weak.⁹ For example, the Parliament voted in July 2018 to dismiss a member of the council that oversees the anti-corruption agency on allegations of conflict of interest, but the member leads an anti-corruption NGO that has reported on activities of political figures.¹⁰

Newer programs also affect the financial and national security of the country: in 2018, Montenegro officially launched its "Citizenship by Investment" program, which will allow foreigners making an investment of at least €500,000 to obtain citizenship for themselves and their family (similar to programs in EU member states Cyprus and Hungary).¹¹ The European Union has recently voiced concerns over this type of so-called golden visa scheme, as it allows potentially malign-intentioned investors or illicit actors to "Europeanize" their investments, hide assets, or launder money through the investment.¹² The high level of Russian investments in Montenegro is likely to produce an inflow of passport seekers, putting additional strains on the weak Montenegrin security system.

Montenegro's political scene is ruled by a small circle of actors who have been in power for decades. The Democratic Party of Socialists of Montenegro has been in power since before independence, with its leader Milo Dukanovic assuming either the presidency or premiership of Montenegro for 28 years despite his support for Montenegro's Euro-Atlantic orientation.¹³ This concentration and his prolonged hold on power led to

- 5 Bojan Baća and Kenneth Morrison, *Nations in Transit 2018, Montenegro – Country Profile* (Washington, D.C.: Freedom House, 2018), <https://freedomhouse.org/report/nations-transit/2018/montenegro>.
- 6 Ibid.
- 7 "Montenegro," Transparency International, <https://www.transparency.org/country/MNE>.
- 8 Baća and Morrison, *Nations in Transit*.
- 9 Southeast European for Development and Integrity, *Shadow Power: Assessment of Corruption and Hidden Economy in Southeast Europe* (Sofia, Bulgaria: Southeast European for Development and Integrity, 2016), <http://seldi.net/publications/publications/shadow-power-assessment-of-corruption-and-hidden-economy-in-southeast-europe/>.
- 10 "Montenegro's parliament dismisses anti-corruption leader," bne Intellinews, July 8, 2018, <http://www.intellinews.com/montenegro-s-parliament-dismisses-anti-corruption-leader-144793/>.
- 11 "Montenegro to Launch New Citizenship-by-Investment Program in October," Business Wire, July 27, 2018, <https://www.businesswire.com/news/home/20180727005120/en/Montenegro-Launch-New-Citizenship-by-Investment-Program-October>.
- 12 Michael Peel and Mehreen Khan, "EU states warned over billions banked through 'golden visa' schemes," *Financial Times*, October 10, 2018, <https://www.ft.com/content/3084f63a-cc5e-11e8-b276-b9069bde0956>.
- 13 Alan Crosby, "Montenegro's Djukanovic Declares Victory In Presidential Election," Radio Free Europe/Radio Liberty, April 16, 2018, <https://www.rferl.org/a/djukanovic-looks-to-extend-dominance-in-montenegro-s-presidential-vote/29167866.html>.

Mr. Dukanovic being nominated as the Organized Crime and Corruption Reporting Project's (OCCRP) Person of the Year in 2015 "for his work in creating an oppressive political atmosphere and an economy choked by corruption and money laundering."¹⁴ The OCCRP Person of the Year for the prior year was Vladimir Putin.

Beyond its longstanding cultural and historical links with Russia, Montenegro has the highest percentage of Russian foreign direct investments (FDI) and the smallest economy among the report's case study countries, with a GDP of \$4.77 billion in 2017 and a population of little over 622,000. In 2016, Russian FDI represented just over 30 percent of Montenegrin GDP and 13 percent of all inward FDI, and Russia was the largest single investor in the country. Following Montenegro's declaration of independence in 2006, Moscow's corporate footprint (the share of Russian-controlled companies' revenues out of the total turnover in the economy) decreased dramatically from 29 percent in 2006 to 5.5 percent in 2015 due to the pull-out of Oleg Deripaska from the country's largest company, the Podgorica Aluminum Plant (KAP).

But investments originating from Russia have increased since 2006, with the amount never dropping below 10 percent of total FDI. Russian investments in the services sector, principally tourism, have grown substantially. Moreover, Russian companies continue to benefit from a tax structure that allows foreign companies to repatriate profits and dividends without restrictions. In 2016, 32 percent of foreign companies in Montenegro were owned by Russian nationals.¹⁵ Russian investors also participated in non-transparent privatizations of state-owned enterprises in the mid-2000s (after independence), principally in the aluminum and tourism sectors (hotel acquisitions). The state provided important subsidies for these privatizations but sometimes failed to enforce the conditions laid out in privatization and investment agreements (some of which were never fulfilled), potentially allowing Russian investors to pocket the state subsidy.¹⁶

The most visible and consequential Russian acquisition was in the metal industry when Russian businessman Oleg Deripaska's Central European Aluminum Company (CEAC) acquired the KAP in 2005. The agreement required Deripaska's company to repay the plant's legacy debt (tens of millions of euros) and it would receive preferential terms for electricity prices until 2010. At the time, KAP was Montenegro's largest firm, accounting for 15 percent of its GDP and employing over 2,000 people. As the preferential deal for electricity supply was coming to an end, Deripaska tried and failed to extend the agreement. He then attempted to buy the thermal power plant that was supplying KAP, thus controlling the entire power supply chain to reduce energy cost. This acquisition was blocked by Parliament in 2007 after both ruling and opposition MPs objected, un-

14 "2015 Man of the Year in Organized Crime, Milo Djukanovic," Organized Crime and Corruption Reporting Project, 2015, <https://www.occrp.org/personoftheyear/2015/>.

15 Dusica Tomovic, "Russians Dominate Foreign Ownership of Montenegrin Companies," Balkan Insight, August 17, 2016, <http://www.balkaninsight.com/en/article/russians-own-every-third-company-in-montenegro-report-08-17-2016>.

16 Center for the Study of Democracy, *Russian Economic Footprint in the Western Balkans. Corruption and State Capture Risks* (Sofia, Bulgaria: Center for the Study of Democracy, 2018).

derstanding the risk it entailed for the independence of strategic resources and hence the country itself.¹⁷

The 2008 economic crisis deeply affected the global aluminum business, and in 2010 Montenegro reclaimed a part of KAP with certain conditions. It still provided the plant with state loan guarantees amounting to €135 million as well as debt forgiveness.¹⁸ Despite this intervention, and due to huge financial losses, KAP was unable to honor its debts to creditors and initiated a bankruptcy procedure in 2013. Deripaska's CEAC then initiated arbitration against Montenegro, demanding compensation for hundreds of millions of euros (compared to a GDP of €4.2 billion in 2014).¹⁹ CEAC has lost two arbitration cases but has opened a third case in Cyprus. In the meantime, KAP was sold to Montenegrin metal company Uniprom for €28 million.²⁰ But the human, financial and strategic impacts are significant: the plant has lost three-quarters of its employees since privatization, and the lawsuit could bankrupt the government. This exposes the dangers of dubious acquisitions that siphon off state resources in subsidies without sufficient investments, and the failure of the state to protect strategic sectors from becoming dependent on a sole investor.

Unlike other countries in the region, Montenegro's energy sector is not the locus of Russian investments, which are limited to the fuel distribution market. The most visible Russian investment in energy has been Lukoil's acquisition of Roksped, a fuel distribution company, in 2008 for €26.5 million.²¹ Prior to this, Lukoil Montenegro (a subsidiary) had invested around €56 million in the country.²² The Russian private company Novatek and Italy's ENI formed a joint venture that in 2016 received a 30-year exploration concession for Montenegro's exclusive economic zone in the Adriatic Sea.²³ The Italian-Russian energy consortium began seismic explorations studies in November 2018.

The focus of new Russian investments in Montenegro has been in real estate and tourism, where Russia holds leverage over local revenue sources. The state has received nearly €25 million in sales taxes since 2006 from the real estate sector, with an estimated 70,000

17 "DPS izgubio bitku ali se ne predaje," *ND Vijesti*, June 13, 2007.

18 Kenneth Rapoza, "This Crazy Country Is Picking A Fight With A Billionaire Worth 80% Of Its GDP," *Forbes*, November 29, 2015, <https://www.forbes.com/sites/kenrapoza/2015/11/29/this-country-picking-fight-with-a-russian-billionaire-who-is-worth-80-of-its-gdp/#6181f34574c8>.

19 Dusica Tomovic, "Russian Tycoon Sues Montenegro Over Aluminum Plant," *Balkan Insight*, November 15, 2016, <http://www.balkaninsight.com/en/article/russian-tycoon-sues-montenegro-over-aluminum-plant-loses-11-15-2016>.

20 Dusica Tomovic, "Montenegro Sells Bankrupt Aluminum Plant," *Balkan Insight*, June 11, 2014, <https://balkaninsight.com/2014/06/11/montenegro-s-bankrupt-aluminium-plant-sold-to-a-local-company/>.

21 "Russians Buy Montenegro Petrol Stations," *Balkan Insight*, April 2, 2008, <http://www.balkaninsight.com/en/article/russians-buy-montenegro-petrol-stations>.

22 "Lukoil is targeting 15 % fuel market share – Montenegro," *Balkan Energy*, October 31, 2016, <http://balkanenergy.com/lukoil-is-targeting-15-fuel-market-share-montenegro-31-october-2016>.

23 Jessica Resnick-Ault, "Oil dips despite steep draw in U.S. crude stocks," *Reuters*, August 16, 2016, <https://www.reuters.com/article/us-montenegro-oil-contract-idUSKCN11K2DS>.

properties belonging to Russian owners—compared to an estimated 7,000 permanent residents from Russia in Montenegro (though this number differs depending on the source).²⁴ Post-independence privatizations also concentrated on the real estate sector, with Russian businessmen acquiring valuable hotels in attractive locations at only a fraction of their market value. In several cases, as with industrial plants, the privatization agreements were not fully implemented and there was little action by the state to hold the owners accountable. Some of the most valuable hotels were acquired through shell companies.²⁵

In other cases, valuable state-owned lands were initially sold for below market price, only to resurface in a later sale at much higher prices, costing the government millions in lost revenue.²⁶ In one case, an old military complex was sold for €2.35 million, while the land was later resold for €41.7 million; this deal involved Russian-owned companies registered in Montenegro and offshore-registered companies belonging to Montenegrin businessmen.²⁷ It should be noted that the real estate sector has seen some successful prosecution of corruption cases, leading to the criminal conviction of public officials for abuse of office and damage to the budget.²⁸

Tourism has grown in recent years to represent 20 percent of Montenegro's GDP and 54 percent of exports of goods and services.²⁹ The number of Russian tourists has significantly increased since 2006, growing five-fold to reach 316,000 visits in 2016. An estimate based on nightly accommodation prices shows Russian tourists spent around €225 million on accommodation in 2016, or 5 percent of GDP.³⁰ Given that Russians represent the largest group of tourists visiting Montenegro and tourism makes up one-fifth of the Montenegrin economy, this is a sector of great leverage for Moscow. Since 2014, Russian-Montenegrin relations have soured due to Montenegro's adoption of Western sanctions against Russia and its NATO accession; this prompted the Kremlin to discourage its citizens to travel to Montenegro. In 2017, it launched a negative media campaign that described Montenegro as dangerous, and portrayed the country as having rising

24 "Nesterenko: U Crnoj Gori živi do sedam hiljada Rusa," *Vijesti.me*, January 27, 2014, <http://www.vijesti.me/vijesti/nesterenko-u-crnoj-gori-zivi-do-sedam-hiljada-rusa-174290> (cache-based source).

25 Center for the Study of Democracy, *Assessing Russia's Economic Footprint in Montenegro* (Sofia, Bulgaria: Center for the Study of Democracy, 2018).

26 "Prodajom Skočidevojke država oštećena za desetine miliona," *Vijesti.me*, July 7, 2012, <http://www.vijesti.me/ekonomija/prodajom-skocidjevojke-drzava-ostecena-za-desetine-miliona-82917> (cache-based source).

27 Ibid. In this particular deal, companies registered in Cyprus were involved and after the last buyer failed to pay back the loan used to purchase the property, it was ultimately purchased by none other than Meinh Bank AG.

28 "Zavala: Cape Corruption," Organized Crime and Corruption Reporting Project, June 11, 2012, <https://www.reportingproject.net/firstbank/en/zavala-cape-corruption>.

29 "Predrag JELUŠIĆ: Turizam daje petinu BDP-a i čini više od polovine izvoza Crne Gore," *Portal Analitika*, September 27, 2015, <http://www.portalanalitika.me/clanak/203071/predrag-jelusic-turizam-daje-petinu-bdp-a-i-cini-vise-od-polovine-izvoza-crne-gore>.

30 The estimate is based on the average revenue per room rate. See *Horwath Hotel Industry Survey Montenegro 2014*, Horwath Consulting Zagreb (Zagreb, 2014).

crime rates and filthy beaches.³¹ The number of tourists from Russia decreased by 62 percent year-on-year.³² The increasing importance of tourism for Montenegro's economy allowed the Kremlin to weaponize misinformation and affect tourism flows, thus crippling Montenegro's economy.

The Kremlin also retains cultural and societal leverage through the Orthodox Church. A large majority of Montenegrins are Christian Orthodox, and the country's religious authorities (the Metropolitanate of Montenegro and the Littoral) are still ecumenically attached to the Serbian Orthodox Church. There is a Montenegrin Orthodox Church that has declared autocephaly (similar to the Ukrainian Orthodox Church), but it has not been recognized by Eastern Orthodox Churches.³³ The Kremlin effectively uses the Orthodox Church to voice its opposition to Montenegro's foreign policy decisions. For example, in 2016 Patriarch Kirill of the Russian Orthodox Church publicly voiced concern over the country's NATO accession.³⁴ Many ethnic Serbs in Montenegro remain staunchly Orthodox and thus a resource to exploit in support of the Kremlin's interests through pan-Slavic, pan-Orthodox appeals. The Serbian patriarch has also served as a conduit for Russian influence in Montenegro; for example, on one of his recent visits to Montenegro, he was escorted by the infamous pro-Putin bikers' club Night Wolves.³⁵

Russia's focus on Montenegro aimed to prevent the loss of the last section of Adriatic coastline not held by NATO—to no avail as Montenegro ultimately joined the alliance. Montenegro had already declined Russia's request in 2013 to use its deep-water ports of Bar and Kotor for the temporary moorage of warships (giving the fleet easy access to the Eastern Mediterranean).³⁶ The Russian government, through the voice of then-deputy prime minister Dmitry Rogozin, went as far as to say Montenegro would

- 31 "Криминал, минные поля и столбняк: почему Черногория становится опасной для туристов," TV Zvezda, March 25, 2017, https://tvzvezda.ru/news/vstrane_i_mire/content/201703251100-mpeq.htm; See also: "Альянс наготове: Черногория в одном шаге от вступления в НАТО," TV Russia1, March 28, 2017, <http://www.vesti.ru/doc.html?id=2871302>; See also: "Захарова: МИД РФ рекомендует россиянам дважды подумать, прежде чем ехать в Черногорию," Tass.ru, May 29, 2017, <http://tass.ru/politika/4291514>.
- 32 "Tourist numbers up in Montenegro but Russians stay away," bne Intellinews, July 31, 2017, <http://www.intellinews.com/tourist-numbers-up-in-montenegro-but-russians-stay-away-126383/>.
- 33 "Politicko Javno Mnjenje Crne Gore," CEDEM, October 2009, https://web.archive.org/web/20110722171733/http://www.cedem.me/fajlovi/editor_fajlovi/istrazivanja/CEDEM_okto-bar09.pdf.
- 34 Dusica Tomovic, "Serbian Church Urges Montenegro NATO Referendum," Balkan Insight, January 5, 2016, <http://www.balkaninsight.com/en/article/serbian-church-urges-montenegro-to-hold-referendum-on-nato-01-04-2016>.
- 35 Filip Rudic and Dusica Tomovic, "Montenegro Detains Pro-Putin Bikers Escorting Serbian Patriarch," Balkan Insight, October 16, 2018, <http://www.balkaninsight.com/en/article/montenegro-detains-pro-putin-bikers-escorting-serbian-patriarch-10-16-2018>.
- 36 "Montenegro refuses Russian request to use port of Bar for military purposes," *MediTelegraph*, December 20, 2013, <http://www.themeditelegraph.com/en/transport/ports/2013/12/20/montenegro-refuses-russian-request-use-port-bar-for-military-purposes-VoWWwhslw6MuujizwzMj3K/index.html>.

come to regret its decision to join the alliance.³⁷ And the Kremlin tried to make sure Montenegro would do just that—by reportedly helping foment a coup before NATO members ratified Montenegro’s membership.

The day before the parliamentary elections of October 16, 2016, Podgorica police arrested a former Serbian gendarmerie commander and 19 other individuals based on the suspicion (and inside information they had received) that they were planning to overthrow the government and murder the prime minister. Serbian nationals were involved, as well as, according to Montenegrin officials, FSB and GRU operatives.³⁸ The plan was for the individuals to don stolen Montenegrin police uniforms to occupy the parliament on the night of the election, during which the opposition party Democratic Front (DF), a coalition of ethnic Serb and pro-Russian parties, would declare victory and mobilize its voters to storm the parliament. The disguised individuals would fire on the protesters to make it appear that Montenegrin police were trying to prevent the (fictitious) victory of DF, hoping it would trigger violence and chaos across the country. At the same time, there was a plan to assassinate then-prime minister Dukanovic.³⁹ The plan was only thwarted thanks to a former police officer who confessed to the scheme just days before its planned implementation. A few days later, Serbian Prime Minister Vucic confirmed law enforcement had arrested people in connection to the attempted coup, providing support to the theory that third country individuals were involved.⁴⁰ Notably, the Serbian Orthodox Church reportedly hosted a meeting of the instigators of the failed coup in a monastery in 2016 before the elections.⁴¹

Prosecution for the attempted coup is ongoing. An indictment in the case has charged 14 individuals, including two Russian nationals.⁴² The Kremlin has denied any involvement in the coup attempt,⁴³ as have DF party officials and extremist Serb nationalist groups, some members of which have fought in eastern Ukraine.⁴⁴ DF officials are also under investigation in a case of money-laundering concerning the 2016 campaign: the party allegedly used funds of criminal origin wired from Russia through offshore

37 “Rogozin: Crna Gora će zažaliti zbog odluke da pristupi u NATO,” *Vijesti*.

38 Bajrovic et al., “Hanging by a Thread.”

39 Damir Marusic, “Did Russia Botch a Coup in Montenegro?” *American Interest*, October 30, 2016, <https://www.the-american-interest.com/2016/10/30/did-moscow-botch-a-coup-in-montenegro/>.

40 Milivoje Pantovic, “Vucic: Serbia Arrests People Involved in ‘Illegal Acts’ in Montenegro,” *Balkan Insight*, October 25, 2016, <http://www.balkaninsight.com/en/article/serbian-pm-failed-to-explain-coup-in-montenegro-10-24-2016>.

41 Bajrovic et al., “Hanging by a Thread.”

42 Tomovic, “Investigation Uncovers Second Russian.”

43 Maria Tsvetkova and Vladimir Soldatkin, “Kremlin denies involvement in alleged plot against Montenegro’s PM,” *Reuters*, November 7, 2016, <https://www.reuters.com/article/us-russia-montenegro-election-idUSKBN132170>.

44 “I am a Serb nationalist, they told me that the authorities in Montenegro should be taken down,” *Telegraf*, October 26, 2017, <http://www.telegraf.rs/english/2906860-i-am-a-serb-nationalist-they-told-me-that-the-authorities-in-montenegro-should-be-taken-down-sindjelic-spoke-at-the-trial-of-the-terrorist-attempt-on-the-election-day>.

accounts which ultimately ended up in the party's coffers after an elaborate scheme through small individual donations.⁴⁵

Montenegro is a classic example of the unvirtuous circle of Russian malign influence. Especially in a very small economy, Russia can concentrate its economic influence in the sectors that have the most influence over the country, and those that are the most important source of economic growth (e.g., tourism). If the Kremlin cannot alter the country's policy orientation through economic means, it can use cultural tools and influence networks from both within (a sympathetic ethnic Serbian population) and outside Montenegro (intelligence and criminal networks in the region) to bring about change to the country's orientation or to fray ties in the transatlantic community. This is exactly the risk to which the leaders of Central and Eastern Europe so presciently alerted the U.S. government a decade ago, and it nearly came to pass in Montenegro.

45 "Money laundering probe into Montenegro's pro-Russian Democratic Front extended," bne IntelliNews, August 31, 2017, <http://www.intellinews.com/money-laundering-probe-into-montenegro-s-pro-russian-democratic-front-extended-128143/>.

Case Study

Romania

Ever since its independence in 1878, Romania has been at political odds with Russia. Divisions deepened in 1940 when Moldova, then part of Romania, became a Soviet republic. During the Cold War, Romania's communist path diverged from Moscow's under the leadership of authoritarian ruler Nicolae Ceausescu (in power from 1965 to 1989), who emphasized national production and self-sufficiency to limit Romania's reliance on Soviet industries. And though both countries are majority Orthodox, they have a different language and they respond to different Patriarchates (Constantinople for Romania and Moscow for Russia), limiting Russia's cultural reach into Romania. For these reasons, Romania's cultural and historical ties to Russia are much less developed than its Central and Eastern European Slavic counterparts. It is less economically dependent on Moscow and is the third most energy independent country in the European Union. Romania also asserts its independence against the Kremlin's foreign and security policy agenda more prominently: it has been a strong proponent of sanctions against Russia since 2014, hosts part of NATO's ballistic missile defense system, and is home to a U.S. forward operating air base strategically located on the Black Sea, Mihail Kogalniceanu, which hosts on average between 500 and 700 U.S. troops.

Despite these longstanding differences, which have hampered unfettered Russian influence in the country, some economic and cultural connections have remained and others been made in recent decades through economic activity and the Orthodox Church. Romania's weak institutions and rampant domestic corruption remain key weaknesses, providing opportunities for Russian companies to exploit local vested interests, particularly those related to privatizations and acquisitions. Indeed, of all the *Kremlin Playbook* (1 and 2) case study countries, Romania's corruption score rivals only that of Serbia, Montenegro, and Bulgaria. Even after joining NATO in 2004 and the European Union in 2007, Romania has continued to be plagued by high levels of corruption and limited reform to its judicial system. At the time, the European Union created a verification mechanism to oversee the government's efforts to improve its governance and rule of law and has maintained it to this day, judging progress to be insufficient.¹

Governance standards and corruption in Romania gradually improved after the country's accession to the European Union in 2007 until 2016, during which more than a thousand high- and mid-level politicians and businessmen (including a former prime minister) have been indicted on corruption charges. In 2015, the whole government resigned under pressure from large public demonstrations following a deadly nightclub

1 The Cooperation and Verification Mechanism was created to help Bulgaria and Romania bring their rule of law systems up to the EU standards, as these were deemed insufficient at the time of the two countries' accession to the European Union in 2007. As of February 2019, it has still not been lifted.

fire and accusations of corruption. Since then, these improvements have ground to a halt despite the work of Romania's National Anticorruption Directorate (DNA), which has pursued high-profile corruption cases. The DNA has been a critical element in stemming systemic corruption in the country and has weathered frequent attempts to impede its investigative and prosecutorial work by the ruling Social Democratic Party (PSD, a frequent subject of the Directorate's investigations). However, the government managed to dismiss the DNA's chief prosecutor in 2018 after two years of political and legal disputes.² Following national trends, local democratic governance has also worsened since 2016.³

Over the past twenty years, the close interaction between state-owned enterprises and politicians that reinforces corruption in Romania has produced a number of non-transparent procedures that can open the door to unintended interferences. One of the prime examples has been the privatization of Rompetrol. The deal was followed by a controversial debt cancellation (of more than \$600 million) that was viewed by the press and experts in Romania as a favor to Romanian businessman Dinu Patriciu, and the company that took over Rompetrol after Patriciu also benefited from favorable takeover conditions that experts believe did not match the economic needs of the state.⁴ The poor health of Romanian institutions overseeing mergers and acquisitions or privatization deals also allows Russian investments to enter Romania at low cost and offer preferential treatment for local companies and Russian conglomerates like Gazprom. And though some Russian investments in Romania were not always successful—in part because of inexorable industrial decline—Russian individuals and firms have successfully penetrated certain important sectors of the economy.

Over the past decade, bilateral trade between Romania and Russia has been muted at below 2 percent of total Romanian foreign trade, though important Russian investments have been made in such strategic sectors as mining and metallurgy. Russia is Romania's 11th largest trading partner, with exports to Russia rising until 2014, and Russia's corporate footprint in Romania in 2016 was 1.5 percent of Romanian GDP. But while official data shows inward FDI stocks into Romania from Russia reached only €139 million in 2016, or 0.2 percent of total inward FDI stocks, the real figures are likely higher if Russian subsidiaries registered outside Russia are included (over 82 percent of the turnover of companies with Russian ultimate beneficial ownership in Romania is made through companies registered in the Netherlands).⁵ For example, Lukoil's fuel distribu-

2 Radu-Sorin Marinas, "Romania's president removes chief anti-corruption prosecutor," Reuters, July 9, 2018, <https://uk.reuters.com/article/uk-romania-corruption/romanias-president-signs-decree-to-remove-chief-anti-corruption-idUKKBN1JZ0MK>.

3 Laura Ștefan, Sorin Ioniță, and Septimius Pârnu, Nations in Transit 2018, *Romania – Country Profile* (Washington, D.C.: Freedom House, 2018), <https://freedomhouse.org/report/nations-transit/2018/romania>.

4 Claudia Pirvoiu, "Cum a renunțat Guvernul, de doua ori, la datoria Rompetrol de 600 de milioane de dolari, in schimbul unor promisiuni," Hotnews, May 10, 2016, <https://economie.hotnews.ro/stiri-companii-20987882-cum-renunatat-guvernul-doua-ori-datoria-rompetrol-600-milioane-dolari-schimbul-unor-promisiuni.htm>.

5 CSD calculations based on data from Corporate Registers and Databases.

tion business accounted for €2 billion out of the total of €3.5 billion in revenues in 2016 for all Russian companies registered in Romania.⁶ This small footprint hides a few large Russian industries that also account for concentrated pockets of local employment, creating dependencies at the local level.

The focus of Russian economic activity in Romania has been largely limited to the energy and metallurgy sectors. In some cases, fruitful investments have been determined by a long-term regional strategy: for example, in its initial investment in 1998, Lukoil acquired Romanian energy company Petrotel, which today accounts for around 20 percent of Romania's total refining capacity (this was coupled with, among others, the acquisition of the second-largest retail fuel supply chain in Serbia). Other acquisitions were less successful and more opportunistic, focused on Romanian plants that struggled to achieve profitability (sometimes burdened with previously-accumulated debt) or later succumbed to the 2008 global financial crisis. These acquisitions sometimes failed to produce returns on investment, leading to bankruptcies and plant closures. Such was the case of Russia's Mechel acquisition of steel plants in Romania, which later left the state incapable of recovering outstanding arrears.⁷ In 2005, Russian businessman Vitaly Mashitsky's Vimetco, an aluminum producer registered in the Netherlands, acquired 84 percent of ALRO Slatina, Romania's largest aluminum producer. The same year, it acquired another aluminum company, Alum Tulcea, and consolidated its quasi-monopoly status on the domestic market. ALRO is also one of the largest heat and gas consumers in the country, accounting for about 6 percent of Romania's total energy consumption in 2016.

In 2012, Lukoil obtained a concession on two extraction blocs in the Black Sea in a joint bid with Vanco International LTD (although Romgaz subsequently bought a 10 percent stake in the blocs). The oil giant has run into legal issues with its subsidiary in Romania; it was investigated for a transfer pricing and tax evasion scheme through Petrotel Lukoil, a case in which the prosecution went after €1.7 billion in asset seizure. The case was dismissed for lack of evidence (and poor prosecution) but part of the file was resubmitted, concerning a much smaller prejudice of €1.7 million, and is still ongoing.⁸

The Romanian gas sector has provided important economic rewards for Russia's economic giant Gazprom. Prior to 2013, it had a virtual monopoly on Romanian gas imports, representing between 20 and 30 percent of the total market (domestic suppliers Romgaz and Petrom accounted for the other 70 to 80 percent). Gazprom benefitted from its long-term contracts with intermediaries Conef Gaz and WIEE, the latter of which became a Gazprom subsidiary after asset swaps in 2015, and both of which signed 23-

6 Ibid.

7 "România furată. Cazul Mechel – cum au ajuns rușii să controleze mare parte din siderurgia românească," Digi24, January 6, 2015, <https://www.digi24.ro/special/campanii-digi24/romania-furata/romania-furata-cazul-mechel-cum-au-ajuns-rusii-sa-controleze-mare-parte-din-siderurgia-romaneasca-343777>.

8 "Petrotel Lukoil nu mai este anchetată pentru evaziune și spălare de bani," Agerpres, November 17, 2017, http://www.economica.net/petrotel-lukoil-ploiesti-cercetata-pentru-subevaluarea-valorii-construcțiilor-si-instalațiilor_146386.html.

year contracts with Gazprom in 2007 for gas deliveries to Romania.^{9,10} Though market liberalization and the shuttering of the largest industrial gas consumer (Interagro) in recent years led to a drop in gas imports, Conef Gaz and WIEE still control about 50 percent of gas imports today. Gazprom also benefitted from repeated delays in market liberalization and in the completion of interconnections and reverse flows with Bulgaria and Hungary. In what has been a typical state capture pattern involving Russian interests, in 2006, Conef Gaz's manager, Dan Victor Alesandru, became state secretary at the Ministry of Economy and supported a non-competitive, below-market price electricity deal between a state-owned company that fell under his portfolio and ALRO.^{11,12} He later received shares in Conef Gaz from ALRO's management (ALRO owns Conef Gaz).¹³

Gazprom has also made inroads into the Romanian offshore energy sector. In 2009, it signed the largest contract to date between a Romanian entity (Grup Servicii Petroliere, or GSP) and a Russian company—a contract worth €270 million.¹⁴ GSP has a quasi-monopoly on platforms required for gas companies to operate in the Black Sea and is owned by Romanian multimillionaire Gabriel Comanescu through his Upetrom Group. Ahead of the 2014 Sochi Olympic Games, GSP secured yet another contract with Gazprom—this one worth \$269 million—to build a section of the undersea pipeline that fueled the area.¹⁵ GSP obtained a \$70 million guarantee from Romania's EximBank for the project,¹⁶ thus involving public funds in the project (EximBank is a publicly owned entity through the Romanian Ministry of Finance, which holds 95.3 percent of the shares).¹⁷ Around 2005, Comanescu began to transfer most of his companies' assets to Malta through 26 companies registered there. These companies processed Gazprom

- 9 "Gazprom and Wintershall sign Agreement on closing asset swap deal," Gazprom, September 4, 2015, <http://www.gazprom.com/press/news/2015/september/article245878>.
- 10 "Gazprom, Romania's Conef Energy sign long-term gas deal," *Budapest Business Journal*, April 5, 2007, https://bbj.hu/energy/gazprom-romania-conef-energy-sign-long-term-gas-deal_25104. See also: OAO Gazprom, Annual Report 2007 (Moscow, Russia: Gazprom, 2008), 61.
- 11 Alesandru was also a director at Interagro, one of the largest gas consumers in the country before its bankruptcy.
- 12 Nicoleta Savin, "Misteriosul om-punte între ruși, Voiculescu și Ioan Niculae. Cine arde gazul ieftin românesc?" *Evenimentul Zilei*, January 13, 2012, <http://evz.ro/omul-punte-dintre-voiculescu-si-rusii-de-la-alro-si-gazprom-cine-arde-gazul-ieftin-romane-96134.html>.
- 13 Ibid. See also: "Dan Victor Alesandru, fost secretar de stat in Ministerul Economiei, omul de legatura dintre ruși și Ioan Niculae in afacerea cu gaze naturale," *B1*, January 13, 2012, <https://www.b1.ro/stiri/economic/dan-victor-alesandru-fost-secretar-de-stat-in-ministerul-economiei-omul-de-legatura-dintre-rusi-si-ioan-niculae-in-afacerea-cu-gaze-naturale-18998.html>.
- 14 Attila Biro and Roxana Jipa, "Reteaua Comanescu (III): Un Cuvant de 30 de Milioane de Euro," *Rise Project*, October 25, 2017, <https://www.riseproject.ro/articol/reteaua-comanescu-iii-un-cu-vant-de-30-de-milioane-de-euro>
- 15 "Comanescu takes 269m dollars from Russians for 150km of Gazprom pipeline," *Ziarul Financiar*, December 7, 2009, <https://www.zf.ro/zf-english/comanescu-takes-269m-dollars-from-russians-for-150km-of-gazprom-pipeline-5161240>.
- 16 "Comanescu ia 269 mil. dolari de la rusi pentru 150 km din gazoductul Gazprom," *Ziarul Financiar*, December 6, 2009, <https://www.zf.ro/companii/comanescu-ia-269-mil-dolari-de-la-rusi-pentru-150-km-din-gazoductul-gazprom-5158016>.
- 17 "General Information," EximBank Romania, <https://www.eximbank.ro/en/general-informations>.

contracts as well as contracts with Austria's OMV. In what seems to be a classic profit-shifting operation, the company still officially registered in Romania has reported losses over the last few years, but the Maltese companies (which own the ships and platforms) have reported significant profits.¹⁸ This has created losses for the Romanian state: had the profits recorded by the ship that installed the undersea pipeline for Gazprom been taxed in Romania (instead of Malta), the state would have received €8 million in tax revenue.¹⁹ This may not seem large, but it exemplifies the flight of revenue and can accumulate to significant sums; importantly, it can mean a lot to some localities and populations in Romania and can hurt the trust in government.

Such revenue losses are compounded by changes made to Romania's offshore tax law, which also seem influenced by business interests. Comanescu has close ties to Iulian Iancu, the PSD chairman of the Chamber of Deputies' Industrial Affairs Committee and a representative of the constituency where Comanescu's business is registered.²⁰ He has been a vocal opponent of opening up Romania's gas market and has been described by a member of his own party as "owned by Gazprom" due to his support of the South Stream pipeline.²¹ Iancu and members of the PSD amended the offshore law that parliament approved in October 2018 to lower the tax deductions that companies could claim for investments in Black Sea exploration and drilling. The amendments also required all companies to work with a substantial percentage of Romanian companies and labor and to sell 50 percent of the gas extracted from the Black Sea on the Romanian market.²² While there is no sign of collusion or communication with Russian interests, the changes in offshore legislation certainly affect Romania's position as a potential major energy exporter in Europe and limit its ability to threaten Gazprom's regional dominance of the gas market. Analysts believe the new legislation could block major investments in energy capacities, gas extraction (Petrotrans announced it would postpone its investment decision to late 2019), and electricity and gas transmission while threatening the sustainability of the energy sector.²³

18 Biro and Jipa, "Reteaua Comanescu (III)."

19 Ibid. An audit by a large consultancy company in 2011 presented a picture that recommended keeping companies in Malta to avoid the Romanian tax rate.

20 Sorina Matei, "'Rețeaua' AMICOM, faza pe regate sponsorizate din banii prietenilor personali și colegilor din KGB ai președintelui rus, Vladimir Putin," *Sorina Matei*, December 4, 2016, <http://sorinamatei.ro/exclusiv-reteaua-amicom-faza-pe-regate-sponsorizate-din-banii-prietenilor-personali-si-colegilor-din-kgb-ai-presedintelui-rus-vladimir-putin-sri-nu-confirma-nu-infirma-dar-lasa/>.

21 "Stampeding into coalition, perhaps into a trap too: PSD legislator on intraparty cabinet negotiations," WikiLeaks, Cable 08BUCHAREST971_a, December 12, 2008, https://wikileaks.org/plusd/cables/08BUCHAREST971_a.html.

22 E-nergia, "Nemulțumirile deputatului Iulian Iancu față de legea offshore, crucială pentru gazele din Marea Neagră," *Economica*, June 11, 2018, http://www.economica.net/lege-offshore-gaze-marea-neagra-iulian-iancu_154858.html.

23 Dorin Oancea, "Analiza: ordonanta de urgenta a taxelor. Cat ne vor ajuta taxa pe lacomie, plafonarea pretului gazelor si Fondul de investitii," *Mediafax*, December 22, 2018, <https://www.mediafax.ro/economic/analiza-ordonanta-de-urgenta-a-taxelor-cat-ne-vor-ajuta-taxa-pe-lacomie-plafonarea-pretului-gazelor-si-fondul-de-investitii-17794893>.

Beyond the economic sphere, Moscow's influence over and ability to destabilize the former Soviet republic of Moldova, Romania's impoverished neighbor, continues to be a political flashpoint between Russia and Romania. Romania has been a strong proponent of Moldova's Euro-Atlantic integration despite Russia's long-standing military presence in Transnistria, a separatist region of Moldova that declared independence in the early 1990s but has not been recognized by the international community. There has recently been a sharp increase in the number of joint Russia-separatist military exercises in the region, from 48 in 2016 to over 150 in 2017 (300 according to some reports).²⁴ The exercises have simulated crossing the river from Transnistria over to Moldova, in a similar fashion to the exercises on the Russian-Georgian border before Moscow's military incursion there in 2008.

Moldova's current president, Igor Dodon, is also vocally pro-Kremlin, and Moldova has been fertile ground for Russian illicit financing. In 2014, three major Moldovan banks collapsed after \$1 billion (15 percent of Moldovan GDP at the time) disappeared from their treasuries. The investigation later found the money disappeared in a massive laundering scheme that relied on corrupt judges and involved Russian banks and individuals; the scandal led to the demise of the government.²⁵ Through its military presence in Transnistria, financial coercion, and supporters like Dodon, Russia can thus affect Moldova's stability and in turn influence Romania's domestic landscape and security concerns.

Romania is increasingly surrounded by Kremlin-friendly regimes, from Moldova in the east and Hungary in the northwest, to Serbia in the southwest and Bulgaria in the south. This heightens Romania's geostrategic tension with Russia and reinforces Romania's strategic importance for NATO and the United States. These tensions extend to the Black Sea, where Russia has substantially reinforced its military posture in Crimea (through the advance post in Sevastopol) and modernized its Black Sea Fleet.²⁶ The Kremlin has singled out Romania for its hosting of the Aegis Ashore ballistic missile defense system at Deveselu, a strategic resource for NATO which was agreed to in 2013 under strong Russian protest and activated in 2016.²⁷ Romania also hosts an average of 500-700 U.S. troops at Mihail Kogalniceanu Air Base, which also serves as a NATO hub in the Black Sea region. Russia's increasing military presence in the Black Sea puts additional pressure on Romania's security as well as its neighbors'.

24 Madalin Necsutu, "US Congressmen Back Moldova's Stance Against Russia," Balkan Insight, February 22, 2018, <http://www.balkaninsight.com/en/article/us-backs-moldova-for-russian-military-withdrawal-from-transnistria-02-22-2018>.

25 Kit Gillet, "The missing billion," Politico, May 14, 2015, <https://www.politico.eu/article/mol-dova-missing-billion/>.

26 Anton Lavrov, *Russian Military Reforms from Georgia to Syria*, (Washington, D.C.: Center for Strategic and International Studies, 2018).

27 In Vladimir Putin's words: "If yesterday in those areas of Romania people simply did not know what it means to be in the cross-hairs, then today we will be forced to carry out certain measures to ensure our security." Denis Dyomkin, "Putin says Romania, Poland may now be in Russia's cross-hairs," Reuters, May 27, 2016, <https://www.reuters.com/article/us-russia-europe-shield-idUSKCN0YI2ER>.

Finally, a potential vulnerability in Romania for Russian meddling has been the Orthodox Church (over 85 percent of Romanians are Orthodox.), which has been serving as a natural ally to Russian propaganda to create fault lines with European “liberal” values. While the Bucharest and Moscow church leaders have been vying for influence over the region’s Orthodox population, there has been a recent thawing of relations. In October 2017, Patriarch Kirill of Moscow was the first Russian patriarch to visit Romania since 1962, and a month later, Patriarch Daniel of Romania visited Moscow.^{28,29} Despite long-standing rifts between the two churches,³⁰ Romanian Orthodox patriarchs welcomed the Russian Orthodox Church as an ally in the fight for “traditional,” conservative values before a referendum on the definition of marriage in October 2018 that would have amended the constitution to define marriage as the union of a man and a woman (the referendum failed to reach the necessary turnout threshold).³¹ Russian outlet Sputnik weighed in on the debate before the referendum, accusing Europe of a hybrid war on the subject to create a rift between populations and “fundamental [societal] institutions.”³² Perhaps in an attempt to maintain improved ties with Moscow, the Romanian Orthodox Church has not recognized the independence of the Ukrainian Orthodox Church since its 2018 split from the Moscow Patriarchate, instead recommending dialogue to preserve the unity of the orthodoxy.³³

Russia has cast itself as a defender of traditional family values, intervening in national political debates in Europe and building political relations with different stakeholders on this ground. An organization that led the charge in favor of this constitutional amendment and has potential ties to Russian figures is the Coalition for Family, which called for such a referendum as early as 2014. The Coalition presents itself as a collection of many different grassroots organizations, but it is part of a larger, international network of ultra-conservative activists from the United States to Kremlin-affiliated oligarchs who have attempted to organize similar referendums across Europe from Croatia to Slovakia.³⁴ The organization received public support from the Russian ambassador

28 “Patriarch Kirill visits Romania,” Euronews, October 27, 2017, <https://www.euronews.com/2017/10/27/patriarch-kirill-visits-romania>.

29 Irina Marica, “Romanian Orthodox Church Patriarch to pay visit to Moscow,” Romania Insider, November 28, 2017, <https://www.romania-insider.com/romanian-patriarch-visit-moscow/>.

30 The Moscow Patriarchate broke ties with the Constantinople Church over Ukraine’s religious independence from Moscow in October 2018. Andrew Roth and Harriet Sherwood, “Russian Orthodox Church cuts ties with Constantinople,” *Guardian*, October 15, 2018, <https://www.theguardian.com/world/2018/oct/15/russian-orthodox-church-cuts-ties-with-constantinople>.

31 Luiza Ilie, “Romanian constitutional ban on same sex marriage fails on low vote turnout,” Reuters, October 7, 2018, <https://www.reuters.com/article/us-romania-referendum/romanian-constitutional-ban-on-same-sex-marriage-fails-on-low-vote-turnout-idUSKCN1MH0XI>.

32 Cristian Preda, “Influenta recenta a Rusiei in trei tari ex-comuniste,” *Adevarul*, October 10, 2018, https://adevarul.ro/international/europa/influenta-recenta-rusiei-trei-tari-ex-comuniste-1_5bbd979ddf52022f755bc909/index.html.

33 “BOR nu recunoaste independenta Bisericii Ortodoxe din Ucraina fata de Moscova,” *Ziare.com*, October 26, 2018, <http://www.ziare.com/social/biserica/bor-nu-recunoaste-independenta-bisericii-ortodoxe-din-ucraina-fata-de-moscova-1535461>.

34 Claudia Ciobanu, “‘New World Order’: The ‘Natural Family’ Franchise Goes Global,” *Balkan In-*

to Romania in 2017.³⁵ One of the coalition's members, the European Centre for Law and Justice, is a vocal anti-LGBT organization whose director, Gregor Puppink, has praised Russia as a "beacon of hope" for Europe on gay rights suppression.³⁶ In 2014, the center sent a delegation to Moscow, where it reportedly met with Orthodox church figures and Russian politicians.³⁷

Another Coalition for Family member, Pro-Vita Bucharest, reportedly controlled the donations that went to the Coalition in 2016.³⁸ Its leader, Bogdan Stanciu, has long been involved with far-right circles in Romania. He was part of the New Right, an organization reportedly close to Russian ultra-nationalist Aleksandr Dugin, and has participated in the management of a propaganda and misinformation outlet for which contributors include Vladimir Yakunin's wife, Natalia (Yakunin is considered part of Vladimir Putin's inner circle).³⁹ Stanciu has reportedly attended Yakunin's Rhodes Forum and Dialogue of Civilizations events.⁴⁰ He appeared on the "Dugin List," a list of prominent European figures who have met Dugin or discussed through intermediaries the possibility of creating pro-Russian influence groups (the list was leaked from hacked email correspondence from a close collaborator of Dugin's).⁴¹ The effort was reportedly financed by Konstantin Malofeev, a nationalist and ultra-conservative Russian figure under U.S. and EU sanctions, who was featured prominently in *The Kremlin Playbook* as part of larger Russian malign influence operations.⁴² The list included such high-level figures as former Romanian prime minister Nastase and former president Iliescu.⁴³

Romania remains a strong proponent of sanctions against Russia, of the European Union (it holds the rotating EU presidency from January to June 2019), and of increasing

sight, November 21, 2018, <http://www.balkaninsight.com/en/article/new-world-order-the-natural-family-franchise-goes-global-11-05-2018>.

35 Oana Popescu and Rufin Zamfir, eds, *Propaganda Made-to-Measure: How our Vulnerabilities Facilitate Russian Influence* (Bucharest, Romania: Global Focus, 2018), 67.

36 "10 Things You Should Know About the American Center for Law And Justice," Human Rights Campaign, <https://www.hrc.org/resources/10-things-you-should-know-about-the-american-center-for-law-and-justice>.

37 Ibid.

38 Popescu and Zamfir, *Propaganda Made-to-Measure*, 108.

39 Karen Dawisha, *Putin's Kleptocracy: Who Owns Russia?* (New York: Simon & Schuster, 2015), 333-339.

40 Traian Danciu, "Cum au ajuns prietenii lui Putin și fondatorul Noua Dreaptă să formeze Coaliția pentru Familie," *Vice*, November 9, 2016, <https://www.vice.com/ro/article/53bkkmz/cine-sunt-oamenii-din-spatele-coalitiei-pentru-familie>.

41 Anca Cernea, "Lista prietenilor Rusiei din Romania deconspirata de Alexandr Dughin&Co. Prin e-mail!" In Linie Dreapta, December 2, 2014, <http://inliniedreapta.net/lista-prietenilor-ru-siei-din-romania-deconspirata-de-alexander-dughin-prin-e-mail/>.

42 Heather Conley et al., *The Kremlin Playbook: Understanding Russian Influence in Central and Eastern Europe* (Lanham: Rowman & Littlefield, 2016), 23.

43 Ionut Ilascu, "Russian Hackers Leak List of Pro-Russian Influence Group Made of High-Profile European Individuals," Softpedia News, December 3, 2014, <https://news.softpedia.com/news/Russian-Hackers-Leak-List-of-Pro-Russian-Influence-Group-Made-of-High-Profile-European-Individuals-466418.shtml>.

NATO's military deterrence against Russia. Nevertheless, the country illustrates the risks of malign influence created by weak governance standards, rampant corruption, and receptivity to social and cultural influencers supported by the Kremlin. Romania has not acted as a Russian enabler but there are many receptive elements within the country (in the economy, religion, and politics) that provide entry points for the Kremlin and feed the unvirtuous cycle on influence. The historic 'anti-Russian' antibodies present in the country do not automatically shield the population from attempts to divide the country along cultural lines. Societal divisions can be exploited, including divisions between the government and citizens who protest the government's efforts to weaken democratic institutions and the rule of law—protests that have continued to occur.⁴⁴ Policy decisions related to the taxation regime (of offshore profits and drilling, for example) and those that impede energy diversification point towards state capture risks linked to Russia, diminish Romania's state resources, and further weaken the country. All of these elements fulfill the objective of Russian malign influence: "breaking the internal coherence of the enemy system."⁴⁵

44 Anca Gurzu, "Brussels slams Romania on corruption as EU presidency nears," Politico, November 13, 2018, <https://www.politico.eu/article/brussels-slams-romania-anti-corruption-ef-forts-as-eu-presidency-nears/>.

45 Conley et al., *The Kremlin Playbook*.

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