

THE KREMLIN PLAYBOOK IN SOUTHEAST EUROPE

ECONOMIC INFLUENCE AND SHARP POWER



CENTER FOR
THE STUDY OF
DEMOCRACY

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AND SHARP POWER**

The weakening of the EU gravitational pull leaves a power vacuum in Southeast Europe that is readily filled in by authoritarian powers such as Russia. The Kremlin is taking advantage of the democratic backsliding and the widespread state capture among dysfunctional institutions to enhance its economic and political influence in the region. While Russian economic power in Southeast Europe has visibly declined since the imposition of EU and NATO sanctions on the Kremlin in 2014, its overall ability to influence domestic politics has remained potent and has even gained effectiveness. Russia has preserved its sway over strategic decision-making in the region most notably in the energy sector where it has locked governments in costly infrastructure projects. By exploiting governance deficits, the Russian economic footprint has expanded to include some of the biggest companies in the region in oil refining, wholesale fuel and natural gas distribution, telecommunications and retail. Their strategic importance for the national economies in Southeast Europe has provided Russia with an outsized political leverage. To amplify its influence, Russia has aptly employed a range of sharp power instruments such as media propaganda, leveraging cultural and religious ties and sponsoring of civil society activities. This report looks into the Kremlin playbook instruments in eight Southeast European countries: Albania, Bulgaria, Bosnia and Herzegovina, Croatia, Kosovo, Montenegro, North Macedonia and Serbia.

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LIST OF ABBREVIATIONS

ABV	Alternative for Bulgaria
AML	Anti-money-laundering
BiH	Bosnia and Herzegovina
BSP	Bulgarian Socialist Party
BTC	Bulgarian Telecommunications Company EAD
CAATSA	Countering America's Adversaries Through Sanctions Act
CCB	Corporate Commercial Bank (Bulgaria)
CEAC	Central European Aluminum Company
CSD	Center for the Study of Democracy
DF	Democratic Front (Montenegro)
DPS	Movement for Rights and Freedoms (Bulgaria)
EPCG	Elektroprivreda Crne Gore AD
FDI	Foreign Direct Investment
GRU	Main Intelligence Directorate (Russia)
HDZ	Croatian Democratic Union
ICSID	International Center for Settlement of Investment Disputes
IGB	Gas Interconnector Greece-Bulgaria
KAP	Podgorica Aluminum Plant
LNG	Liquefied natural gas
LTC	long-term gas supply contract
MOC	Montenegrin Orthodox Church
NIS	Naftna Industrija Srbije
NPP	Nuclear Power Plant
OTE	Hellenic Telecommunications Organisation S.A.
RS	Republika Srpska
RT	Russia Today
SAI	State Audit Institution (Montenegro)
SDSM	Social Democratic Union of Macedonia
SNSD	Alliance of Independent Social Democrats (Republika Srpska)
SOC	Serbian Orthodox Church
SPS	Socialist Party of Serbia
UBO	Ultimate beneficial owner
UNCITRAL	United Nations Commission on International Trade Law
VTB	Vneshtorgbank

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EXECUTIVE SUMMARY

The political and economic development of the countries in Southeast Europe (SEE) has long been affected by forces outside the region. In the mid-2010s, the migration crisis in Europe, the conflict in Ukraine and the rise of Eurosceptic parties have made European Union states increasingly reluctant to invite new members. The October 2019 EU decision not to start accession negotiations with Albania and North Macedonia was yet another sign of the lack of political will of EU politicians to commit to the Euro-Atlantic integration of SEE. The outcome has been the discrediting of EU's neighborhood policy – its relations with the countries in the east and south of the continent. Any such disengagement, however, risks the rising of destabilizing forces in SEE. The region is still struggling with its wartime past and is unable to reverse the backsliding of its democracies, readily exploited by authoritarian states. **The weakening of the EU gravitational pull leaves a power vacuum in SEE which Russia fills in.** The Kremlin takes advantage of and exacerbates the dysfunctionality of government institutions in the region in order to expand its economic and political influence.

Political elites in the Balkans have readily embraced the Russian authoritarian model. It fits well with the **mechanisms of state capture** which are prevalent in the region. The collaboration of local decision makers is ensured by, among other things, allowing them to get corrupt rents from Russian large-scale infrastructure and energy projects. The rising role of authoritarian states in the politics and the economy of SEE further entrenches state capture networks that are controlling the countries' key decision-making processes. In a kind of negative feedback loop, this in turn undermines the credibility of democratic reform assistance provided by the region's Euro-Atlantic partners. For example, EU's policy of making issues such as the rule of law, free press and independent judiciary pre-conditions for membership and access to European funds come up against the appeal of the existing governance model which receives support from countries such as Russia.

In the face of hesitant political engagement by the EU, the **US is once again becoming the indispensable counterbalance to disruptive forces in the Balkans.** The US increased its diplomatic presence in the region in 2019. It appointed two special envoys and upheld the commitment to integrate SEE states in NATO. These positive steps should now be matched by equally strong push for regional anticorruption policies and the rebuilding of democratic institutions as bulwarks to malign foreign influence.

The current report zooms in on the continuity and change in the Russian strategy in Southeast Europe after the annexation of Crimea in 2014. It provides recommendations to the Euro-Atlantic community and the SEE countries for strengthening the region's resilience to foreign authoritarian

influence. The text uncovers the Kremlin playbook in Southeast Europe, and more particularly in two EU member states (Bulgaria and Croatia) and the six Western Balkans countries (Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia, and Serbia).

Assessing the Russian economic footprint and state capture channels in SEE

The imposition of sanctions against Russia in the aftermath of the invasion of Ukraine in combination with plummeting oil and gas prices has led to an overall **decline of Russia's economic footprint across SEE**. Still, Russian companies control some strategic assets, such as all the major refineries, the wholesale fuel and natural gas supply markets. Russia is still the largest oil and gas supplier to the region, although it has seen more competition recently, especially in Bulgaria, Greece and Croatia. These EU member states have sought to build alternative supply of Azeri gas and LNG, which has contributed to a small decline in their level of energy dependence on Russia.

Russian imports of goods to the region have fallen from € 7 billion in 2007 to € 5.35 billion in 2018. With the exception of Bulgaria, where Russia is the second biggest trading partner trailing only Germany, in all other countries it is not among the top five. Russian trade and investment relationships with the region are often compared to that of the EU as a whole. But that would be incorrect for the needs of assessing economic influence since the European Union lacks the coherent foreign economic and political strategy of a unitary or even a federal state. Even so, Russia remains mainly a supplier of energy resources to the region, while the SEE countries' exports of goods to Russia amounts to slightly over € 1 billion or on average less than 0.5% of each of their national GDPs.

Russia has run large trade deficits with SEE countries, thus pumping out scarce financial resources out of the region. The size of Russia-SEE **trade deficits** has been most heavily impacted by volatile oil and gas prices and the region's dependence on Russian energy. These deficits have declined since 2014 from as high as 10% of GDP to 1.4% of GDP in 2018. They are projected to fall further in 2019/2020 on the back of expected lower average energy prices and the introduction of some energy diversification in the region. Many countries in the region have sought to offset these energy trade deficits with large reliance on income from Russian tourists, thus increasing their economic entrenchment with Russia. Montenegro has been a particular case in point, where the export of tourist services to Russia plays an enormous role in the small Adriatic country's economy.

Russian foreign direct investment (FDI) in SEE started growing in the early 2000s driven by price increases of raw materials, providing the Russian economy with windfall profits to invest abroad. Russian FDI in the region has increased from just below € 1 billion in 2007 to around € 5.1 billion in 2019. Close to 90% of Russian FDI is concentrated in three countries – Bulgaria, Serbia, and Montenegro. However, actual

Russian investments in the region are much higher than the official statistics reveals. Their true scope and potential for economic influence are only revealed when Russian investments channeled through offshore areas such as Cyprus, the Netherlands, and Luxembourg are taken into consideration.

In terms of **corporate footprint**, i.e. the share of Russian controlled companies' revenues, assets and employment in the total for the SEE economies, Russia directly or indirectly controlled between 5% and 10% of the regional economies in 2018. Russia's corporate footprint has been on the decline in the past decade too. Yet its influence clout has stayed high as Russia-controlled capital has been heavily **concentrated in strategic sectors** including energy, infrastructure, telecommunications, finance and retail. The Kremlin and Russian oil and gas companies have also locked the region in costly and economically questionable large-scale projects such as the **Turkish Stream** gas pipeline. These have been used to strain poorly resourced national administrations and to feed networks of domestic and Russian businesses with significant leverage over policy-makers and government institutions.

The contraction of the Russian corporate footprint in SEE is a reflection of the structural trends resulting from declining oil prices and sanctions against Russia, as well as the sale of some large strategic enterprises, such as Montenegro's aluminum plant KAP or Bulgaria's telecommunications company Vivacom. However, the full extent of Russia's corporate presence can only be assessed if **opaque ownership structures** are taken into account.

The Russian corporate footprint impacts indirectly a range of businesses in SEE. These are either dependent on Russian resources, such as raw materials and bank loans, or are closely related to economic-political networks receiving support from Russia. A typical example for this indirect relationship and a game changer for the scope of the Russian economic footprint in SEE has been the 2018 acquisition of the region's largest retail company, Agrokor. Russian state-owned banks Sberbank and VTB took over the company, using its default on their loans. Agrokor employs close to 100,000 people across the region and does business with thousands of small and medium-sized firms in the agriculture and food sectors, thus commanding the core of the region's economy.

Among the most vulnerable sectors to Russian influence in the region is **energy**. Russia has continued to use the region's energy dependence as a political tool, exacerbating security risks in SEE, despite EU attempts at energy market integration, liberalization and diversification. Russia has continued to over-charge and earn monopoly rents from for the energy it supplies to SEE continues, taking advantage of the relative isolation of the region's energy markets. Russia has also hampered the diversification of energy supply and the liberalization of energy markets in the region.

The Kremlin has leveraged structural market deficits, the lack of independence of regulators and widespread deficits in the management of state-owned enterprises to lure SEE countries in **costly and unnecessary**

energy infrastructure projects. The Turkish Stream natural gas pipeline and the Belene nuclear power plant project in Bulgaria are some of the more notable examples. Russia has enabled these projects by capturing powerful local brokers through providing them with government sponsored business opportunities at premium returns. These clients, who are embedded in oligarchic networks consisting of Russian and local businessmen, then further Kremlin's strategic business interests and foreign policy goals.

The energy sector has been the principal target of the Russian economic penetration in SEE. But the increase of oil and gas prices in the early 2000s and 2010s has allowed for a diversification of the portfolio of assets controlled by Russian entities. Several other sectors have seen an influx of Russian capital, including infrastructure, finance, retail, telecommunications, metallurgy and real estate. The expansion of the Russian footprint in these areas has been enabled by the **active role that Russian state-owned banks** (Sberbank and VTB) have played on the regional market after 2011/12.

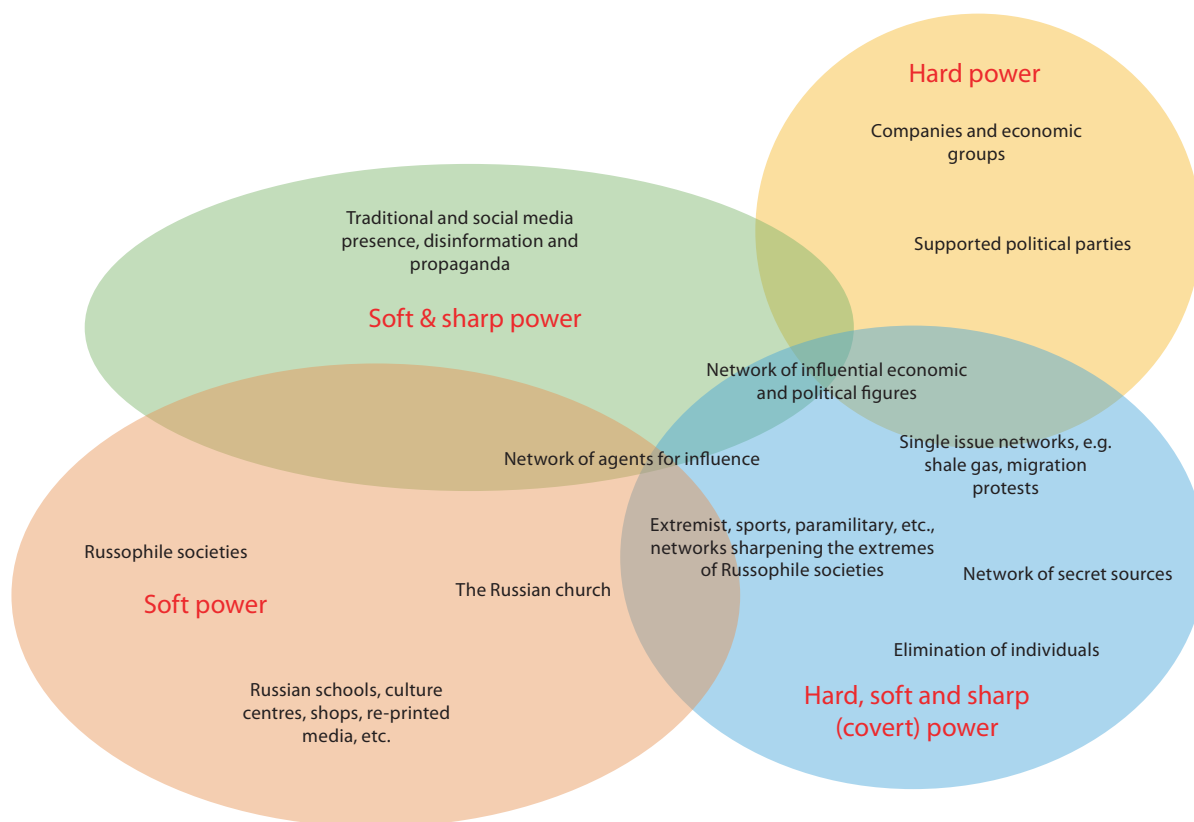
To gain a foothold in strategic economic sectors, Russia has also exploited rigged **privatization procedures** to acquire largely bankrupt state-owned companies in the region at a token price. The objective of these new investors has not been to turn the failed state companies in successful businesses but rather to use them as cash cows siphoning profits abroad or using assets as collateral to obtain loans for their activities. Russian companies have also systematically exploited governance gaps such as poorly defined privatization agreements that impose obligations on the state to implement social programs, provide subventions or tax rebates, etc. long after the change in ownership. The acquisition of the largest tobacco company in Bulgaria, Bulgartabac, the privatization of the largest firm in Montenegro, the aluminum plant KAP, and that of the oil and gas industry of Serbia, NIS, are all prime examples of Russia's strategy.

Sharp power amplifiers

One of the most effective mechanisms for amplifying Russian influence in SEE has been the deployment of sharp power instruments such as media capture, cultural and religious ties and sponsoring of civil society activities. These aim to create a favorable environment for the presence of Russia's businesses, while at the same time deepen political divides and sow mistrust in the Euro-Atlantic integration of the region. Political influence is secured by fomenting popular discontent and exposing the vulnerabilities of the liberal democratic system of governance.

Underpinned by **targeted economic presence in the media sector** and aggressive military and geopolitical posturing, sharp power tools have successfully changed socio-cultural narratives in many SEE countries. Russia has actively sought to undermine societal perceptions about liberal and democratic values and cultural-historical attitudes by openly questioning facts and by pushing forward narratives not grounded in evidence.

Power instruments employed by the Kremlin in Southeast Europe



The outcome of this strategy has been an **increase of social tensions and political instability** in SEE. The most visible fault lines on which the Kremlin has put further pressure have been the growth of ethnic nationalism in Bosnia and Herzegovina, the anti-NATO protests in Montenegro and the political turmoil in North Macedonia following the 2016 elections. Russia-supported groups have played a key role in fomenting internal conflicts with the objective of changing strategic policy decisions.

Another key channel of Russian sharp power in SEE has been the Orthodox Church. It plays the role of a key intermediary for the spread of the Russian agenda in SEE, organizing various initiatives under a religious veil. Russian and many SEE orthodox churches have provided cover for both Communist-era and acting security services officials, further strengthening the Kremlin's influence.

The Kremlin has also blanketed the regional media with Russian **propaganda and disinformation narratives**. Russia has exploited financial problems in content provision and the low level of media freedom in SEE to enhance its sharp power. It has pushed forward free content favorable to the Kremlin, reinforced media economic dependency through direct capital ownership or advertising flows, and fostered (in)formal political links of media outlets to pro-Russian groups and interests. The lack of transparency of media ownership combined with weakly implemented conflicts of interest and ethical provisions have obfuscated Russia's influence operations in the region. In addition, the

region's small advertisement markets dependent on large commercial advertisers have aided the oligarchization of media, further easing Russia's penetration.

Russia has also secured political influence by directly supporting mainstream and fringe political parties, but also by fomenting popular discontent and denigrating the liberal democratic system of governance through the following set of enablers:

- Civil society organizations and quasi-parties receiving direct official or hidden financing from Russian foundations or local Russia-proxy funders, including banks.
- Support to protest and pressure groups, which are mobilized on an ad-hoc basis to sow confusion and push back against specific government decisions. These have often been linked to football clubs, combat sports clubs, etc., which have received support from Russian businesses.
- Internet trolls, bloggers, talk-show hosts and creators of obscure news websites aiming to amplify certain Kremlin-backed disinformation narratives.

Capture-proofing Southeast Europe

Kremlin's strategy of penetration and disruption is made possible by persistent deficits in public governance in SEE countries. Addressing these deficits requires a number of actions to be implemented by both national champions of reform and international partners. This report recommends the following non-exhaustive list of critical measures:

- **SEE governments**, in coalition with civil society and international partners, need to design and enforce **strategies to counter state capture**. A key element in these should be the implementation of regular **state capture assessment diagnostics** that would measure the level of capture (risks) in strategic economic sectors and identify key governance deficits which allow excessive market concentration. These diagnostics should be carried on a regional basis so as to identify trends in the whole region.
- SEE countries should **diversify foreign capital inflows** away from overreliance on capital from authoritarian countries targeting structurally important sectors through non-competitive means. Foreign direct investment exposure should be vetted by central banks and financial regulators, which need to regularly assess the true size and potential impact of capital inflows from Russia.
- In a related measure, anti-trust authorities, tax inspectorates, financial market regulators, anti-money laundering institutions and national security agencies should work to **establish final beneficial ownership of FDI** so as to avoid market concentration, prevent money laundering, and the acquisition of strategic assets by companies linked to authoritarian states.

- SEE governments should improve their countries' **energy security** through implementing the following measures:
 - full natural gas market liberalization in line with the EU energy and competition laws;
 - continuation of the SEE regional market integration through the construction of pipeline interconnectors, gas storage facilities and underground storages, as well as the diversification of supply routes and sources;
 - renegotiation of long-term natural gas contracts with Gazprom in order to abolish destination and take-or-pay clauses, as well as to remove oil indexation from the pricing methodology.

SEE countries should reconsider their involvement in large-scale energy projects pursued by the Kremlin, such as the **Turkish Stream** gas pipeline, in light of the risks they pose to energy security and their role in reinforcing Russia-backed state capture networks.

- Fiscal and anti-trust authorities should increase their efforts to prevent Russian companies from engaging in **tax avoidance and abuse of monopoly power** by:
 - implementing the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations in bilateral government-to-company tax negotiations, so as to limit the amount of profits shifted to offshore-registered subsidiaries;
 - dismantling the oligopolies in fuel retail and wholesale in the region which allow Russian oil majors to extract excessive rents.
- The **European Union** should reinforce its economic and political engagement with the Balkans through the enlargement process (for non-EU countries) and through its cohesion policy (for EU members). In particular, it should seek a more **active engagement in the areas of rule of law and anticorruption**. In addition, it could follow the US example of appointing a **special envoy** for the region with direct access to Brussels, Berlin and Paris. The EU should be assertive in its political engagement on rule of law issues.
- The EU should include the Western Balkans in its Multiannual Financial Framework planning, providing a stronger basis for the integration of the region and encouraging private EU investments. In particular, the EU should aim to **engage directly with civil society** in SEE, including through Brussels-managed programs on rule of law, justice, etc.
- The European Commission and the European Central Bank should enhance efforts to enforce **anti-money laundering** legislation and close loopholes in the corporate ownership and foreign direct investment regulatory frameworks. There is a strong need for a dedicated EU AML institution that would oversee the cooperation of national institutions and would have the capacity to conduct independent cross-border investigations within Europe. The US Treasury Department should increase its efforts to counter money-laundering transactions in the region.

- The **United States** should use more aggressively the **Foreign Corrupt Practices Act** as well as expand the scope of the **Global Magnitsky Act** to investigate high-level corruption in Europe and in SEE, in particular such that furthers Russian strategic interests.
- To build up regional demand for natural gas in SEE, the United States should work together with the European Commission and the European Energy Community on the development of **a regional platform** and the necessary, associated energy infrastructure **for the joint purchasing of LNG** from the global natural gas market.
- The US Agency for International Development should reinstitute instruments and platforms for supporting **good governance initiatives on a regional level** in SEE. These would be the most effective delivery mechanism for enabling policy change. A regional approach would reduce the national political sensitivity of rule of law reforms and improve the likelihood for peer pressure among national governments.
- The US Department of State should enhance multilateral exchange programs such as **technology and media corps** that can mobilize civil society and volunteer engagement to support the region's reform agenda. Such programs would also create regional resilience to the Kremlin's propaganda and disinformation narratives.

STATE CAPTURE AT THE CORE OF KREMLIN'S SHARP POWER

The current assessment is a deep dive study of how Russian economic footprint¹ translates into leverage within the political and societal realms of eight Southeast European countries – Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Kosovo, Montenegro, North Macedonia, and Serbia. The report highlights the results of an economic analysis, provides a detailed assessment of the impact of Russian influence, cross-references governance and rule-of-law standards, and identifies specific areas of vulnerability. The analysis thereby reveals the different **layers of Kremlin's overall approach to international relations** and the international economy. Indeed, a policy of disrupting Euro-Atlantic integration and regional cooperation and stability in the Balkans fits well with Russia's overall positioning within the international community of a non-recognized great power, striving for reassertion. Russia has been antithetical to liberal internationalism through the employment of corruptive capital networks, state-sponsored mega projects, and trans-imperial patrimonialism.² The assessment draws conclusions about the economic and political priorities and strategic objectives in Russian foreign policy making.

Southeast Europe (SEE) has been one of the key targets in Kremlin's drive for reasserting Russia's great power status. Using **different amplifiers, including corruption, informal networks and state and media capture**,³ the Kremlin has been trying to leverage Russia's economic footprint in the region to influence SEE countries' stance on their Euro-Atlantic integration.⁴ Russia's economic presence in some European countries is sizable and allows for a more impactful application of Kremlin's playbook for exerting influence.⁵ Russian entities control directly or indirectly⁶ between 10% and 20% of the turnover in the economies of the most vulnerable countries in Central

¹ See the Appendix for methodology and definitions.

² Wallander, C. 2007. "Russian Transimperialism and Its Implications". The Washington Quarterly 30, no. 2: 107-22.

³ For an in-depth methodological review and a pilot of state capture monitoring see Center for the Study of Democracy. (2019). *State Capture Assessment Diagnostics*. Sofia: Center for the Study of Democracy. For an analysis of Russian influence through state capture see Shentov, O., Stefanov, R. and Vladimirov, M. (Eds.). 2019. *The Russian Economic Grip in Central and Eastern Europe*. Abingdon: Routledge.

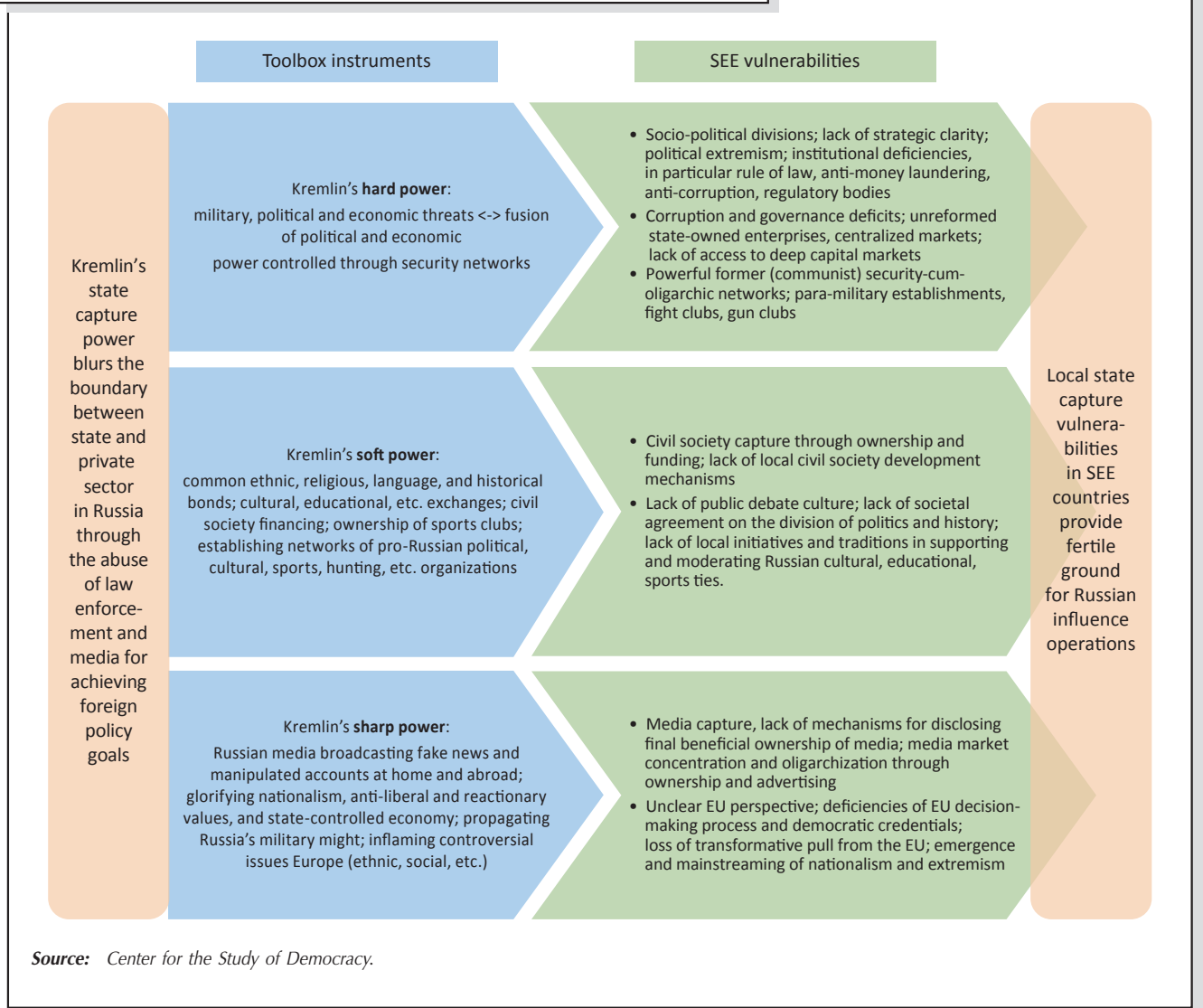
⁴ Vladimirov, M. et. al. 2018. *Russian Economic Footprint in the Western Balkans. Corruption and State Capture Risks*. Sofia: Center for the Study of Democracy.

⁵ In 2016 and in 2019, the Center for the Study of Democracy, Sofia and the Center for Strategic and International Studies, Washington D.C. have described in detail Kremlin's versatile toolbox based on state capture in their groundbreaking reports *Kremlin Playbook: Understanding Russian Influence in Central and Eastern Europe* and *Kremlin Playbook 2: the Enablers*. They assessed the Russian economic influence and its policy impact in 11 European countries.

⁶ Direct corporate control refers to domestic subsidiaries of companies with ultimate beneficial ownership of at least 25% in Russia. The indirect corporate control refers to domestic firms with no Russian ultimate beneficial ownership but which are dependent for more than 50% of their business activities on Russia, which could be based on the dependence of raw materials imports, sales to the Russian market, loan exposure to a Russian bank, etc.

and Eastern Europe (CEE), such as Bulgaria, Serbia and Latvia. Russian economic influence is very often disguised and channeled through Western European **enabler countries** with strong business ties to Russia and the Kremlin. For two decades following the dissolution of the former Soviet Union, Russian capital has been using governance deficits in Europe, such as the lack of common investment screening and anti-money laundering mechanisms, to enter and spread in the European financial system. Conservative estimates put Russian offshore wealth at close to € 1 trillion.⁷ In the Balkans, such capital has been more than welcome, as countries have been severely cash strapped and infrastructure deficient for centuries. Yet, all too often it has come through or has gone into state capture networks, which have sought to subvert market economy and democratic institutions.

FIGURE 1. THE KREMLIN PLAYBOOK IN THE BALKANS: RUSSIA'S SHARP POWER TOOLBOX VS. SEE VULNERABILITIES



⁷ Novokmet, F. Pikkety, T. and Zucman, G. 2017. "From Soviets to Oligarchs: Inequality and Property in Russia, 1905 – 2016", Working Paper No. 23712. Cambridge, Massachusetts: National Bureau of Economic Research.

There are several distinctive features of Russia's influence in CEE and in the Balkans in particular, which make it a potent disruption force. At its core is the amalgamation of hard, soft and sharp power⁸ instruments through state capture in Russia itself. The Kremlin, like China, has gradually **removed the boundary between the public and the private sector, capturing the Russian economy** using security services and control over the media. Unlike during Soviet times, the Kremlin has effectively masked state capture by allowing the highly concentrated economy to function on market principles, while using both state-owned and clientelist private businesses as the cat's paw of its policies abroad. Competing groups within state-owned and private conglomerates are vying for the benevolence of the Kremlin. The ticket to prosperity and riches for such groups, besides entrepreneurial vigor, is to know not to challenge the Kremlin in any way and to oblige if called for service. If someone does not get the message, they are pressured through the state regulatory institutions, the law enforcement or ultimately jailed or expelled. This breeds fear and ensures compliance.

At the pinnacle of the Kremlin's hard power playbook is the aggressive **military** and influence peddling **political posturing**, actively seeking to sow fear and division in Europe and in the Balkans.⁹ The Kremlin has demonstrated it does not shy away from using force at individual level (e.g. the poisoning of Sergei Skripal in the UK and other similar cases) and at country level (e.g. in Moldova, Georgia, Ukraine, and beyond). Its security services have added their contribution in numerous cases across Europe, including most recently in what appears to be their closest ally Serbia.¹⁰

At the same time, the Kremlin has developed official and unofficial¹¹ **ties with political parties in Europe** seeking to challenge the existing European order – from opposition extremist parties in Germany and France, to anti-establishment, anti-European governing parties in Austria, Italy, Bulgaria and Serbia, to name just a few cases. Russia has also sweetened the retirement plans of many top European countries' officials by providing them with lucrative jobs in the boards of state-owned and private Russian energy and banking companies. The most notable examples have been German and Austrian former chancellors and ministers. This military-political aggressiveness has been accompanied

⁸ The concept of sharp power was developed in the 2017 report by the National Endowment for Democracy (NED) titled *Sharp Power: Rising Authoritarian Influence* analyzing how China and Russia have invested significant resources in media, academic, cultural, and think tank initiatives designed to shape public opinion and perceptions around the world. These authoritarian influence efforts have traditionally been viewed by the democracies through the familiar lens of "soft power," a concept which has become a term for all forms of influence that are not "hard" in the sense of military force or economic might. While there are no clear boundaries between the three power terms, authoritarian influence efforts in young and vulnerable democracies have been described as "sharp" in the sense that they pierce, penetrate, or perforate the information and political environments in the targeted countries. These regimes are not necessarily seeking to "win hearts and minds," the common frame of reference for "soft power" efforts, but they are seeking to influence their target audiences by manipulating or distorting the information that reaches them.

⁹ Rustemi, A. et al. 2019. *Geopolitical Influences of External Powers in the Western Balkans*. The Hague Centre for Strategic Studies.

¹⁰ Zivanovic, M. "Serbia Documented Russia Espionage Effort, President Says", *BalkanInsight*. 21 November 21 2019.

¹¹ There have been numerous reports of the Kremlin providing financing to parties across Europe, including in Germany, France, Italy, Bulgaria and Serbia.

by constant conflict or hate language from the Kremlin and its foreign ministry, targeting the most vulnerable countries from Central and Eastern Europe and on the Balkans.

The Russian captured state allows the Kremlin to turn any economic opportunity into a tactical or strategic political influence weapon as it pleases. At the same time, it stimulates the oligarchs, dependent on the state for their ultimate survival, to actively seek ways to impress the Kremlin by expecting and meeting its strategic interests or whims. This has the added value of creating the alibi of plausible deniability for the Kremlin as it can claim the respective action – such as the coup attempt in Montenegro – had been the making of an oligarch gone rogue. Many analyses of the Russian influence in Europe and in Southeast Europe have taken on board this alibi, developing the narrative of political entrepreneurs seeking to impress the Kremlin but not taking orders from it.¹² Yet, direct lines of subordination between the Kremlin and its oligarchy have been exposed in many cases, one of the most conspicuous being the relation between Russian Deputy Prime Minister Sergei Prikhodko and the aluminum tycoon Oleg Deripaska.¹³

Economic influence, which is the focal point of this analysis, has for a long time been discounted as close to irrelevant for Russian hard power in SEE. The consensus has been that Russia is a weak economic power, which is on the path of long-term decline, putting a dent to its super-power aspirations.¹⁴ The heavy focus of such research on Russia's bleak growth fundamentals including aging population, failing infrastructure and the lack of diversification into higher added-value goods have missed the point. The Kremlin has gradually centralized control over the country's economic resources converting them into instruments of influence. Russia has employed these economic tools for exerting pressure abroad including very visibly in the SEE region.¹⁵ This trend coincided with the increase of energy prices to historically high levels prompting the Russian leadership to more aggressively deploy them in combination with old time security networks to take over strategic assets, markets and companies in the region. As a result, Russia's economic influence has become an integral part of analyses of Kremlin's influence on the Balkans¹⁶ and its impact of the regions EU aspirations.¹⁷ The success of Russia in bringing Serbia

¹² For the latest example of this thesis see Deimel, J. (Ed.) 2019. *Southeast Europe in Focus. External Actors Series: Russia*. Munich: Südosteuropa Gesellschaft.

¹³ Ibid.

¹⁴ Goldman, M. I. 2008. *Petrostate: Putin, Power, and the New Russia*. Oxford University Press.

Hancock, K. J. 2007. "Russia: Great Power Image Versus Economic Reality". *Asian Perspective*, Vol. 31, No. 4: 71-98.

Ledeneva, A. V. 2013. *Can Russia Modernise?: Sistema, Power Networks and Informal Governance*. Cambridge University Press.

Aslund, A. et. al. (Eds.) 2010. *Russia After the Global Economic Crisis*. Washington D.C.: Peterson Institute for International Economics.

¹⁵ Hake, M. and Radzyner, A. 2019. *Western Balkans: Growing Economic Ties with Turkey, Russia and China, Policy Brief No. 1*. Helsinki: Bank of Finland Institute of Economics in Transition.

¹⁶ Bieber, F. and Tzifakis, N. 2019. *Policy Brief The Western Balkans as a Geopolitical Chessboard? Myths, Realities and Policy Options*. Balkans in Europe Policy Advisory Group.

¹⁷ Grieseson, R., Grübler, J. and Holzner, M. 2018. *Western Balkans EU Accession: Is the 2025 Target Date Realistic?*. Policy Notes and Reports 22, The Vienna Institute for International Economic Studies.

into a free trade agreement with the Eurasian Economic Union at the end of 2019, has starkly demonstrated the Kremlin's capacity to make tactical wins,¹⁸ which could further derail the region's EU enlargement.¹⁹ Russia's economic presence in strategic sectors, such as energy, will continue providing it with important leverage, which augments its spoiler capacity.²⁰

Many analyses of the Russian influence in Europe have focused on its **sharp power elements, and the "active measures"**²¹ the Kremlin has employed to sow distrust and political instability in the West via media propaganda and disinformation techniques. Yet, the Russian sharp power influence is just the most visible part of a more coherent, vertically integrated Russian strategy to weave a web of influence in the SEE, through networks of patronage and corruption.²² Russia has amplified its military and economic hard power with numerous soft power instruments, which have all been wrapped in sharp power narratives.²³ The centuries old soft power presence of Russia in the Balkans allows it to win approval from national governments with proposals for cultural, church, youth, etc., initiatives. These are then used to actively spread Kremlin's narratives, disrupt local political discourse and oppose Euro-Atlantic stances and viewpoints.²⁴ The emergence and proliferation of social media and the spread of media digitization has allowed Russia to further its messages and have direct, low-cost access to the local population in Southeast Europe.²⁵ Cohorts of local proxies act alongside paid Kremlin assets (influencers) and troll factories to provide further credence and boost narratives. In addition, Russia has gradually centralized and consolidated the development and spreading of Kremlin-centric messaging at home, reducing open debate and arguably increasing the effects of its disinformation and propaganda campaigns.²⁶

When its overall economic influence is limited, Russia engages much more aggressively through sharp power instruments – such as media disinformation, targeted cultural and educational initiatives – in changing narratives, sowing discord, opposing European integration, and legitimizing illiberal governance trends. Conversely, when Russian companies are very active in a country through large-scale investments and projects, the

¹⁸ Secieru, S. 2019. *Russia in the Western Balkans: Tactical Wins, Strategic Setbacks*. European Union Institute for Security Studies, Brief 8, July 2019.

¹⁹ Begic, D. 2018. "Russia's Resurgence in the Western Balkans: Effects on the Political and Social Context of the EU Negotiations of Serbia and Bosnia and Herzegovina", Master Thesis. Budapest: Central European University, Department of International Relations.

²⁰ Freund, P. and Petritsch, W. 2018. "External actors and European integration in the Western Balkans". In: Oesterreichische Nationalbank. *Focus on European Economic Integration*, Q3-18: 57-67.

²¹ A term used by Soviet and Russian security services to denote covert operations intended to disrupt or shape events in other countries.

²² Benyon, R. 2017. *Economic Transition in the Western Balkans: An Assessment*. Report to the Economics and Security Committee, NATO Parliamentary Assembly. October 2017.

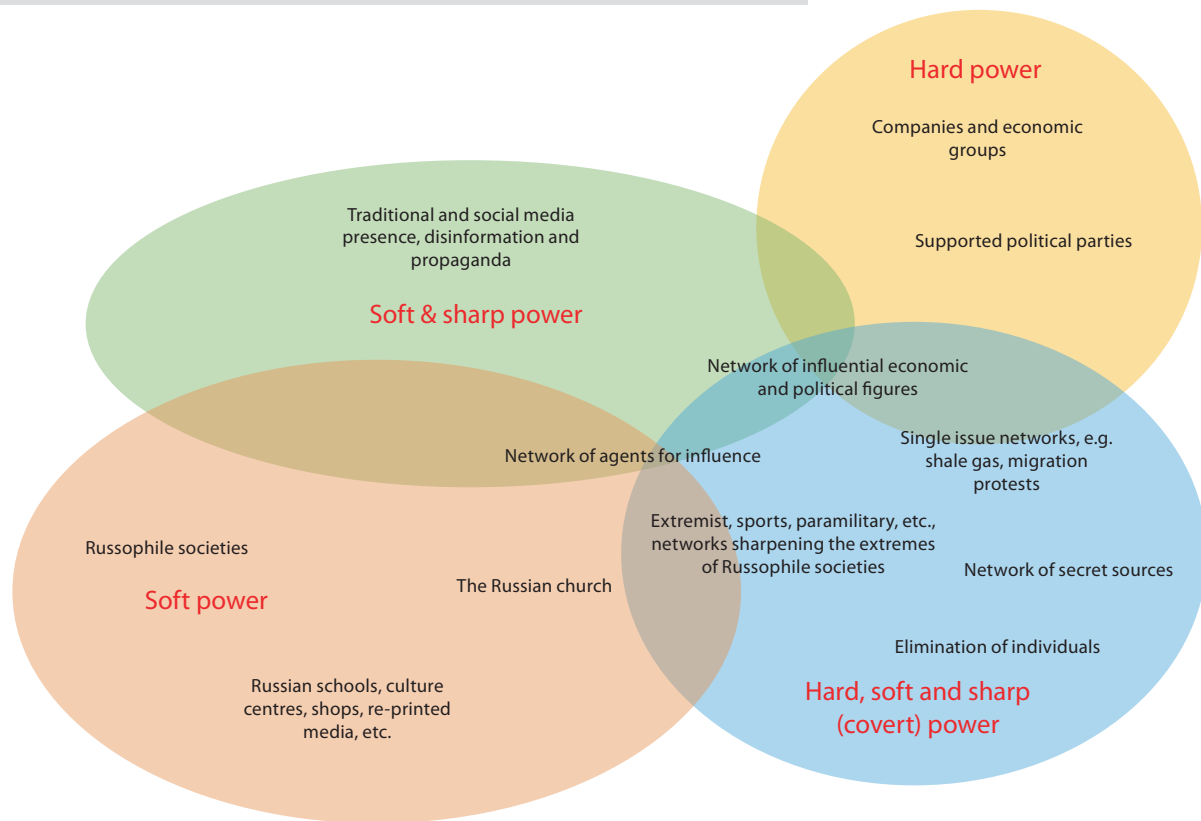
²³ Warsaw Institute. 2019. *Russia's Hybrid Warfare in the Western Balkans, Special Report*. March 2019.

²⁴ Free Russia Foundation. 2019. *Misrule of Law: How Russia Uses Western Institutions to Undermine the West*. Washington D.C.: Free Russia Foundation.

²⁵ Jensen, D. and Doran, P. 2018. *Chaos as a Strategy: Putin's "Promethean" Gamble*. Washington D.C.: Center for European Policy Analysis.

²⁶ Barbashin, A. and Graef, A. 2019. *Thinking foreign policy in Russia: think tanks and grand narratives*. The Atlantic Council of the United States.

FIGURE 2. TYPES OF POWER INSTRUMENTS EMPLOYED BY THE KREMLIN IN SOUTHEAST EUROPE



Source: Center for the Study of Democracy.

need for public engagement is reduced as local Russia-linked networks of influence could capture decision-making process without external pressure. It seems also that **Russia chooses the toolbox mix** according to the specific opportunity at hand (e.g. current political events or issue of division), the priority of the issue to the Kremlin (e.g. prioritization of gas pipelines over other energy projects), as well as popular attitudes towards Russia in the target country.

In this respect, there seem to be **three types of countries on Kremlin's sharp power influence maps**. **First**, there are the countries in which most of the population holds (traditionally) positive views towards Russia. In this case, Russia deploys the full spectrum of its influence playbook, amplifying its economic presence for strategic gains and fanning historical links, pan-Slavic or Orthodox grandstanding. Typical CEE countries in this group are Bulgaria, Bosnia and Herzegovina (Republika Srpska), Montenegro, Serbia, and Slovakia. **Second**, there are the countries which can be termed unscrupulous pragmatists; in these, the public is either split or indifferent about Russia or considers it as an inescapable factor to be reckoned with. Such countries are Croatia, North Macedonia, the Czech Republic, and Hungary. In their case Russia relies on providing the promise of business opportunities, while peddling anti-European,

extremely conservative messages. In the **third group** are countries in which most of the population is negative or highly suspicious towards Russia. Such are for example Albania, Kosovo, Poland and the Baltics. In this case the Kremlin relies mostly on sharp power instruments, spreading anti-European, anti-establishment, and extremely conservative narratives.

Ultimately, the effectiveness of Russian influence in the Balkans has been made possible by the strategic retreat of the EU and the US from the region, as well as the persistent governance deficits and state capture vulnerabilities.²⁷ For a while, the US had been unwinding its regional initiatives in the region, leaving economic and democratic rebuilding and recovery to the European Union. In 2003, the EU stepped up its commitment to Southeast Europe with a pledge to the European future of the Western Balkans. Meeting that pledge, however, has been sidetracked by various external and internal crises, which kept the Western Balkans off the top of the EU agenda. The Bulgarian EU Presidency sought to change that in 2018, when the pledge to enlargement was renewed. Although in 2015 the EU hastily started negotiations with Montenegro and Serbia – mostly prompted by Russia's resurgence globally and in the region – by 2019 Serbia's EU accession had stalled, thus failing to prevent the country from engaging further politically, militarily and economically with Russia. At the very end of 2019, France, the Netherlands and Denmark vetoed the start of accession negotiations with Albania and North Macedonia, dealing a further blow to the EU standing in the region.

While Washington continued its engagement with individual countries in the region, more specifically in Bosnia and Herzegovina and Kosovo, it only renewed its political pledge in 2018/2019 with the regional tour of the US Vice-President and the appointment of two special US envoys, for the Balkans and for the Serbia – Kosovo conflict. Restoring the regional instruments of engagement, however, would require more time and efforts.

The stalled integration of the Balkans with the EU has left the door wide open for corruption and state capture across the region, providing fertile ground for Russia's hard, soft and sharp power penetration.²⁸ Endemic corruption in Bulgaria and Romania has prompted the European Commission to introduce a special monitoring mechanism over the performance of the two countries in the area of rule of law, very similar to the accession negotiation benchmarks in this area for their Western Balkan neighbors. In a stark example of the ineffectiveness of the EU in tackling corruption even among its members, the so-called Cooperation and Verification Mechanism²⁹ on Bulgaria and Romania remains in place even after 12 years of membership.³⁰ The size of the corruption and state

²⁷ Nuttall, C. "BALKAN BLOG: EU rejection creates space for Russian return to the Western Balkans". *Intellinews*. 31 October 2019.

²⁸ Bassuener, K. 2019. *Pushing on an Open Door: Foreign Authoritarian Influence in the Western Balkans*. Washington D. C.: National Endowment for Democracy, International Forum for Democratic Studies.

²⁹ For a review of the Cooperation and Verification Mechanism and the progress reports on its implementation visit the [CVM page](#) on the European Commission website.

³⁰ The two countries joined the European Union in 2007.

capture challenge for the EU in the Western Balkans is demonstrated by the fact that in 2019 **the best performing country – Serbia – faces twice as high corruption pressure as the worst performing EU member state, Bulgaria.**³¹ Both countries have been among the prime targets and clients of Russian influence in Europe. In its 2019 enlargement package, the EU notes that credible progress in the rule of law remains a significant challenge in the Western Balkans. The primary reasons for such dismal progress are seen in the lack of political will, bureaucratic resistance and an increasingly hostile environment for civil society, which partly reflects the existence of certain elements of state capture.³²

This comparative regional assessment will provide:

- A detailed examination of the **economic channels of Russia's influence** in Southeast Europe, i.e., the means through which the Russian economic footprint are being converted into political leverage. The analysis reveals how a significant Russian economic presence can shape the overall decision-making context by creating dependencies (both structural and on the individual level) and limiting possibilities for political maneuver. Strategic and political factors can amplify but also prevail and undermine the translation of economic into political power, leading to additional strategic wins for Russia.
- The study examines the **role that each Balkan country** plays in the Kremlin playbook by analyzing the differentiated character of Russia's footprint in each case so that the reasons for this differentiation can provide an insight into the extent and limits of Russian power as well as the levels of susceptibility or resilience of each country.
- The **sharp power amplifiers** of the Russian economic and political influence are also analyzed. These amplifiers include elaborate campaigns to discredit the Euro-Atlantic integration of the countries in the region as well as democratic and liberal values as a whole.³³ By looking to alter public perceptions and social narratives, Russia has exploited and further accentuated existing social divisions or national rifts in a combustible region still scarred by the recent history of civil and ethnic wars.

³¹ Southeast European Leadership for Development and Integrity. 2019. *Policy Brief 9: Corruption in the Western Balkans: Trends and Policy Options*. Skopje: Macedonian Centre for International Cooperation.

³² European Commission. 2019 *Communication on EU Enlargement Policy*. COM 260 final, Brussels.

³³ The International Forum for Democratic Studies and National Endowment for Democracy. 2017. *Sharp Power: Rising Authoritarian Influence*.

OVERVIEW OF THE RUSSIAN ECONOMIC FOOTPRINT

After the annexation of Crimea in 2014 and the imposition of US and EU sanctions against Russia, the latter's economic footprint has declined across the SEE region. This is mostly the result of the economic recession in Russia that ensued following the slump of international oil and gas prices after 2014, squeezing the revenues and investment potential of the largest Russian companies. Still, Russian companies control all the major refineries, the wholesale fuel and natural gas supply markets and some of the most lucrative firms in SEE. These include Bulgaria's largest telecom, BTC, and the Western Balkans biggest retail chain, Agrokor. While Russia is still the largest oil and gas supplier to the region, it has seen more competition recently, especially in Bulgaria, Greece and Croatia. In these countries, a decade of US and EU efforts have resulted in the emergence of alternative supply in the form of Azeri gas and LNG, contributing to a small decline in the overall level of energy dependence on Russia.

STRUCTURAL ECONOMIC TIES

Russian-based imports to the region declined from € 7 billion in 2007 to € 5.35 billion in 2018. Except for Bulgaria, where Russia is the second biggest trading partner following Germany, in all the other countries from the region Russia is not among the top five.³⁴ Russia remains mainly a supplier of energy resources to the region. SEE countries' exports to Russia total slightly over € 1 billion or on average less than 0.5% of each of their national GDPs. The asymmetric trade relationship with Russia has led to persistent trade deficits based on the energy trade fluctuating on the back of volatile oil and gas prices.

The significance of bilateral trade deficits has declined since 2014 from as high as 10% of GDP in Bulgaria to 5.3% in 2018.³⁵ The average weight of the trade deficit for the whole region was 1.4% of GDP in 2018. It is expected to fall further in 2019 on the back of expected lower average energy prices and continuing diversification efforts in the region. Over the last 10 years, **economic growth and restructuring in the SEE, albeit much more limited than in Central Europe, have made all the countries in the region less vulnerable** to, for example, the severance

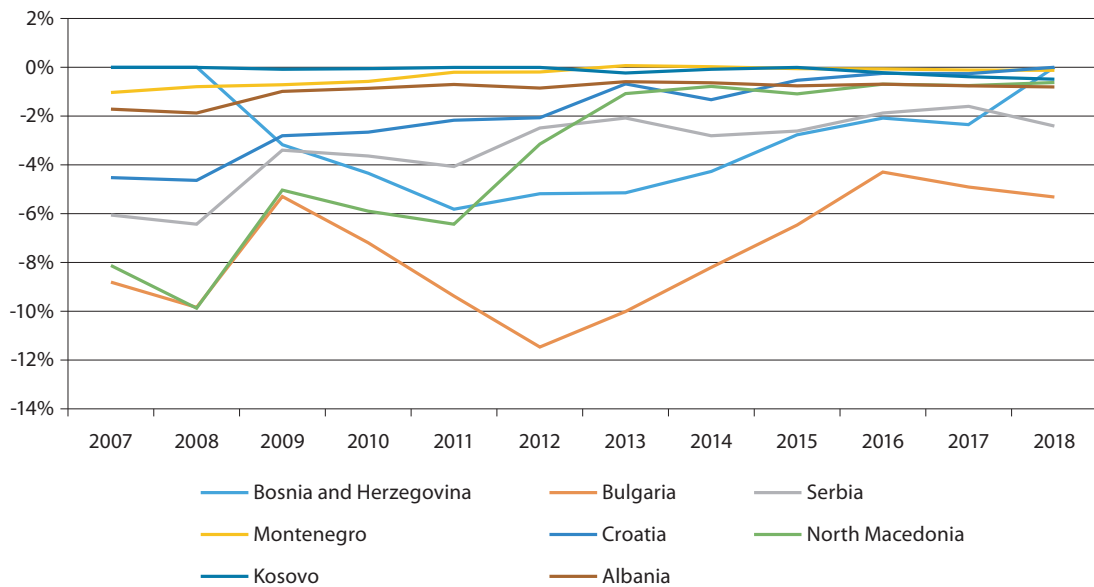
³⁴ It should be noted that comparing Russian economic influence in SEE to that of the EU as a whole, as most analyses on Russia do, could be misleading as the EU still lacks the policy coherence of a nation or even federal state.

³⁵ Russian trade with Kosovo, Albania and North Macedonia is miniscule. The three countries have combined imports from Russia worth less than € 250 million. In fact, Kosovo has almost no trade with Russia. Albania's imports from Russia have fallen to below € 100 million, most of it in fuels. Similarly, North Macedonia, which used to import more than € 350 million in fuels from Russia, has now diversified its supply to the refineries in Greece. The only major import in these three countries remains natural gas. North Macedonia depends 100% on Gazprom for gas supply via the Transbalkan pipeline.

of economic ties with Russia. Yet, in the end of 2019 Russia struck a symbolic win over the EU by having Serbia sign a free trade agreement with the Eurasian Economic Union.

Unless there is an unprecedented spike in international oil prices, it is unlikely that Russia would strengthen its trading position vis-à-vis the region. However, Russia's success in developing its strategic South Stream project into **Turkish Stream** despite EU and US objections, shows the Kremlin is still capable of using energy as a political tool. Russia continues to charge monopoly rents, taking advantage of more isolated markets such as those of many of the SEE countries including Bulgaria, Serbia, North Macedonia and Bosnia and Herzegovina.

FIGURE 3. BILATERAL TRADE DEFICIT OF SEE COUNTRIES WITH RUSSIA AS A SHARE OF GDP (%)



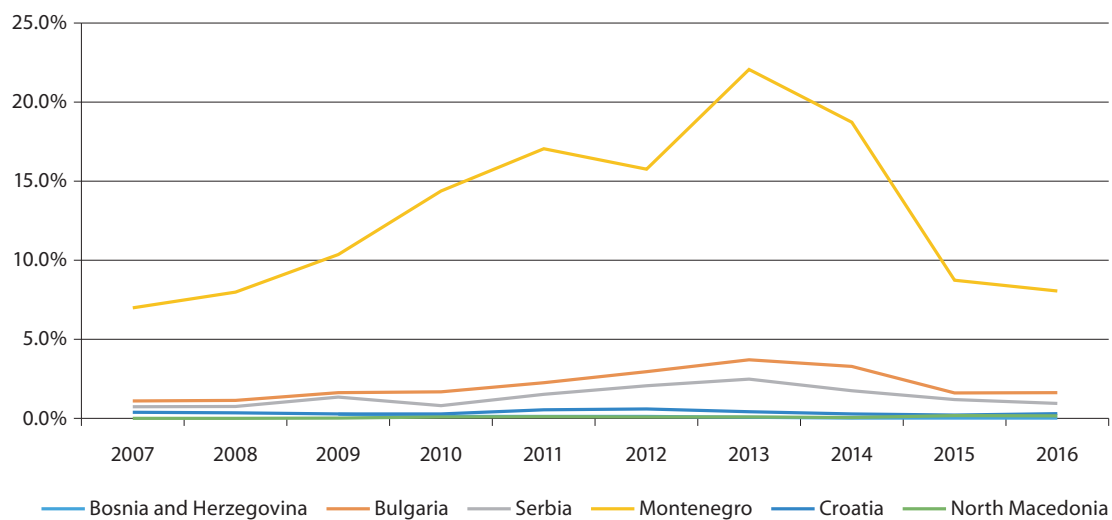
Source: CSD, based on data from the Eurostat International Trade Database (Comext).

The analysis of the SEE services trade shows a similar pattern. Russia remains a largely small trading partner, except for Montenegro. The export of tourist services to Russia plays an enormous role in the small Adriatic country's economy. Yet, even there, the export of services to Russia as a share of GDP fell from its peak of 22% in 2013 to 8% in 2016.³⁶ SEE countries have gradually diversified their supply of tourists, and as their economies have continued to grow, the importance of Russian visitors has diminished. This is not to underestimate the potential vulnerability of the tourism industry, for example in Montenegro and in Bulgaria (which received respectively around 350,000 and 600,000 Russian tourists in

³⁶ The latest year for which official data is available from the database of the United Nations Conference on Trade and Development (UNCTAD).

2018). A potential breakdown of visa cooperation or the imposition of a Russian ban on travel to these countries could temporarily hurt their economies. Russians made up 16.3% of all visits to Montenegro in 2018 spending around € 200 million or 5% of GDP. More importantly for the region, the dependence on Russian tourists is also related to the real estate boom in both countries, which is discussed in the vulnerable sectors section below.

FIGURE 4. EXPORT OF SERVICES OF SEE COUNTRIES TO RUSSIA AS A SHARE OF GDP (%)



Source: CSD, based on data from the United Nations Conference on Trade and Development.

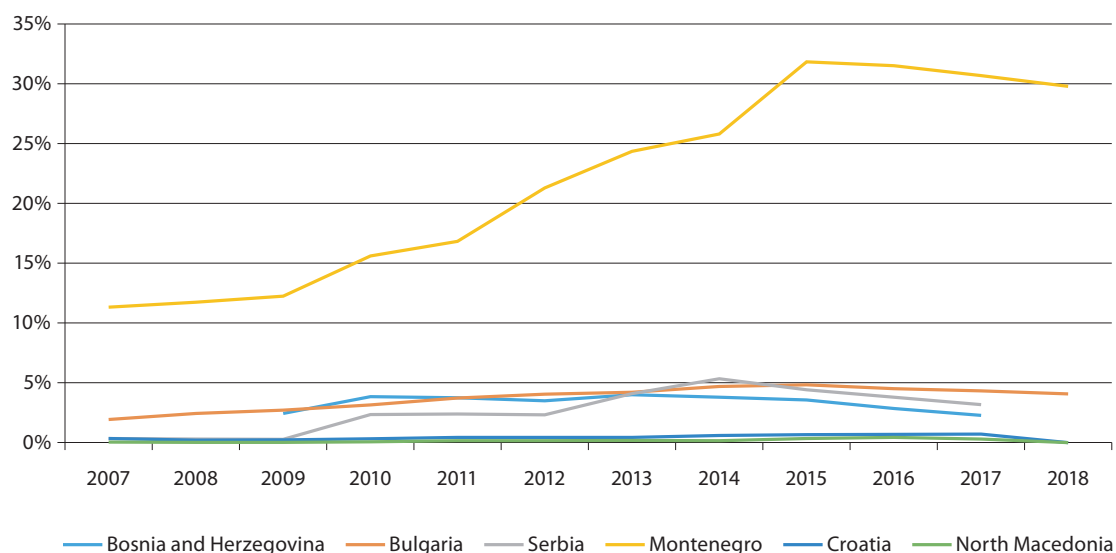
Russian foreign direct investment (FDI) in SEE started growing in the early 2000s on the back of raw materials' price increases, providing the Russian economy with windfall profits to invest abroad. Russia's total outward FDI stock rose from just over \$ 3.5 billion in 1995 to close to half a trillion dollars at the beginning of 2014. It has since fallen back during the latest economic recession to around \$ 387 billion in Q2, 2019 or a quarter of the country's nominal GDP in 2018. In the eight SEE countries under study here, the Russian inward FDI stock has increased from just below € 1 billion in 2007 to around € 5.1 billion.³⁷ Most of the investments have been concentrated in the energy, mining, banking, telecommunications and real estate sector, and Russian companies have taken over strategic assets such as refineries, wholesale oil and gas distribution companies, gold, aluminum and copper mines, the biggest telecom in Bulgaria and several retail banks across the region. Close to 90% of all Russian investments in SEE are accounted for by only three countries, namely Bulgaria, Montenegro and Serbia. Russian investments have had the biggest impact on the economy of Montenegro where they constitute roughly a third of the country's GDP. They have been largely

³⁷ Data from national central banks.

concentrated in just two sectors of the Montenegrin economy – real estate and tourism, which make up a quarter of the added value in the country. Russia practically does not have any FDI stocks in Albania and Kosovo.

Although Russian investments in the eight SEE countries have been growing over the past decade, in some cases substantially, they are dwarfed by the total investment coming from the EU. The situation changes though, if Russia's investment presence in the eight countries is compared instead with that of the largest European economy Germany alone. It then becomes evident that **Russia's investment presence is comparable to that of the largest EU countries**, in particular in some economies such as Bulgaria, Serbia, Bosnia and Herzegovina, and Montenegro.

FIGURE 5. TOTAL FDI STOCKS FROM RUSSIA AS SHARE OF GDP IN SEE COUNTRIES (%)



Source: CSD, based on national central bank data.

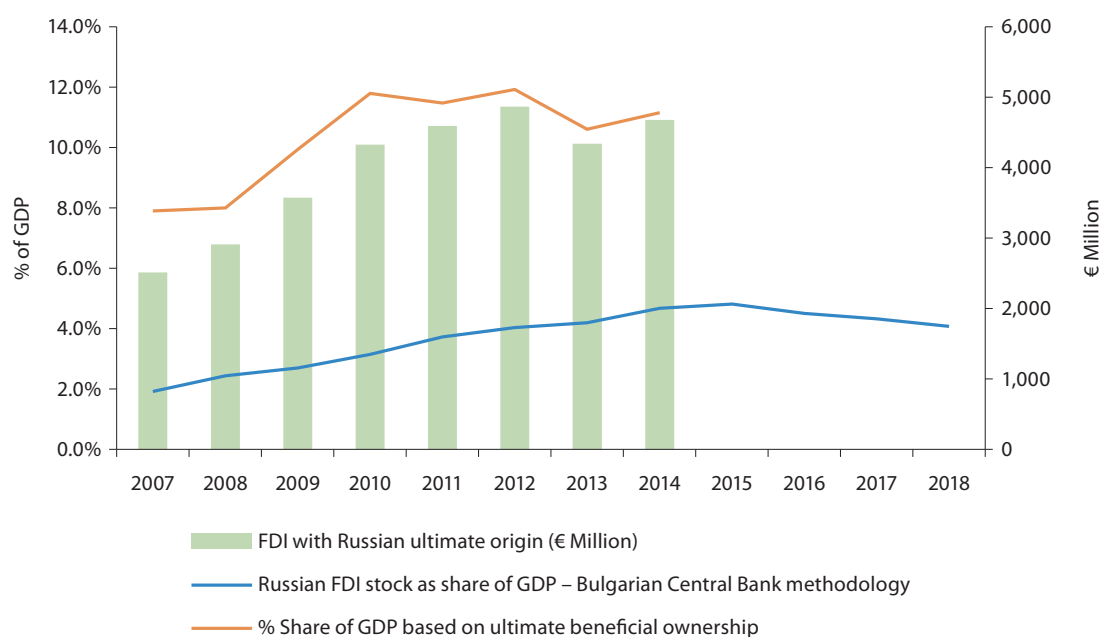
Actual Russian investments in the region would be much higher if **all flows ultimately controlled by Russian entities** are considered. These include investments channeled through offshore areas such as Cyprus or the use of intermediate investment countries like the Netherlands, Luxembourg, and Austria. These countries are among the largest foreign investors in Serbia and Bulgaria, for example. Some investments channeled through them are ultimately Russian.

Until 2014, the Russian Central Bank provided data on Russian outward FDI stock by ultimate beneficial owner, capturing part of the investments in SEE originating from Russia, which were channeled through third countries. The data shows that in cases such as Bulgaria and Serbia the investments with Russian ultimate origin are much larger than reported

by the respective national central banks. According to the Russian Central Bank, in 2007 – 2018, Russian companies have invested in Bulgaria about 30% more (or around € 2.8 billion more) than the Bulgarian national statistics has accounted for. The difference in the case of Serbia is similar (€ 1.16 billion versus € 1.4 billion).

If the **FDI stocks coming from the Dutch-registered Russian subsidiaries** are added, the total amount of Russian FDI in Bulgaria would more than double to around € 4.5 billion. This would make Russia by far the largest foreign investor in the country, with investments of around 11% of GDP.³⁸ Russian investments in Bulgaria are also the most varied in the region in terms of sectors targeted: Russian companies have taken over assets in oil refining, fuel and gas distribution, telecommunications, steel production and arms production. On top of that come investments of more than € 1 billion in real estate property located at the Black Sea or in the mountain resorts of the country.

FIGURE 6. TOTAL FDI STOCKS FROM RUSSIA BY ULTIMATE BENEFICIAL OWNERSHIP – THE BULGARIAN CASE



Source: CSD, based on the Bulgarian National Bank statistics.

³⁸ The estimate is based on data analysis on company-level foreign investments coming from different countries. The statistical breakdown is available only until 2014 but it still clearly shows the ultimate Russian corporate ownership of many of the investments in the country.

RUSSIAN CORPORATE FOOTPRINT

A measure of Russian corporate presence and networks in the region is needed in order to understand how structural economic vulnerabilities and the investment presence of Russia in SEE translate into an augmented Russian political influence and what are the amplifiers at work. It identifies companies with direct and indirect links to Russian entities or political structures. The method includes analyses the **revenues, assets, and employment figures of all Russian-owned or controlled companies** in SEE. The aggregate values of these three indicators are then compared with the totals for the respective economy creating a proxy for the share of Russian corporate presence in each of the countries. These three indicators have been identified in field research and expert analyses as the most reliable evidence of potential vulnerability to Russian political meddling.

The development of the bulk of this corporate presence in SEE has naturally followed a profit motive. However, Russian captured state as well as persisting governance deficiencies in the region have allowed the Kremlin to exploit even profit-seeking economic presence for its own tactical or strategic political benefit.

Similar to investments and trade, the **corporate footprint (share of revenues) of Russian companies in the region has declined**. It has been on the decline since 2014 when it was on average 6.3% of the total revenues for the economy to around 3.6% at the end of 2018. The fall is driven largely by the decrease of oil and gas prices determining the revenues components of large Russian energy companies in SEE. The continuing growth of the regional economies also contributes to the shrinking of Russia's share in it. Even in Croatia where the Russian state-owned banks, Sberbank and VTB, took over the country's largest company, Agrokor, the overall corporate footprint has fallen as the holding's revenues have plummeted and the Croatian economy has been growing. This downward trend could change, however, depending on the development of work energy prices and strategic factors, such as the signing of a free trade agreement between Serbia and the Eurasian Economic Union. While the Russian footprint has stabilized in most countries, it bounced back in Bulgaria from 2.3% in 2017 to 4% in 2018.

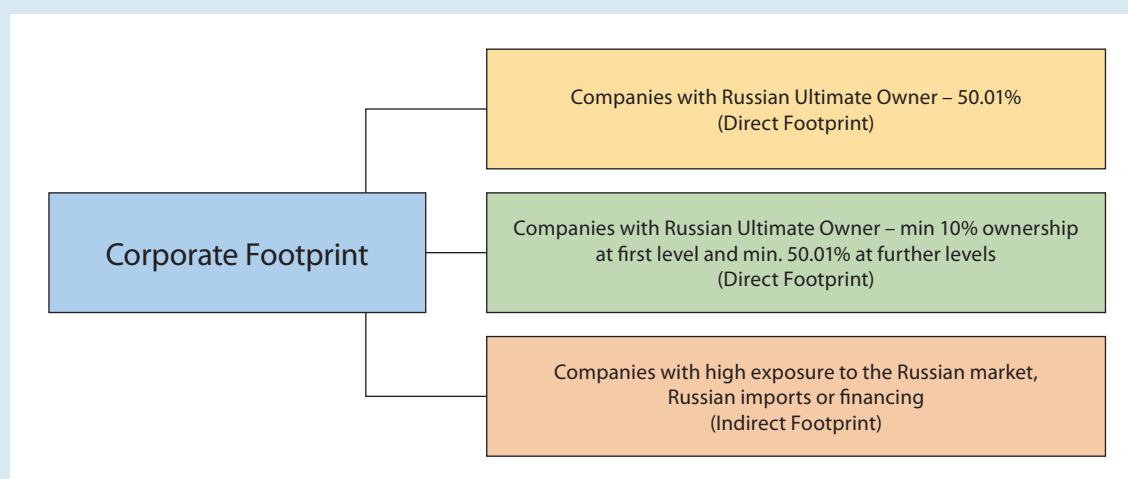
Due to gaps in the coverage of the financial data, the measure of the corporate footprint is based on a conservative estimate. It can be concluded that in the past decade Russian companies have controlled on average between 5% and 10% of the SEE economy under consideration. The fact that many of the controlled companies are strategic firms with sometimes significant weight in highly regulated industries (such as energy, telecommunications, and metallurgy) indicates that their indirect influence over pricing and competition could be assessed as much greater than the nominal values suggest. It should also be noted, that the numbers do not take into account opaque ownership structures, which many Russian companies use to hide their presence.

**Box 1. Measuring Russian economic footprint:
note on methodology**

The measurement methodology of Russian economic footprint assumes three levels have been considered for SEE companies, each time with a different criterion for the identification of their ultimate owner or beneficial owner. The first two relate to direct ownership, while the third one explores indirect measures of influence or control. The measurement methodology distinguishes between economic and corporate footprint – *corporate* includes only the share of Russian controlled revenues in total revenues for the economy, whereas *economic* includes also investments, employment, assets, and is less strictly defined.

The first level corporate footprint analysis identifies all business entities with revenues over € 1 million that have a Russian legal or natural person as the ultimate beneficial owner (UBO) of a minimum of 50.01% of the company's shares. A second level of analysis expands the coverage to all companies with Russian UBO of a minimum of 10%. Finally, a qualitative assessment of the structure of the domestic economy reveals which local companies that have no Russian UBO still have a significant exposure to the Russian market akin to indirect control or influence. The exposure could be very high dependence (typically beyond 50% or of critical importance) on exports, on imports and/or on loan/capital to/from Russia.

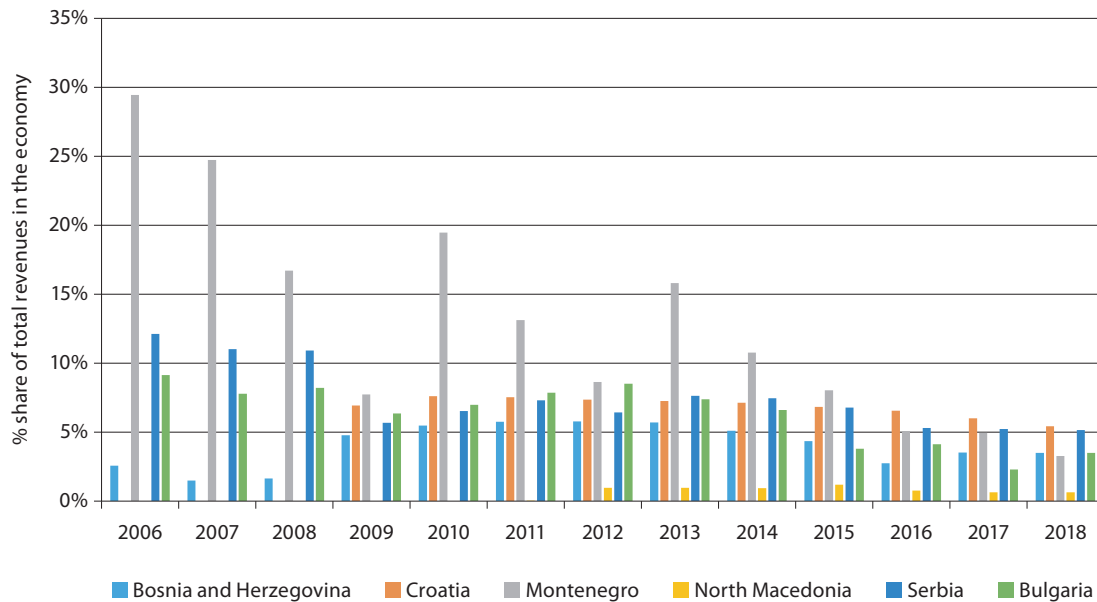
FIGURE 7. CRITERIA FOR THE IDENTIFICATION OF COMPANIES WITH RUSSIAN DIRECT AND INDIRECT CONTROL



To estimate the corporate footprint, the analysis uses one main indicator – revenues, and two additional – assets and employment. The revenue (corporate footprint) indicator provides an assessment of the cash firepower of Russian corporates, including potential to inflict budget revenue loss, capacity to influence the wider value-added chains in the economy, outreach, PR and advertising budget potency (often including corrupt payments), etc. The assets indicator points to the presence of cash cows or other structurally important enterprises, and/or can provide an overview of the willingness of Russian capital to commit to the local economy, and its potential to engage in further acquisitions. The employment indicator is the most socially relevant one, and shows the level of embeddedness of Russian business interests in the local communities.

The more concentrated in fewer entities any of the indicators is, the higher the vulnerability to misuse. Drawing upon the results of the corporate quantitative analysis and the data on investments and trade, as well as upon corporate network insights in each of the eight countries, the assessment describes the mechanics and impact of Russian influence and identifies areas of vulnerability.

FIGURE 8. OPERATING REVENUES OF RUSSIAN CONTROLLED COMPANIES AS A SHARE OF THE TOTAL OPERATING REVENUES OF ALL COMPANIES IN THE ECONOMY (%)



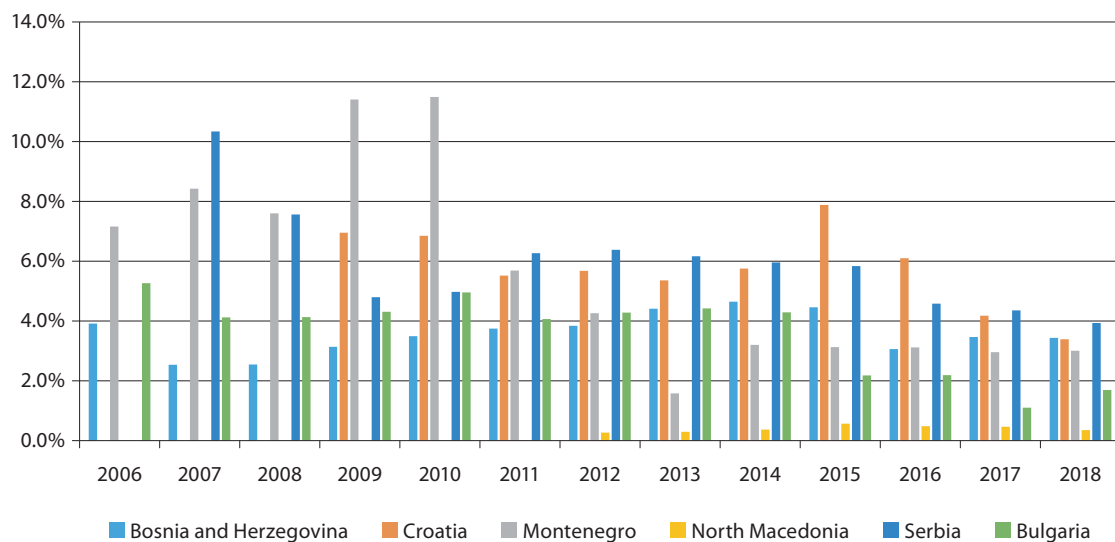
Source: CSD calculations based on statistics from national and international corporate databases.

As with the investment analysis, the obvious outlier on the **corporate footprint indicator** has been Montenegro. It saw the biggest influx of Russian capital immediately after its independence in 2006. Most notably, the Russian aluminum tycoon, Oleg Deripaska, acquired the country's largest company, the Podgorica Aluminum Plant (KAP). KAP accounted for around 50% of Montenegro's exports at that time. The share of Russian corporate footprint in the overall economy (in terms revenues) has, however, shrunk significantly, from 29.4% in 2006 to 3% in 2018. This has mainly been due to the bankruptcy of KAP in 2013, and the subsequent withdrawal of Mr. Deripaska. In terms of nominal values, Russian companies in Montenegro control a total turnover of around \$ 500 million, which is 46% lower than the level in 2014. In addition, as the Montenegrin economy has continued growing, the Russian presence has gradually declined. Yet, it must be noted that these figures could underestimate the actual Russian corporate footprint. Financial statistics is missing for more than half of all Russia-owned companies in Montenegro.

The slump in Russian corporate footprint in Bulgaria and Serbia is mostly a reflection of the structural trends resulting from declining oil prices and economic growth. The recent sale of some large Russian controlled companies in Bulgaria has contributed to the trend, such as Bulgaria's state-owned tobacco company or the failure in 2014 of the fourth largest bank in the country (the Corporate Commercial Bank) with links to Russia's VTB. Somewhat surprisingly, Russia's revenue corporate footprint in Croatia has stayed above the 5% threshold during the whole of the past decade.

In terms of **corporate assets**, in the past decade, Russian holdings have been cut in half from an average of 6.5% to 2.8% of the value of all assets in the SEE economy. The fall has been the steepest in Montenegro and Bulgaria where Russian corporate assets have declined threefold in the former and fivefold in the latter. The biggest contributors to this decline have been the continuing economic growth in the region, as well as the decline in the valuation of energy-related Russian companies, following the fall in the price of oil and gas. Even the Russian acquisition of Agrokor did not change the situation much in any of the countries most affected (Croatia, Bosnia and Herzegovina and Serbia) as the company's financial troubles had devalued its assets. Some of the largest Russian companies in the region have actually been loss-making entities, including most refineries, fuel and gas distribution companies and retail firms. One plausible explanation is that they have been using tax avoidance schemes to shift profits out of the region. But it has also been generally true that Russian companies have been taking over troubled businesses with little growth prospects. These have then been used either as cash cows for Russian oligarchic networks and/or as an instrument for monopolization of markets. The latter has become a source of economic and political vulnerability used to pressure governments on other strategic issues.

FIGURE 9. VALUE OF ASSETS OF RUSSIAN CONTROLLED COMPANIES AS A SHARE OF THE TOTAL VALUE OF ASSETS OF ALL COMPANIES IN THE ECONOMY (%)

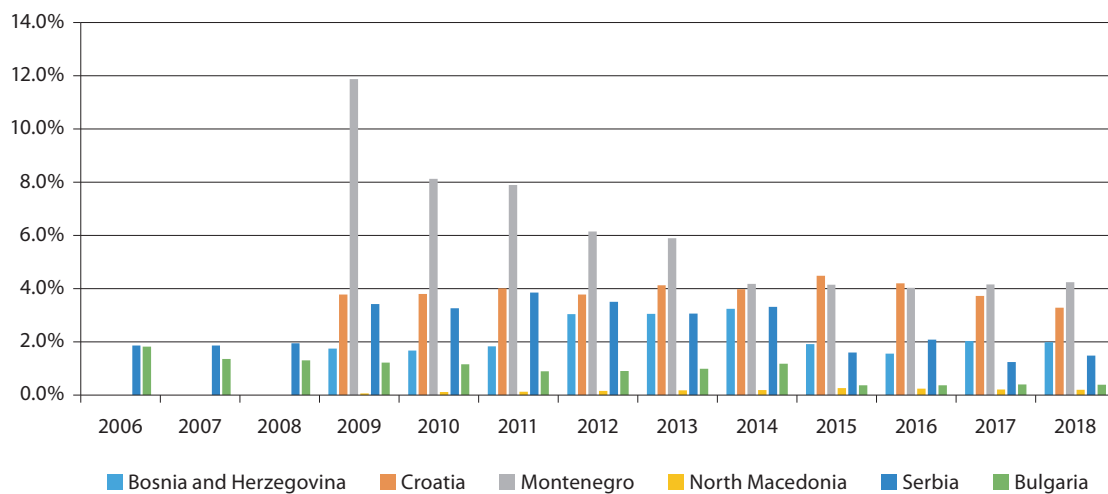


Source: CSD calculations based on statistics from national and international corporate databases.

In employment, Russian companies control roughly the same number of people in the region as ten years ago, or some 85,000 people in all 8 countries under consideration. Montenegro has been an outlier also in this corporate footprint indicator due to the KAP case. At the height of the company's power in the 2006 – 2010 period Russian firms, including KAP, employed around 12% of all employees in Montenegro. The

decline in the number of people working in Russian-owned companies in traditionally the most important Russian investment destinations in SEE – Bulgaria and Serbia – have been compensated by the expansion of Russian presence in Agrokor in Croatia. The number of people working in Russia-controlled entities in Croatia rose from around 3,500 to between 35,000 and 40,000 in the last three years.

FIGURE 10. EMPLOYMENT IN RUSSIAN CONTROLLED COMPANIES AS A SHARE OF TOTAL EMPLOYMENT IN ALL COMPANIES IN THE ECONOMY (%)



Source: CSD calculations based on statistics from national and international corporate databases.

Agrokor is an important case to watch. It has been, like many others, a very risky bet by the Russian state-owned Sberbank, which holds very high strategic potential for influence in SEE. Indirectly, Agrokor, has influence over thousands of small and medium-sized enterprises in the whole region, which employ up to 100,000 people. In that respect, Bosnia and Herzegovina is likely to be the most affected by potential instability in the supply chains of Agrokor. The eventual restructuring of Agrokor would increase Russian corporate presence in BiH. Agrokor has a total of eight subsidiaries in Bosnia and Herzegovina, with a total of over 5,000 employees. The sale of the largest of them, Konzum (3,854 employees), could have a domino effect of its suppliers if it results in bankruptcy and non-payment of its dues to suppliers. Konzum has more than 100 suppliers, including large meat and dairy plants.³⁹

Penetration by Russian corporations has reached the core of the economies of Croatia, Bosnia and Herzegovina, Montenegro, Serbia and Bulgaria, but Russian companies have very little presence in Albania, Kosovo and North Macedonia. The corporate data analysis reveals that there have not been any sizable Russian companies registered in the

³⁹ Among the biggest suppliers are the following companies: Coca Cola, AS Jeloh Group, Atacco, Violeta, Orbico, Megamix, Milkos, Meggle, Akova, Perutnina Ptuj and Bimal Brcko.

latter three countries. One possible explanation could be that some Russian investments might have preferred to enter these countries using the cloak of shell companies originating in popular European offshore destinations such as Cyprus and Luxembourg. In Albania, for example, the vast presence of shell companies with anonymous owners could mean that Russian companies might attempt to obfuscate their ultimate beneficial ownership too. Such has been the case of Transoil Group AG. The company,⁴⁰ formally incorporated in Switzerland, is believed to be connected to Gazprom Neft and the Serbian NIS. It won the tender of the state-owned company, Albpetrol, for the concession on three oil fields in Southern Albania.

In another instance of cloaked Russian presence in the region, Spas Roussev – a Bulgarian businessman who has been associated with Russian interests – has acquired Telekom Albania, the second-largest telecommunications company in the country, through a Luxembourg-registered company called Albania Telecom Invest. At that point Mr. Roussev was the controlling shareholder of the largest Bulgarian telecom, which had the Russian state-owned bank, VTB, as the ultimate beneficial owner.

In Kosovo, Russian business is represented only through three NIS gas stations in the Serb populated areas of the country.⁴¹ This is despite the fact that the government of Kosovo specifically listed Gazprom in its decision to sanction Russian companies operating in the country. A Serbian cabinet minister has been publicly urging Russian companies, including Lukoil and Gazprom-owned NIS, to invest in the Serb populated areas of Kosovo.

In North Macedonia, there are 106 companies with direct Russian ownership with total revenue of just below \$ 160 million. These revenues have been highly concentrated in several entities, including in Lukoil, in the real estate, gambling and sports companies of Sergei Samsonenko (the self-proclaimed richest person in the country), in the heating plant Te-To, and in the gas pipeline construction entities of Stroytransgaz (under joint US and EU sanctions). Another 85 North Macedonian companies are members of the Macedonian-Russian Chamber of Commerce in Skopje, most of which are in the agricultural, food and beverages sectors. Still, they make up a little over half a percent of the total revenues in the economy. However, as in the case of Albania, there are several large companies such as Solvay and Jugohrom, which are controlled by offshore entities but appear to be in the hands of Russian individuals.

⁴⁰ Transoil Group AG is a company established in 2011 in Switzerland, with operations in Russia, Belarus and Albania. The company owns Transoil Group Sh.a, an Albanian company that since 2011 has exploration and exploitation rights through agreement with the state owned company in Albania for the oil field of Visoka. (see: Likmeta, B. "Koncesioni i fushave të naftës, Gjijnuri favorizoi kompaninë e lidhur me Gazprom". *Reporter.al*. 6 June 2018.

⁴¹ "Kompania ruse e naftës futet ilegalisht në Kosovë". *Zeri.info*. 15 December 2016.

VULNERABILITIES IN THE ENERGY SECTOR

Energy has been the most visible and well-studied channel for Russian economic influence in Europe.⁴² Energy import has been the core element in persistent trade deficits between Russia and most European countries. In the eight SEE countries under study, the bilateral trade deficit with Russia is mostly due to the import of oil and gas. The gap, however, has been shrinking on the back of falling global oil and gas prices since 2014 and the limited but ongoing diversification of supply sources. Russian natural gas deliveries have fallen by a quarter in 2019 as Turkey and Greece have expanded the import of Azeri gas via the newly launched TANAP pipeline.⁴³ At the same time Bulgaria has imported around 15% of its annual consumption from LNG delivered at the Revithoussa regasification terminal near Athens.⁴⁴ Serbia, North Macedonia and Bosnia and Herzegovina, have remained 100% reliant on Gazprom for their gas supply. They have done very little work on diversification projects such as interconnectors with neighboring countries or the conclusion of alternative import contracts with non-Russian suppliers. Surprisingly, Croatia, which – together with Romania – has been seen as the beacon of natural gas independence in SEE due to its significant domestic production, increased the share of its Gazprom deliveries from around a third in 2012 to around two-thirds in 2018. The dependence on imported gas would have been even greater if not for the six-year recession of the Croatian economy (2009 – 2015) causing energy consumption over that period to stall or even decrease.

The SEE dependence on Russia for natural gas has been cemented with **long-term gas supply contracts** (LTCs) with the dominant supplier Gazprom, containing highly inflexible strict take-or-pay clauses⁴⁵ and oil indexation. As a result, SEE wholesale gas market players have been **overpaying Gazprom by between 15% and 25%** in comparison to the average Gazprom price in Western Europe.⁴⁶ The decline in oil and gas markets after 2015 and the antitrust case initiated by the European Commission against Gazprom have reduced the profit margins that the Russian monopolist has been able to extract from SEE clients. SEE prices have respectively converged somewhat to European levels but they still pay a premium even compared to Central European countries.

⁴² For a review of the use of Russian energy policy as a tool for influence see Rühle, M. and Grubliauskas, J. 2015. *Energy as a Tool of Hybrid Warfare*. NATO Research Paper, No. 113. Rome: NATO Defense College.

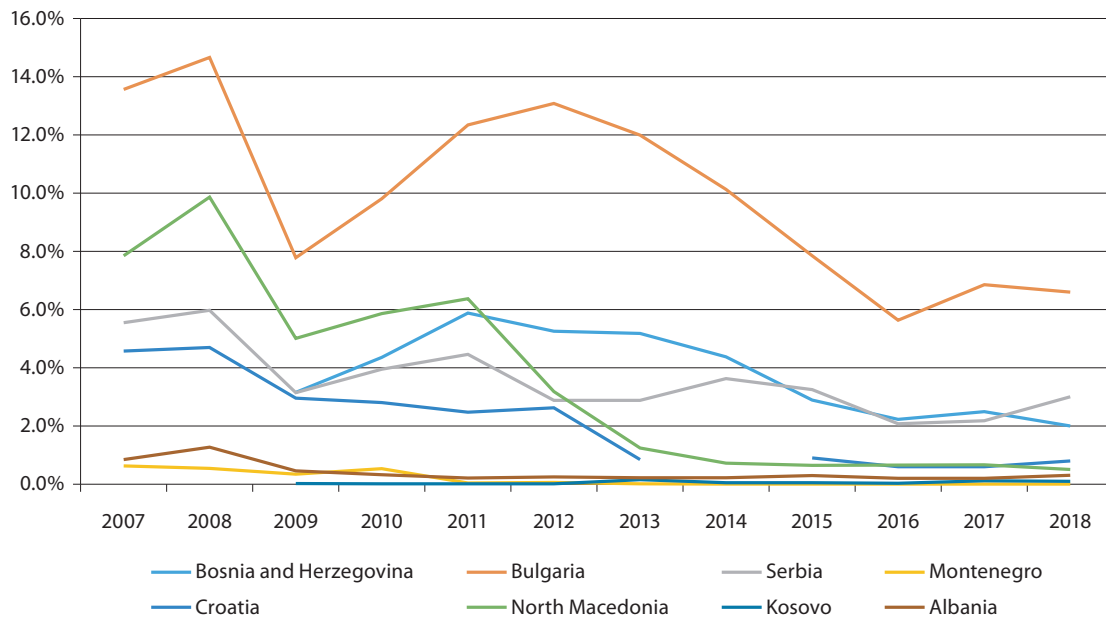
⁴³ Based on the analysis of customs data on volumes and costs.

⁴⁴ Bulgargaz report to the Bulgarian energy regulator, the Energy and Water Regulatory Commission, for the price setting for Q1, 2020.

⁴⁵ The take-or-pay clause refers to the existence of a minimum volume to be supplied under a long-term agreement, which has to be paid by the customer even if the latter's consumption is below these minimum quantities.

⁴⁶ Based on the analysis of customs data on volumes and costs.

FIGURE 11. RUSSIAN OIL AND GAS IMPORTS IN SEE COUNTRIES AS A SHARE OF GDP (%)*



* 2014 data for Croatia was not available.

Source: CSD, based on COMEXT statistics.

There exists a wide body of knowledge and evidence that Russia has used Gazprom to punish or reward CEE and SEE countries depending on their foreign policy stance on Russian commercial and political interests.⁴⁷ Most LTCs will have to be renegotiated in the early 2020s but with the lack of viable diversification options, it would be difficult for the SEE governments to improve their bargaining position and, thus, the terms of the contracts.

One major exception could be Bulgaria, which is expected to complete the strategic **interconnector Greece-Bulgaria** (IGB) by the end of 2020 allowing the biggest wholesale market player in the country, Bulgargaz, to begin purchasing Azeri gas from the Trans-Adriatic pipeline through Greece. IGB would be able to meet around a third of the current Bulgarian consumption providing the Bulgarian government with leverage to demand the reduction of supply volumes from Gazprom, and the abolition of the punitive take-or-pay clause in the new LTC to be negotiated until 2022. Currently, Bulgaria has to pay for 80% of the natural gas it receives from Russia no matter if it is used or not. In addition, until 2016 and before the anti-trust settlement between Gazprom and the European Commission that forced the Russian company to amend its pricing policies in Central and Eastern Europe, Bulgaria had a destination clause in its LTC. It barred the country from reselling the Russian gas it

⁴⁷ See for example Vagin, K. V. 2012. "Russian Energy Policy vis-à-vis Europe: Natural Resources as a Means of Foreign Policy", Thesis. Monterey: Naval Postgraduate School.

did not consume. Similar destination clauses were found in the contracts of other eight CEE countries leading to an effective monopolization of the CEE gas market by Gazprom. In the Western Balkan countries, which are yet to implement the EU energy acquis and liberalize their gas markets, Gazprom continues to control all the variables in the contractual relationships.

The Kremlin uses the negotiations on the LTCs' terms as a bargaining chip on large infrastructure deals such as South Stream and Turkish Stream or for delaying gas market liberalization. Back in 2012, Gazprom gave Bulgaria a 20% discount on the natural gas price under the new 10-year LTC provided the Bulgarian government met its commitment to complete the South Stream pipeline. This has been identified by EU's DG Competition as an illegal practice and has contributed to the Commission's decision in 2017 that Gazprom had been abusing its **dominant position in CEE markets**.⁴⁸

LTCs in SEE are shrouded in secrecy but what they all share in common is the existence of natural gas **intermediaries that serve as exclusive resellers of Gazprom gas on the domestic markets**. These firms are usually directly controlled by the Russian supplier, or jointly with a local well-connected oligarch or player. The intermediaries act as resellers of the Russian gas to the national gas incumbents at a higher than the import price in the long-term contract. The intermediary scheme has been institutionalized through bilateral state contracts allowing such companies to act as important determinants of the host country's gas policy.

The intermediaries in gas imports have served also as political envoys pressuring the national governments on issues of strategic importance to Russia. In the cases of Bulgaria, Serbia and Hungary, the intermediaries were among the most active **promoters of large-scale strategic Russian energy projects such as the South and Turkish Stream gas pipelines**.⁴⁹ Similar intermediary schemes have also been applied in the cases of the Belene (Bulgaria) and Paks (Hungary) nuclear power plants. Energy intermediaries have been instrumental to creating good will towards Russia through engaging key local policy makers. In many cases, intermediaries have used their PR and advertising infrastructure to fund media and public protest campaigns that further Russia's political and economic interests. The most notable case in this respect has been the EU-wide anti-fracking campaign.⁵⁰

In the cases of Serbia and Bulgaria, Russia's energy leverage has been sufficiently effective as to allow it to place close allies in key political

⁴⁸ Toplensky, R. "Gazprom reaches draft anti-trust deal with EU". *Financial Times*. 13 March 2017.

⁴⁹ For a more detailed assessment of the governance deficits of large scale Russia – backed energy infrastructure projects, see Shentov, O., Stoyanov, A. and Yordanova, M. (Eds.). 2014. *Energy Sector Governance and Energy (In)Security in Bulgaria*. Sofia: Center for the Study of Democracy; and Shentov, O., Stoyanov, A. and Yordanova, M. (Eds.). 2011. *Energy and Good Governance in Bulgaria: Trends and Policy Options*. Sofia: Center for the Study of Democracy.

⁵⁰ In 2014, following many media reports to this effect, the outgoing NATO Secretary-General Anders Fogh Rasmussen was quoted as saying that he "has met allies who can report that Russia, as part of their sophisticated information and disinformation operations, engaged actively with so-called non-governmental organizations – environmental organizations working against shale gas – to maintain European dependence on imported Russian gas."

positions.⁵¹ The lower price that Gazprom subsidiary intermediaries receive for their imports translates also in larger share on the local markets, where they can offer better contractual terms to households and industrial clients. These **additional profits are reinvested in bolstering the dominance of the intermediaries on the local markets** through the expansion of domestic gas distribution networks (as in Bulgaria) or the financing of cultural, media and sports projects. At the same time, the intermediaries put the national gas incumbent at a disadvantage, as it is forced to buy at a premium. Covering such premiums often leads to the accumulation of losses, in particular in times of internationally high prices, when national energy regulators try to safeguard social peace by mandating lower price hikes. The accumulation of gas debts to Gazprom (directly) or to its intermediaries could be used as a pretext by the Russian company to leverage potential cut of supply flows or debt reduction for achieving political purposes.

Therefore, by **implanting politically privileged economic actors in the energy sectors** of the SEE countries, Russia has been able to exert much **larger impact on the political scene** than its corporate or investment presence suggests it can. Ultimately, Russia has been successful in significantly delaying or preventing the full gas market liberalization and key interconnection projects from becoming a reality in SEE. For example, Russia has used its political influence to cement the Serbian energy dependence. In 2014, a few days before President Putin's visit to Belgrade, Gazprom cut gas deliveries to Serbia by 30% citing Srbijagas' outstanding debt to the Russian major.⁵² The real reason for the supply cut, though, had probably more to do with the Serbian government's probe into the legality of the 2008 state contract with Gazprom on the sale of NIS.⁵³ Intergovernmental agreements such as the one on the acquisition of NIS in Serbia open up the way for Gazprom's influence over the financial management and governance of state-owned gas supply in SEE. Similar patterns have been observed in Bulgaria too.

Box 2. Gas intermediaries: mixing business with politics in Serbia

One of the prime examples of the fusion between politics and business and the role of Russia in SEE gas markets has been the case of Srbijagas. The company's CEO Dušan Bajatović, is also vice president of the ruling SPS, the party founded by former Serbian President Slobodan Milošević. He is widely considered to be the principal Gazprom intermediary in Serbia. Bajatović has kept his position at the helm of Srbijagas for almost a decade with the alleged support of the Kremlin. In addition, he is Srbijagas' representative (co-director, member of the Boards of Directors or of the Supervisory Boards), in all joint ventures and projects involving Gazprom (where Gazprom is a majority shareholder controlling at least 51%): South Stream Serbia A.G., Južni tok d.o.o., Banatski Dvor Gas Storage Facility, Yugorosgaz and Sogaz insurance. In Yugorosgaz alone, which is the principal reseller

⁵¹ The CEO of Srbijagas (the Serbian state-owned gas monopoly) is also the Vice President of the largest opposition party – the Socialist Party.

⁵² "Russia Reduces Gas Flow to Serbia over Unpaid Debt". *Novinite.com*. 1 November 2014.

⁵³ Montes Torralba, R. "Belgrade at the crossroads: Serbian-Russian relations in light of the Ukraine crisis". The Elcano Royal Institute, ARI 63/2014. 22 December 2014.

Box 2. Gas intermediaries: mixing business with politics in Serbia (continued)

of Russian gas to Srbijagas and other clients on the wholesale market, his salary is more than 10 times higher than what he receives as a CEO of Srbijagas.⁵⁴ Although in 2014 Serbia's anticorruption agency reacted to these visible conflicts of interest with official recommendation for his removal from office on the grounds that he was in a conflict of interest position, he managed to defy it.⁵⁵ In addition to acting as a key intermediary for Gazprom, Bajatović has also been openly objecting to Serbia's efforts to diversify its gas supply via an interconnector with Bulgaria for years.⁵⁶ Although there have been attempts to change the management of Srbijagas, it seems that after the intervention from President Putin via then Serbian president Tomislav Nikolić, in 2014 his position was firmly secured.⁵⁷

Gazprom intermediaries have also played an important role in expanding Russia's presence in the **Croatian** energy sector. The most important Russia-related player in the Croatian energy sector is PPD, a reseller of Gazprom's natural gas. In 2017, Gazprom signed a ten-year contract with PPD to supply it with 1 billion m³ of natural gas per year. The deal was first announced by Gazprom Export, claiming that it would eliminate the need for an LNG terminal in Croatia.⁵⁸ An LNG terminal in Croatia would allow a diversified gas supply route to the whole region that is currently almost exclusively dependent on Gazprom's natural gas, but is a direct threat to Russia's interests.

The sudden business expansion of PPD and its parent group ENNA has been described in the Croatian press like "an American dream story". Formerly owned by a Hungarian subsidiary of E.ON, PPD changed hands in 2010 when it was bought by its current owner Pavao Vujnovac. Back then it was a small company, established to connect households in Vukovar to gas supply. When Mr. Vujnovac took ownership, the company was netting losses and its yearly turnover amounted to around € 7 million.⁵⁹ In the years since, PPD has become the most successful privately-owned Croatian company, with yearly turnover of more than € 1 billion. The company's success was largely built on its partnership

⁵⁴ Latković, N. "Srbijagas" u sve većoj dubiozi, a Bajatoviću VEĆA PLATA za čak 1.400 evra.". *Blic*. 7 February 2017.

⁵⁵ Baković, B. "Kako je Bajatović zadržao sve funkcije". *Politika Online*. 10 April 2016.

⁵⁶ The management of Srbijagas has delayed the liberalization of the natural gas sector despite repeated criticism from the European Energy Community and the agreement with the European Commission that the sectoral restructuring would unlock funding for the gas interconnector Bulgaria-Serbia. According to the Energy Community Secretariat, the two transmission system operators licensed in Serbia, the state-owned Srbijagas and the Gazprom intermediary, Yügorosgaz, did not fulfil their obligations to effectively separate the activities related to gas transmission from gas production and supply, as required by the EU energy rules. After strong pressure from the Energy Community and the EU, two new companies were formally established within the Srbijagas holding, one tasked with gas transportation and the other with gas supply. With a government decision, they received an operational permit in January 2017, despite the fact that Serbia's energy regulator declined to license these companies, since the unbundling process happened only on paper (both companies had neither property, nor employees). The Energy Community and the EU still insist that the task of restructuring both companies has not yet been finished.

⁵⁷ "Resetnjikov: Ministarka sabotira sporazum Podeli Tvituju". *Radio Televizija Vojvodine*. 6 November 2013.

⁵⁸ Барсуков, Ю. ("Хорватия вернулась к "Газпрому"). *Коммерсантъ*. 18 September 2017.

⁵⁹ Fina. Register of Annual Financial Results of Companies in Croatia.

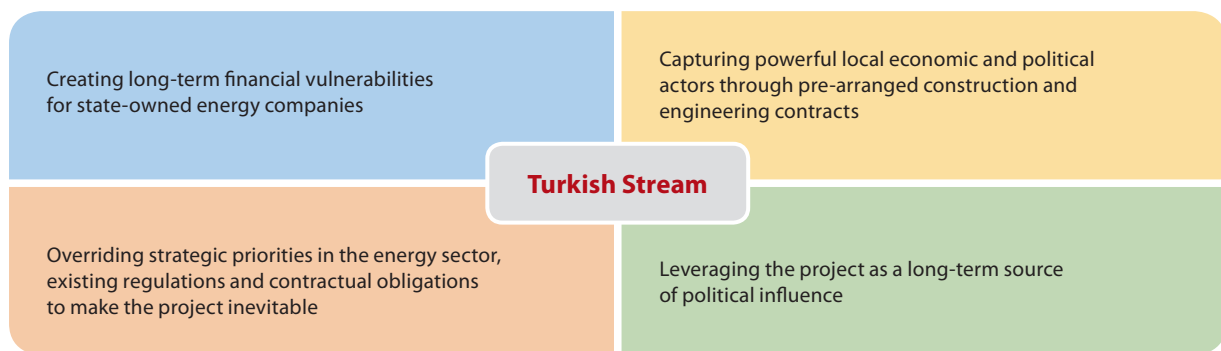
with Gazprom, which enabled it to offer competitive prices on the Croatian gas market.

LEVERAGING LARGE-SCALE PROJECTS

Natural gas pipelines

Russian energy companies have actively sought to lure Balkan (state-owned) energy companies and government officials in risky grand-scale energy projects. An apt example is the development of the **South Stream** gas pipeline project and its reincarnation – **Turkish Stream**.⁶⁰ These projects have been way beyond the management capacity of the national administrations of the countries in SEE. The Russian side offers nominal equal partnership, while leaving all major risk variables under its control. This strategy provides leverage both on political level, as well as on powerful business groups in the region, handpicked to participate in the construction of the pipeline. Hence, when Russia unilaterally discontinued the South Stream project in late 2014, the governments in SEE immediately jumped on the bandwagon of the new replacement pipeline. The governments and their oligarchic networks poised to benefit most from the project in the region began jockeying to convince Gazprom and the Kremlin that the new pipeline should also pass through their countries.

FIGURE 12. MODEL OF RUSSIA'S USE OF LARGE-SCALE ENERGY PROJECTS AS CAPTURE TOOLS



Source: Center for the Study of Democracy.

⁶⁰ Despite many attempts to portray the newer incarnations of South Stream as more economically than geopolitically based versions of the original, the project remains Kremlin's most important political pet project in the region. While in particular the Bulgarian government has been trying to gloss the project with formally abiding by EU rules, the key shortcomings of the original project were repeated: rushing through parliament decisions in clear opposition to national energy security principles, hastily structured public procurement deals with odd companies for the European market, with pre-selected Russian suppliers, etc. In addition, in late 2019 Bulgaria has been continuously pressured by both Serbia and Russia to speed up the laying of the pipeline.

Russia's leverage and capture over SEE countries' energy policy and its implications for energy security has probably been most visible in the management of the Bulgarian section of the South Stream gas pipeline project. Negotiations on the project had been opaque, involving frequent pressure from the Russian side. There have been repeated unexpected visits at the highest political level and from Gazprom's top management as well as wide media pressure and disinformation. At an estimated cost of over € 3.8 billion in 2014, the Bulgarian section of the South Stream pipeline became almost twice as expensive as initially planned in 2008. The cost inflation was not explained by any credible financial analysis, hence raising reasonable doubts that the project's price tag serves to benefit special interests. These doubts were confirmed by the collapse in the summer of 2014 of Bulgaria's fourth largest bank, which had been seen as instrumental to financing South Stream in Bulgaria. Also, from an energy security perspective, the project contradicted the country's strategic objectives, as it would not have alleviated the overall natural gas dependence on Russia.

Box 3. Seeking a southern route: South and Turkish Streams

The South Stream pipeline formed the crux of Kremlin's strategy of completely circumventing Ukraine as a transit country. However, the worsening ties between the EU and Russia following the annexation of Crimea and the imposition of sanctions led to growing pressure on governments in Southeast Europe, and in particular Bulgaria, to abide by EU energy, competition and public procurement laws. By the end of 2014, the South Stream project had been cancelled, which the Kremlin saw as a considerable blow to its foreign policy. Yet, the Russian government swiftly replaced it with a new, amended version – Turkish Stream, and renewed its pressure on SEE countries to join the new version of the pipeline.⁶¹

Meanwhile, Bulgaria was preparing the ground for hosting the new Russian pipeline project by launching the concept for a **Balkan gas hub**. The Bulgarian government tries to portray the hub to its European and US partners as a diversification tool which would serve as a trading point for Russian (via Turkish Stream), Azeri, and LNG gas (via the Trans-Adriatic pipeline and the Greece-Bulgaria interconnector), as well as for potential domestic production from Black Sea offshore reserves. The hub concept has little to do with the actual formation of a liquid gas market exchange but rather with the construction of new gas transmission infrastructure mirroring the South Stream route, as well as the expansion of the existing capacity. Bulgartransgaz estimates the costs of the new infrastructure to reach around € 1.75 billion with most of the funding to come directly from the construction contractors, which will be compensated from the future transit revenues from Turkish Stream.

⁶¹ With Turkish Stream the Kremlin sought to pitch Bulgaria against Greece (and by extension North Macedonia) to compete to earn the continuation of the pipeline from Turkey into Europe. Russia's leverage on Bulgaria was further increased by the ascendancy of the Syriza party in Greece, which tried to warm up ties with the Kremlin in the 2015/2016 period. However, the disappointment from the failure to secure much needed Russian investments and financial assistance in exchange for moving forward on Turkish Stream gradually estranged Greece from Russia. Greek-Russian relations cooled further down as Russian interference in the Greek efforts to find a solution to the name dispute with neighboring Macedonia became evident. Hence, Russia revived the idea for a pipeline project that would traverse Bulgaria along roughly the same route as the defunct South Stream.

The development of Turkish Stream in Bulgaria demonstrated repeatedly the asymmetric relations between the country and Russia. When Russia announced that it considers directing Turkish Stream through Bulgaria in December 2018, the Bulgarian government undertook a series of hasty measures to accommodate the pipeline. The Bulgarian authorities amended the country's energy strategy without public discussion in order to accommodate the construction of the pipeline and the impending cancellation of Gazprom's transit contract with Ukraine providing gas to Bulgaria through the Transbalkan pipeline. Bulgaria agreed to the new project surrendering any attempt to demand compensation from Gazprom for transit fees due during the next decade under the existing ship-or-pay contract valid until 2030.⁶² Indeed, Sofia cannot rely on the ship-or-pay clause because Bulgaria forfeited its chances for a fair trial in case of irreconcilable differences with Gazprom by agreeing, in 2006, that arbitration would be carried out at the International Commercial Arbitration Court at the Russian Federation's own Chamber of Commerce and Industry.⁶³ During the negotiations for Turkish Stream, the Russian government occupied the driver's seat and directed the dialogue, whereas Bulgarian politicians viewed an agreement as a gracious favor from Russia to Bulgaria rather than a mutually-beneficial deal between equal partners.⁶⁴

Under continuous pressure from Russia, Bulgaria rushed through all the needed procedures to start construction in October 2019. Tellingly, Bulgaria laid down the first pipes of Turkish Stream before the country finally commenced the construction of the strategically important for diversification interconnector with Greece, supported by the EU. The tender for choosing the construction contractor to build the Bulgarian section of the pipeline has been marred in problems similar to the cancelled South Stream before that. Despite Bulgarian authorities' claim that they followed precisely EU public procurement rules, no major company with experience in Europe applied. It looked as if whoever wins the tender had to work with the already appointed Russian supplier of the pipelines. Initially, the Bulgarian state-owned investor in Turkish Stream, Bulgartransgaz chose the Saudi consortium Arkad, only to disqualify it shortly thereafter on the grounds that it had failed to supply the required documentation in time.⁶⁵ It then started negotiations with the second-ranked, the Russia-affiliated consortium, Gas Development and Expansion in Bulgaria. In this case Moscow was set to benefit not only as the primary user of the pipeline, but also through collecting transit fees for the first 10 to 15 years of exploitation of the pipeline.⁶⁶ However, following a complaint by the Saudi consortium, the Bulgarian Supreme Administrative Court instructed Bulgartransgaz to sign the contract with the Saudi

⁶² "Кабинетът даде индулгенция за скъпи газови проекти в интерес на Русия". *Mediapool.bg*. 30 November 2018.

⁶³ Vassilev, I. "Кой допусна да уреждаме споровете си пред Руската Търговска Палата?". *Terminal 3*. 23 November 2018.

⁶⁴ "Без унижения за „Турски Поток“. *Capital*. 23 November 2018.

⁶⁵ "Смениха Саудитския изпълнител на 'Турски Поток' у нас с руска компания в сянка". *News.bg*. 29 May 2019.

⁶⁶ Stanchev, I. "Руски поток през България". *Capital*. 31 May 2019.

consortium.⁶⁷ In late September 2019, an agreement between the two competing consortia paved the way for the ultimate signing of an engineering, procurement and construction contract with the Saudi-led consortium but with the participation of a key partner in the Russia-linked consortium – the Russian pipeline maker, TMK. An investigative report revealed that Bulgaria had already started the shipment of pipes for the project way before the contract tender was completed meaning that one of the key aspects of the project had been decided in advance.⁶⁸ Unlike in the case of South Stream, though, when the European Commission launched an infringement procedure against Bulgaria for violating the EU competition and public procurement laws, with Turkish Stream there has been no reaction from EU authorities. Thus, after a decade of implementation of the EU Energy Union and even following the annexation of Crimea and the imposition of sanctions on Russia, **Europe has effectively endorsed Kremlin's two strategic pipelines of North and South Stream.**

In Serbia, Turkish Stream has been implemented under the direct participation of Gazprom, which controls 51% of the project company (49% are owned by Srbijagas). The Serbian energy agency exempted the pipeline from EU's Third Energy Package, which means that Gazprom will control both the gas in the pipeline and the infrastructure itself. Serbia later applied to the Energy Community to approve this exemption, but the Secretariat requested "a number of conditions to ensure the project does not lead to market foreclosure in Serbia and beyond."⁶⁹ It seems that with or without fulfilling the Secretariat's request, the project will be implemented by the end of 2019 as per reports by the project company. In December 2018, the Serbian Parliament passed a law issuing a € 60 million guarantee for Srbijagas' commercial loan from domestic banks for the Turkish Stream construction.⁷⁰ Serbia obliged itself with this law that it will „irrevocably, unconditionally, without objection” settle the debt to the creditors.⁷¹ This means that in case the project fails, the Serbian taxpayers will be the ones to repay the debt.

Meanwhile, Serbia has signed a memorandum of understanding with Hungary on the continuation of the pipeline, while Bajatović announced that the pipeline would be extended to Republika Srpska in Bosnia and

⁶⁷ Stanchev, I. "BAC не позволи на „Булгартрансгаз” да склучи договор с руския кандидат за "Турски моток". *Capital*. 14 July 2019.

⁶⁸ Ibid.

⁶⁹ "Gastrans pipeline project: Secretariat issues opinion with request for additional conditions to Serbian energy regulator". Energy Community. 1 February 2019.

⁷⁰ "Novi kredit 'Srbijagasa' za "Turski tok". *Danas*. 9 April 2019.

⁷¹ Article 7. Закон о давању гаранције републике Србије у корист Societe Generale Banke srbija a.d. Beograd, Комерцијалне Банке а.д. Београд, Банке Поштанска Штедионица а.д. Београд, ОТП Банке Србија а.д. Нови Сад и Vojvodanske Banke a.d. Novi Sad по задужењу Јавног предузећа „Србијас” Нови Сад, по основу уговора о кредиту за изградњу гасовода на територији Републике Србије од границе са Републиком Бугарском до границе са Мађарском и другим суседним земљама са Републиком Србијом (Article 7. Law on the Guarantee of the Republic of Serbia in favor of Societe Generale Bank of Serbia a.d. Belgrade, Commercial Banks a.d. Belgrade, Banks Postal Savings Bank a.d. Belgrade, OTP Bank Serbia a.d. Novi Sad and Vojvodjanska Banka a.d. Novi Sad under the assignment of the Public Company "Srbijagas" Novi Sad, on the basis of a loan agreement for the construction of a gas pipeline in the territory of the Republic of Serbia from the border with the Republic of Bulgaria to the border with Hungary and other neighboring countries with the Republic of Serbia).

Herzegovina, and possibly to the Federation of Bosnia and Hercegovina, as well as Croatia.⁷² Yet, it remains unclear who would be the buyer of the projected amount of gas to be shipped through Turkish Stream. The current consumption in the Western Balkans and Bulgaria is relatively low. In total Serbia, Bosnia and Herzegovina, and Bulgaria consume on average around 5.6 billion m³ annually.⁷³ And there are no guarantees that the remainder of the gas can be marketed to consumers in Western Europe. This could actually increase Russia's pressure on the Balkans to take up more gas. For example, to boost gas demand expectations, Serbian officials have already announced the construction of gas-fired electricity plants.⁷⁴ However, the viability of these ventures would rely on natural gas prices, which Gazprom is unlikely to reduce without pressure from alternative suppliers. The Balkans have been paying some of the highest prices in Europe in the past decades due to the lack of alternatives. As a result, for example, although Serbia has invested significant amount of money in the gasification of certain parts of Serbia, the natural gas consumption has not increased much due to its relatively higher price in comparison with other alternatives (coal, wood, etc.). Finally, with the likely coming online of Nord Stream II and the possibility, that the Ukrainian gas transit would be continued after 2020, the overall utility of the Turkish Stream pipeline remains questionable.⁷⁵ Thus, countries from the region which invested heavily in the pipeline will be further pressed to do Russia's bidding or face revenue crunches. It seems that through the **Turkish Stream** megaproject Russia has so far been able to achieve several interrelated objectives:

- **maintain Gazprom's dominance on the natural gas markets** in the SEE region;
- **divert the attention** of SEE governments away from smaller projects crucial for the **diversification and security of supply** including strategic cross-border interconnectors, LNG terminals and storage facilities;
- **funnel large financial resources into Russia-friendly state capture networks** that can be leveraged to achieve an outsized political influence over decision-making.

Nuclear power plants

Nuclear power cooperation is another important avenue of energy influence, only with nuclear it is limited only to **Bulgaria**. It is yet another product of the lasting energy relations formed during the former Soviet bloc integration. The Soviet-built Kozloduy nuclear power plant (NPP) accounts for 34% of the total electricity generation in the country. Bulgaria's single operating nuclear power plant is dependent on Russian companies for the maintenance of its lifecycle from fuel supply to nuclear waste disposal. If the plans for the construction of a second Russia-designed nuclear power plant come to fruition, the Kremlin would expand its influence in the country even further.

⁷² Jakovljevic, G. "Konferencija o regionalnom značaju izgradnje "Turskog toka": Gasifikacija važna za ekonomski razvoj". *Anadolu Agency*. 8 June 2019.

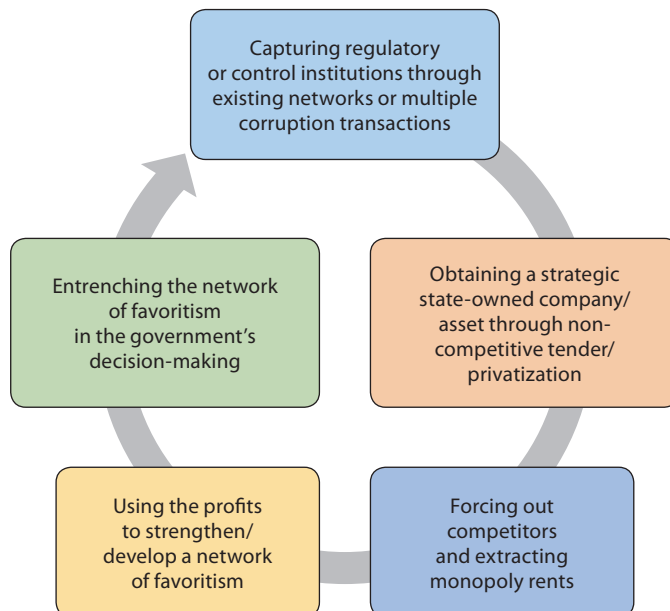
⁷³ Gazprom. *Annual Report 2018*.

⁷⁴ "Antić: Veliki projekti u toku, energetska efikasnost ključna". *Novosti*. 10 June 2019.

⁷⁵ "Veliki projekti – Velike i dileme". 2014. *Savez energetičara Srbije Portal SENERGES*.

Russia has been successful in luring Bulgaria into signing a multi-billion long-term contract for the construction of a new nuclear facility (Belene NPP), without an underlying economic or energy rationale. In 2008, Bulgaria signed a € 4 billion construction contract, which has since sucked in some € 2 billion of the Bulgarian state-owned energy holding's scarce funds, and considerable political attention even after the construction was frozen in 2012. In addition, the rents coming from this lavish spending of resources have fueled strong nuclear energy lobbies consisting of experts, politicians, and engineering consultancies in the country. In turn, these lobbies have been able to monopolize the public debate and the policies on nuclear energy.⁷⁶

FIGURE 13. HOW THE KREMLIN USES STATE CAPTURE TO ACHIEVE POLITICAL INFLUENCE



Source: Center for the Study of Democracy.

In yet another indication of Russia's strong co-opting power, the same ruling party that suspended the Belene project in 2012 revived it in 2017. The implementation of the project will further lock the Bulgarian government in asymmetrical and expensive economic relationship with Russia, which could be leveraged in the future for political gains. The project has already brought Bulgaria's state-owned energy sector into a debt spiral,⁷⁷ which burden on the economy is likely to increase upon the project's restart.⁷⁸

The most favorable conditions for the financially and economically viable operation of Belene would include an average and uninterrupted annual economic growth of between 3 and 4% over the course of a quarter of

a century, a population increase of 300,000 people and a rise in the consumption of energy by 25%. All of these factors are highly unrealistic to materialize, given lags in economic development, an unprecedented demographic crisis and declining energy consumption rates.⁷⁹ From a

⁷⁶ Consultancy costs in the Belene NPP have kept escalating, and the conditions of already awarded public procurement contracts have been repeatedly altered at the taxpayers' expense.

⁷⁷ Vladimirov, M. and Stefanov, R. 2019. "Bulgaria: State capture unplugged". In: Shentov, O., Stefanov, R. and Vladimirov, M. (Eds.) 2019. *The Russian Economic Grip in Central and Eastern Europe*. Abingdon: Routledge: 125-126.

⁷⁸ The Bulgarian government has chosen to rely for the justification of the restart of the NPP on a highly controversial feasibility report prepared by the Bulgarian Academy of Sciences. The report has been kept confidential and not released to the public in full. Tellingly, the report was coordinated by a former Deputy-Prime Minister who had just signed the contract committing Bulgaria to building a joint-venture with Russia on the construction of the now defunct South Stream project. Some of the key energy researches from the academy left the team in protest.

⁷⁹ Tosev, S. „За добрите китайски намерения и финансово неизгодната химера АЕЦ „Белене“. *Factor.bg*. 18 November 2018.

security point of view, **NPP Belene will significantly increase the country's dependency on Russia.** Though Chinese and South Korean investors have expressed interest in the project, their influence will be only marginal compared to the Kremlin's involvement in the entire lifecycle of the nuclear power plant. Regardless of the source of financing, the Rosatom State Nuclear Energy Corporation, in its capacity as a producer of the nuclear reactors for the plant, will be responsible for the construction of Belene (through its subsidiary, Atomstroyexport) as well as the maintenance afterwards.⁸⁰

Oil and refining

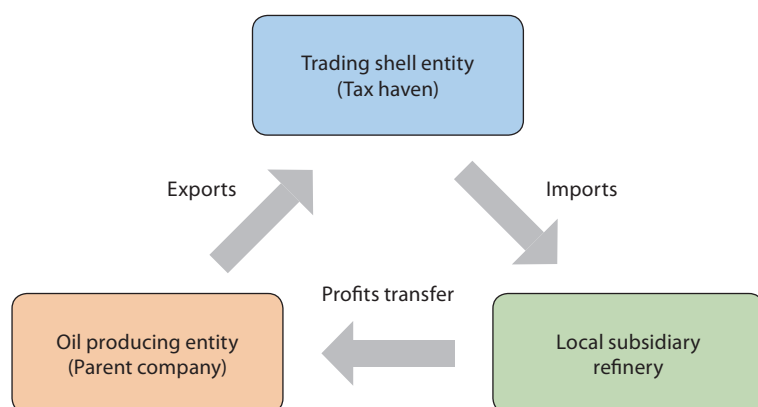
Russian economic influence over the region's oil sector has been similarly extensive albeit not necessarily with the same geopolitical implications. It has however allowed Russian companies to extract marginal economic rents from consumers in the region, by charging slightly higher prices than in Europe, despite the prevailing lower living standard. **Russian companies control all the major refineries in the region** except the Hellenic Petroleum-owned facility near Skopje. Lukoil, Gazprom Neft and Zarubezhneft play a dominant role on the wholesale and retail fuel markets in almost all countries under analysis. The only exception is Croatia, where the Hungarian company, MOL and the domestic oil and gas producer (also partially owned by MOL) INA, play the most important role on the fuels market. Russian fuel producers and traders are some of the largest companies in each country. NIS, owned by Gazprom Neft, is the largest firm in Serbia with multiple subsidiaries that directly control storage facilities, gasoline stations, the largest refinery at Pancevo and the oil pipeline network in the country. Similarly, in Bulgaria, Lukoil controls 2/3 of the wholesale fuel market and is the single importer of crude oil to the country. It is also the owner of the largest refinery in SEE – Lukoil Neftochim with a total processing capacity of 9.5 million tons of oil per year (190,000 barrels per day). The Russian company is not only the biggest business in the country accounting for around 9% of the country's GDP but has also concentrated the largest FDI inflows in Bulgaria in the past decade, both in absolute terms and as share of all FDI flows.⁸¹ Together with its wholesale and retail fuel sister-company, Lukoil Bulgaria, and the aviation, ship, and services companies, Lukoil is also the largest taxpayer, accounting for a very large share of the budget VAT revenues in the country. Lukoil Bulgaria, the trade arm, is also a major exporter of fuels in the region including to Turkey, Greece, and North Macedonia.

⁸⁰ „Възраждането на АЕЦ Белене”. *Capital*. 24 May 2018.

⁸¹ Lukoil has been consistently one of the major foreign investors in a number of CEE countries although the investment flows have been credited to the Netherlands. The reason is that Lukoil has used its Dutch subsidiary for most of its business operations in Eastern Europe. The Bulgarian central bank interprets a large share of Lukoil transactions as originating from the Netherlands, since the Russian firm is officially registered in Amsterdam, a favorite escape destination for many Russian businesses. Russian companies control assets worth around € 140 billion in the Netherlands, many of which are concentrated in the largest private and state-owned Russian energy companies. Opaque company structures conceal the ultimate beneficial ownership which can result in FDI data distortion.

However, for its size, Lukoil has contributed very little in terms of profit taxes to the Bulgarian treasury.⁸² Over the last decades, Lukoil seems to have engaged in **transfer-pricing schemes** to avoid paying corporate taxes in Bulgaria, despite the country's low tax rate of only 10%. Russian oil companies have gained enormous expertise in pursuing this method, with Lukoil being one of the biggest examples.⁸³ It has combined the use of tax treaty jurisdictions for income tax avoidance and trading shell companies to diminish its overall tax bill in the process hurting the public finances of the countries where it operates. The transfer pricing scheme (Figure 14) allows one subsidiary of a holding company to overcharge another, both registered in different jurisdictions, for the sale of a product or service without reflecting general market levels. Hence, the subsidiaries registered in a low or no-tax country, such as the Netherlands, would purchase goods from another subsidiary at a loss, thus reducing corporate tax liability. In the case of Lukoil, the Russian company has used this strategy to avoid paying taxes in the countries of operation in SEE.

FIGURE 14. TRANSFER PRICING SCHEME THROUGH TRADING SHELL COMPANIES



Source: Center for the Study of Democracy.

Lukoil works with related companies on the entry and exit of the refinery including the Swiss-registered trading subsidiary Litasco Group, which is not only the crude oil importer intermediary, but also the main exporting vehicle for Lukoil. Since the **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 its place of registration, Switzerland. This type of tax policy is called **participation exemption** and the logic follows that it is not neces-

sary to tax a company twice – first in the countries where subsidiaries are located, and again in the Netherlands where the company is headquartered. In other words, if the company is forced to pay income tax at subsidiary locations, there is no need to pay again in the Netherlands.

In principle, national governments use EU and OECD guidelines on transfer pricing to determine the most efficient fiscal arrangement and prevent the moving of profits from the country. The recommendations of international institutions are for governments to compare transfer prices to the general market level when evaluating the taxable income. This im-

⁸² „Печели ли „Лукойл“ в България? Отговорът ще ви изненада“. *ClubZ.bg*. 19 October 2015.

⁸³ „Акционери в „Нефтохим“ атакуват „Лукойл“ за занижени приходи“. *Dnevnik.bg*. 20 January 2002.

plies direct **negotiation between multinationals and the countries' tax administrations**, which make the latter very vulnerable to pressure. This is especially the case in the SEE region where the lack of administrative capacity coupled with widespread corruption have made tax and regulatory institutions weak and susceptible to external capture. In addition, the managers of Russian companies appear as important intermediaries between the Kremlin and local political elites, which further intimidates any action on these companies by the local administrations.

Box 4. Lukoil tax practices

In the specific case of Lukoil, the company has not paid corporate taxes as it has operated at a loss due to allegedly low profit margins and rising competition, according to the company. In Bulgaria, there have been investigations into Lukoil's potential misuse of transfer pricing for tax evasion. In order to prevent accounting fraud, in 2011 and 2013, the then director of the Customs Agency tried unsuccessfully to revoke Lukoil's refinery license after the company failed to install tax measurement devices at the entry and exit points of its fuel warehouses.⁸⁴ His claim was that Lukoil is evading taxation by employing the above-mentioned transfer pricing mechanism. After a protracted legal battle, the Supreme Administrative Court ordered the Customs Agency to return Lukoil Neftohim's fuel trading license by justifying its decision with the importance of the company to the country's national security.

Lukoil has been also investing in gasoline stations in Serbia, North Macedonia and Montenegro over the past 15 years. It is currently the second-largest fuel distributor in all three countries as it benefits from its well-developed supply networks in the region that are fed by the Bulgarian refinery. The Russian companies' investments in the region outside Bulgaria are estimated at around € 350 million since Lukoil privatized the Serbian state-owned fuel company, Beopetrol. Lukoil's acquisition of a 79.5% stake in Beopetrol and its network of 180 filling stations made the Russian giant the second largest retail supplier of oil products in the country. According to the privatization agreement, Lukoil pledged to invest an additional \$ 106.8 million into the company's infrastructure. However, in a report on Beopetrol's privatization published in September 2013, the Anti-Corruption Council of the Serbian government stated that Lukoil never honored the agreement, causing millions of US dollars' worth of losses.⁸⁵ The report went on to argue that instead of investing in Beopetrol, Lukoil violated the privatization rules by using Beopetrol's funds to provide the mother company with a \$ 120 million loan, which is around 90% of the amount paid for the purchase of the Serbian firm.⁸⁶

The privatization procedure of the state-owned NIS, Serbia's largest oil and gas company, also exhibited many similar governance deficits. The

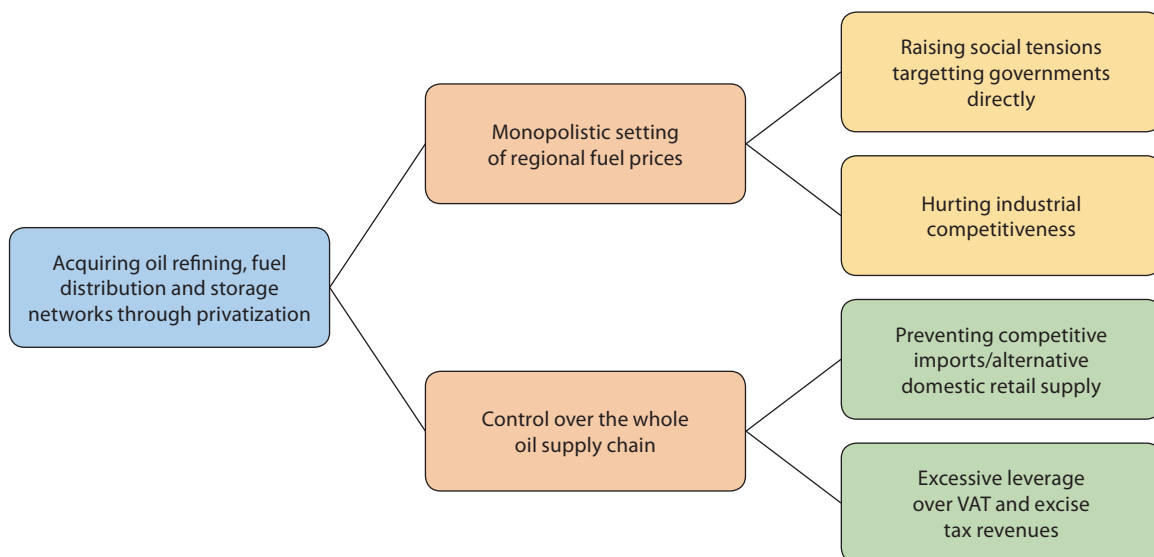
⁸⁴ Vladimirov, M. and Stefanov, R. 2019. "Bulgaria: State capture unplugged". In: Shentov, O., Stefanov, R. and Vladimirov, M. (Eds.). 2019. *The Russian Economic Grip in Central and Eastern Europe*. Abingdon: Routledge: 125-126.

⁸⁵ Stiplija, N. T. and Novakovic, I. 2019, "Serbia: Restoring the Great Game in the Russian Economic Grip on Central and Eastern Europe In: Shentov, O., Stefanov, R. and Vladimirov, M. (Eds.) 2019. *The Russian Economic Grip in Central and Eastern Europe*. Abingdon: Routledge: 207.

⁸⁶ Ibid.

sale of a 51% majority stake of NIS assets to Gazprom Neft, including the Pancevo refinery and the company's oil and gas reserves, came on the back of the 2008 intergovernmental energy agreement between Russia and Serbia.⁸⁷ The deal was non-transparent and non-competitive with the terms of the sale questionable at best. The total value of NIS, according to the preliminary estimates of the privatization advisers in 2006, was between € 1.2 and € 1.6 billion.⁸⁸ This meant that 51% of NIS was worth between € 612 and 816 million, excluding the value of its domestic oil reserves. According to the agreement and its associated protocol, however, the price for NIS was set at € 400 million, with the obligation that Gazprom would finance a modernization program costing another € 500 million. Gazprom fulfilled this obligation, although not by using its own equity but by increasing NIS' debt instead.

FIGURE 15. OIL SECTOR-BASED POLITICAL LEVERAGE SCHEME



Source: Center for the Study of Democracy.

One of the key provisions in the intergovernmental agreement between Russia and Serbia was that any new taxes which would come into force after the day of the agreement, will not be applied to projects that the agreement encompassed (purchase of NIS, Banatski dvor, etc.) "before all of the projects are paid off." This meant that all companies that were covered by the Agreement (NIS above all) could be taxed only according to the legal provisions which were in force in 2008, until the investment is recouped. However, it was not clarified then and still remains unclear who should determine if the investment has been repaid

⁸⁷ MacDonald, N. "Gazprom clinches gas deal with Serbia". *FT.com*. 24 December 2008.

⁸⁸ The Serbian Minister of Economy at the time, Mladjan Dinkic, opposed the Energy Arrangement and claimed that the book value of NIS in 2007 was USD 1.7 billion, which meant that the Russian side had offered a twice lower price. Dinkic then underlined if NIS office buildings in Novi Sad and Belgrade alone had been sold, without even selling the business, this price would probably be around USD 800 million. See: *Insajder: "Energetski (ne)sporazum", četvrti deo, ep. 3. B92*. 9 January 2014.

and when this would happen. This provision has allowed Gazprom Neft to maintain a mining tax of 3% for all of NIS' oil and gas extraction operations, although the mining tax law has increased it to 7%.⁸⁹ In 2009, the Serbian Constitutional Court upheld the constitutionality of the agreement.

Poor **privatization procedures** have also left most of the oil refining and fuels trade business of Bosnia and Herzegovina in the hands of another Russian state-owned company, Zarubezhneft. The latter acquired the companies for a combined € 125.8 million in 2007, far below the initial asking price of € 285 million in 2005. Russian officials described the project as part of a broader political and economic strategy to strengthen alliances with countries of the Western Balkans (Zarubezhneft took a loan from the Russian state-owned Development Bank to buy the two refineries).⁹⁰ Zarubezhneft also acquired an 80% share in the Nestro Petrol wholesale and retail fuels supplier, now the country's largest gas station chain. Thus, Optima Group, uniting all Zarubezhneft's acquisitions in BiH, controls roughly one-third of Bosnia and Herzegovina's wholesale fuels market. This represents half of the market share the company had in 2011 due to the entry of competitors such as the Croatian company, INA, and the Gazprom-owned NIS. Yet, Optima Group, still controls the major oil processing facilities, which means that the Russian firm could still win over margins from the competition by changing supply patterns on the wholesale market.

Optima Group committed to additional investments in the modernization of the refining facilities.⁹¹ But instead of issuing new capital to finance the reconstruction, the costs were financed, similar to the case of Lukoil in Serbia, through loans taken by the newly-acquired companies at interest rates higher than typical banking rates in the country at that time.⁹² Zarubezhneft and Neftgazinkor, another Russian gas company, used these loans to finance a wide range of expenditures, from reconstruction and modernization works, to the payment of local taxes and social security contribution, even for repayment of their own previous loans. By doing

⁸⁹ Independent analysts calculated that by now, the total initial investments should have been paid off. See "Danas pitamo: Zašto NIS i dalje plaća rudnu rentu manje nego što je zakonom propisano?". *Insajder*. 8 August 2018.

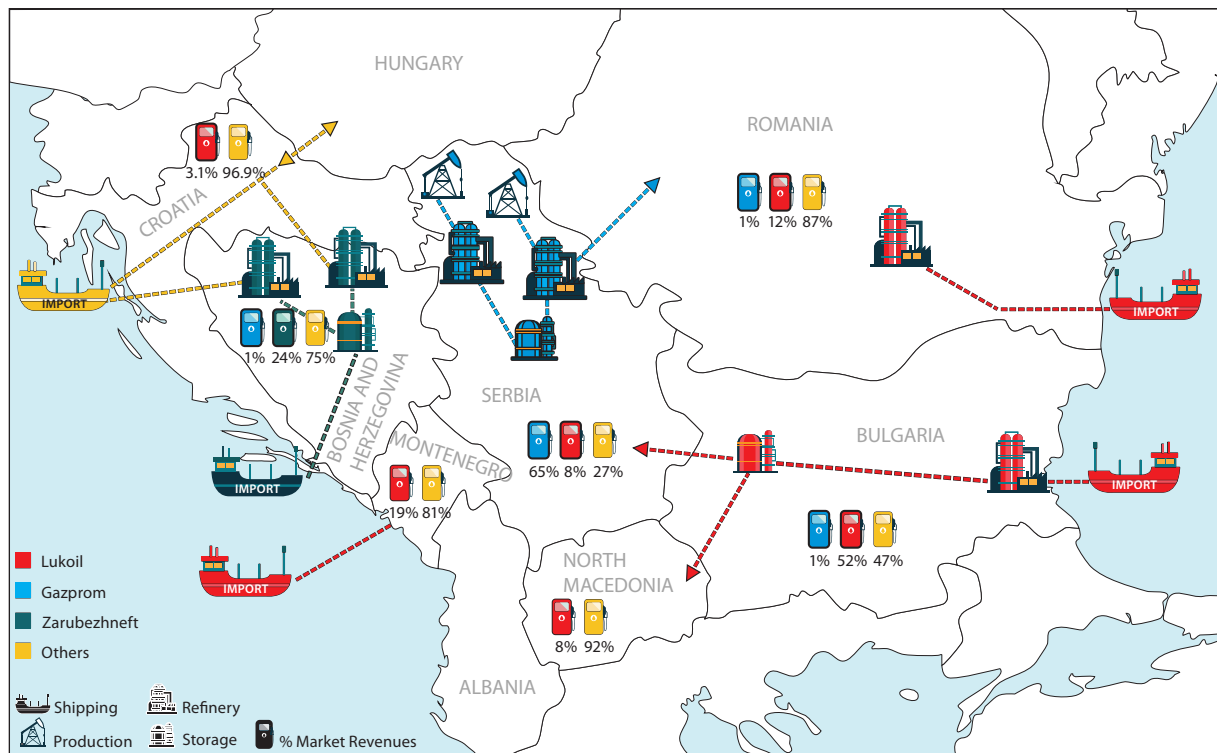
⁹⁰ Sito-Sucic, D. "Bosnian refinery reopening shows Russia's hand". *New York Times*. 6 January 2009.

In 2011, RS granted a Zarubezhneft-NIS joint venture, Jadran-Naftagas, a 28-year exclusive concession for the exploration and production of oil and gas on its territory (but not on the territory of the Federation BiH). Jadran-Naftagas would invest \$ 41 million in exploration for the first three years, and \$ 188 million for the next 25 years. So far, oil reserves have been discovered in several places in northeastern Bosnia and Herzegovina, which could further increase Russia's presence in the oil sector, if and when production starts. However, despite the initial excitement, there has been little activity on the sites.

⁹¹ Maksimović, D. "Rafinerija Brod – ni na nebu ni na zemlji". *Deutsche Welle*. 24 February 2015.

⁹² The Brod Refinery RS Auditor's Report for 2018 shows that this company obtained two loans directly from its owner, Neftgazinkor: one on January 31, 2008, worth € 40 million, with initial annual interest rate of 12%, maturing by December 31, 2010; the second on July 10, 2008, worth € 72.5 million to be repaid by June 10, 2013. Initially, the second loan was approved with the same 12% annual interest rate, but that was later reduced through annexes, first to 10% in 2010 and then to 9.5% after January 1, 2011. Yet according to data by the Central Bank of BiH all these interest rates were still much higher than the average 7.36% interest rate charged on similar loans in this period. According to audit reports from 2016, 2017 and 2018, since 2008 Zarubezhneft and Neftgazinkor have issued a total of 11 loans worth some € 340 million to their three local subsidiaries in RS.

FIGURE 16. RUSSIA-CONTROLLED OIL SUPPLY CHAINS IN SEE



Source: CSD calculations based on statistics from national and international corporate databases.

this, instead of investing the promised fresh capital into the outdated and weak BiH oil industry, the Russian companies have siphoned money out of RS while increasing local companies' debt and bringing them to the edge of bankruptcy. This very issue is in the center of the growing frustration of local RS officials with Russian investors. The latest reports on the three oil-related businesses, Oil refinery Brod, Modrica oil refinery, and Nestro Petrol Banja Luka, show that some 12 years after their broadly celebrated acquisition, all three companies are effectively financially bankrupt with accumulated losses of around € 350 million.⁹³ This is likely to pressure local politicians into further asymmetric negotiations with their counterparts in the Kremlin. This will provide the latter with further leverage besides their political influence in the Serb controlled entity of Bosnia and Herzegovina.

Overall, the Russian economic footprint in the SEE's oil sector has been largely enabled by the **widespread exploitation of existing governance deficits** and the limited ability of governments to protect the national

⁹³ Public concerns related to the fate of the RS oil industry significantly increased after an explosion killed one worker, wounded nine others and damaged a part of the Brod refinery in October 2018. Although the management announced that the refinery will be reconstructed and even modernized by the end of 2019, the refinery has suspended all of its production as of January 2019 and by late September no reconstruction or modernization works had started although the management has pledged to restart production by January 2020.

interest.⁹⁴ These deficits arise at all stages: during the **privatization** of oil assets, implementation of privatization agreements, and the **abuse of dominant market positions** for non-competitive pricing and tax evasion. The outcome has been corporate mismanagement, sizable losses of tax revenues for the governments and the leveraging of these crucial assets for political ends. In addition, the sizable Russian economic footprint in SEE's energy sector provides the Kremlin with leverage for realizing its political strategy for the region.

DIVERSIFYING THE PORTFOLIO

Although the energy sector is the principal entry point of the Russian economic penetration in the SEE region, the increase of oil and gas prices in the early 2000s and 2010s have allowed for a diversification of the portfolio of assets controlled by Russian entities. There have been five main sectors that have seen the most influx of Russian capital: **finance, retail, telecommunications, metallurgy and real estate**. The expansion of the Russian footprint in these areas has been enabled by the active role that Russian state-owned banks have played in facilitating strategic investments in the region. The most visible cases having been the acquisition of the largest Bulgarian tobacco and telecommunications companies, and the take-over of Agrokor's business across the Western Balkans. In the process, the Russian investors have taken advantage of persistent governance deficits including the lack of transparency on the terms of mergers and acquisitions, the inefficiency of banking and financial market regulators, and the capture of key judicial institutions.

Financing Russian influence

The entry in 2011/2012 of two of the largest Russian state-owned banks on the SEE market, **Sberbank** and **VTB**, ushered a period of strategic investments in key industries. Despite the limited presence and market share of the banks on the retail banking market, they have acted similar to **investment banks** focusing on the structuring of business deals that have often included influential domestic oligarchic networks. The Russian financial institutions usually turn from deal underwriters to owners when the local management fails to ensure the sustainability of the investments. The most visible cases have been Sberbank-led debt-financed expansion of the Croatian retail giant Agrokor and the investment tandem formed in Bulgaria between VTB and the now-defunct Corporate Commercial Bank (CCB) to acquire assets worth around € 5.3 billion⁹⁵ in sectors ranging from telecommunications through fuel distribution to glass factories.

⁹⁴ Vladimirov, M. et al. 2018. *Russian Economic Footprint in the Western Balkans. Corruption and State Capture Risks*. Sofia: Center for the Study of Democracy.

⁹⁵ CSD calculations based on the value of the assets as of 2014, before the Corporate Commercial Bank went bankrupt during the same year. The total sum of the calculated assets includes such, which had been acquired and controlled by the bank through special purpose vehicles. Thus, some of the assets did not appear on the bank's balance sheet.

The Russian financial expansion in SEE started in 2008 when Moskovska Banka, now part of the VTB group, opened its first branch as a greenfield investment. Later in 2012, Sberbank entered the market by purchasing the banking arm of Volksbank International in Central and Eastern Europe. Volksbank had developed business in Serbia, Croatia and Bosnia and Herzegovina.

However, none of the Russia-controlled banks are on the list of the top ten major banks that hold more than 78% of the banking market in Serbia.⁹⁶ Upon entering Serbia, Sberbank expressed its readiness to invest € 100 million in Serbian export companies tied to the Russian market, as well as to help attract a strategic partner to purchase the Smederevo steel plant.⁹⁷ However, at the end, it mostly relied on its previous business links established by Volksbank. It preserved the investment policy of its Austrian predecessor and shied away from developing business cooperation with the largest privately-owned companies in the countries where it operated, most of which are under the control of local oligarchs.⁹⁸ One major exception has been the financing of Agrokor, a case examined in detail below.

VTB, on the other hand, has operated primarily through its foreign investment arm, **VTB Capital**. The latter has been most active in Bulgaria since opening a national office in 2011. VTB Capital entered the Bulgarian market with the purchase of a majority stake of 79.83% in the state-owned Bulgartabac, the largest tobacco producer in the region. The bank was chosen as a preferred buyer after nearly two decades of unsuccessful attempts at privatizing the tobacco company. The Movement for Rights and Freedoms, the Turkish minority party and a power-broker of Bulgarian politics since 1990, had repeatedly blocked the deal until agreeing to the VTB acquisition. The very opaque ownership structure of the direct buyer, a company registered in Liechtenstein, made many to suspect VTB was just a front.⁹⁹ Less than a year later, VTB transferred its share to a Dubai-based offshore company associated closely with the media mogul, Delyan Peevski, an influential Member of Parliament from the Movement for Rights and Freedom party.¹⁰⁰ The party is often associated with corruption-related controversies, manipulation of public procurement tenders and involvement in strategic economic sectors such as tourism, construction and agriculture.¹⁰¹ The Bulgartabac deal was not the only time the party was closely related with Russian (business) interests in Bulgaria. Companies close to its honorary Chairman acquired a sprawling compound near Lukoil Neftochim's Rossets port on the Bulgarian sea-side.¹⁰² The party also expelled one of its Chairmen after he an-

⁹⁶ People's Bank of Serbia. 2019. *Banking Sector Analysis in the Third Quarter of 2018*: 4.

⁹⁷ "Sberbanka traži partnera za Železaru Smederevo". *Vojvodina*. 23 August 2012.

⁹⁸ Ibid.

⁹⁹ Nikilov, D. "Руската банка ВТБ се оказа претендент за „Булгартабак“. *Segabg.com*. 9 July 2011.

¹⁰⁰ "Руската инвестиционна банка ВТБ се оттегля от Булгартабак". *Mediapool.bg*. 12 February 2014.

¹⁰¹ H. A., Mina, J., Stefanov, R., and Vladimirov, M. 2016. *The Kremlin Playbook: Understanding Russian Influence in Central and Eastern Europe*. Lanham: Rowman & Littlefield.

¹⁰² "Новият сарай на Доган в „руския“ анклав на Бургас". *Mediapool.bg*. 15 April 2016.

nounced his support for Tukey's downing of a Russian military plane in 2015.¹⁰³

VTB has been even more influential in its strategic partnership with Bulgaria's CCB, where the Russian bank controlled 9.9% of the shares. The rise and fall of CCB in Bulgaria have also been associated with the support of VTB externally and the Movement for Rights and Freedoms through Delyan Peevski internally.¹⁰⁴ Initially a subsidiary of the Bulgarian state-owned Bulbank and the Russian state-owned Vneshekonombank, CCB broke its formal link with both entities upon its privatization in 2000. CCB was then ultimately acquired and run until its bankruptcy in 2014 by its former employee-turned-oligarch Tzvetan Vassilev. Despite this, the informal link with Moscow is believed to have persisted all throughout the years, until formalized again with the arrival of VTB in the bank in the 2010s.

When VTB became a shareholder, CCB had already grown from a boutique bank providing credits to private clients, to the fourth largest bank in Bulgaria responsible for servicing most of the large state-owned energy enterprises such as the Bulgarian Energy Holding, Bulgargaz, Bulgartransgaz, the National Electric Company, the Kozloduy NPP and the largest coal power plant, Maritsa East 2.¹⁰⁵ It also boasted substantial investments in key sectors of the Bulgarian economy including telecom-

munications, tourism, defense, media and construction. Many of those were co-financed with the direct support of VTB, including the privatization of Bulgartabac, the acquisition of the biggest telecoms company in the country BTC, the military plant Dunarit, and the insurance company Victoria. The bank also had influence in the private energy sector as it has been seen as instrumental to the ownership transfer and purchase of a controlling stake in the second largest wholesale fuel supplier in Bulgaria, Petrol.

In 2014, the owner of CCB Tzvetan Vassilev fell out with his powerful partner Delyan Peevski. This led to a prolonged (and still ongoing) battle between the two for the assets

TABLE 1. ASSETS BY SECTOR CONTROLLED BY CCB, BULGARIA BEFORE THE BANK'S COLLAPSE IN JUNE 2014 (€ MILLIONS)

Finance	3165.98
Telecommunications	807.00
Tobacco and alcohol	383.00
Manufacturing, defense & engineering	380.00
Trade	161.00
Construction	180.00
Tourism	102.00
Vehicles leasing	49.66
Media & distribution	41.60
Agriculture	32.40
Total	5,302.64

Source: Center for the Study of Democracy based on corporate commercial registers and media investigations.

¹⁰³ Leviev-Sawyer, C. "Ousted MRF leader Mestan: I remain in politics". Independent Balkan News Agency. 7 January 2016.

¹⁰⁴ КТБ – Какво се случи? Ktbfiles.com.

¹⁰⁵ Mihajlova, G. „Държавни и общински дружества имат около 360 млн. лв. в КТБ“. Capital.bg. 31 July 2014.

of the bankrupted bank. In this battle VTB aided Mr. Peevski, who has been seen as the intermediary of VTB's partnership with CCB.¹⁰⁶ One of the more plausible theories about the reasons for the fallout between the two partners was that in 2013 and in early 2014 Tzvetan Vassilev grew weary of financing the Bulgarian part of the deal for the South Stream gas pipeline.¹⁰⁷ Even though Russia's support in the campaign against CCB which drove the bank to bankruptcy remains unclear, the case is an undoubted illustration of the deep reach of Russian interests into Bulgarian politics and the economy.

Agrokor: A game changer

Russian economic influence in SEE has been seen mainly as an extension of Kremlin's external energy policy. Yet, **the leverage of Russian bank loans to acquire strategic assets** has led to the multiplication of Kremlin's clout over the regional economies. This strategy has become most visible in Russia's handling of the Agrokor failure and its subsequent takeover. The latter allows **Sberbank** and **VTB** to expand the Russian economic footprint throughout the region. Agrokor is the largest company in the Western Balkans operating in Croatia, Slovenia, Bosnia and Herzegovina, Serbia, Montenegro and North Macedonia. It employs around 10,000 workers in Slovenia, with approximately other 70,000 jobs depending on the business they do with Mercator, Slovenia's Agrokor-owned retail chain. In Serbia, Agrokor employs around 6,000 workers and in Bosnia and Herzegovina around 5,000.¹⁰⁸ In addition, Agrokor indirectly affects the business of hundreds of small and medium-sized firms, and thousands more workers engaged largely in the agricultural sector.

Agrokor's previous owner, Ivica Todorić, was known for using the size of his company to influence political and institutional decisions. Mr. Todorić emerged as Croatia's biggest tycoon after the country's transition from Yugoslav socialism to capitalism. Maintaining close relations with the family of Croatia's first President Franjo Tuđman, the founder of HDZ, has enabled Mr. Todorić to gain a stake over a large part of the country's agriculture industry. Mr. Todorić expanded his business by buying up companies in the neighboring countries (primarily Serbia and Bosnia and Herzegovina) and using either Agrokor's revenue or credit lines from banks to fund these acquisitions. Without further room for expansion on eastern markets, after failing to enter the retail market in Turkey, Mr. Todorić turned towards the west, and decided to acquire a majority share in Mercator, the largest retailer in Slovenia. When he couldn't reach a deal with any of the western bank, Mr. Todorić turned to Sberbank.¹⁰⁹

¹⁰⁶ "The KTB Case: The missing names. Part 1: The Government's Bank and Putin's Man". Anticorruption Fund. 18 October 2019.

¹⁰⁷ Shentov, O., Stefanov, R. and Vladimirov, M. (Eds.) 2019. *The Russian Economic Grip in Central and Eastern Europe*. Abingdon: Routledge.

¹⁰⁸ Šoštarić, T. "Regija osluškuje šta se događa s Agrokorom". *Al Jazeera Balkans*. 12 March 2017.

¹⁰⁹ He certainly had the contacts needed to negotiate a cheaper loan in Russia: in 2007 Russian Prime Minister and former President Dmitry Medvedev was vacationing with his family on Mr. Todorić's private island Smokvica. Another guest on the island was his friend Sándor Csányi, the CEO of OTP bank, a board member of MOL and the richest man in Hungary, considered an ally to Prime Minister Orban.

In April 2014, Todorčić took out a € 600 million loan from Sberbank and signed a memorandum of understanding on collaboration with the bank.¹¹⁰ It would be just the first of several loans provided to Agrokor by Sberbank. Towards the end of 2016, rumors started circulating that Agrokor might soon go bankrupt, unable to repay all the debt that the company took on. When the credit rating agency Moody's downgraded Agrokor's rating and the company's attempts to ensure a loan from a consortium of western banks fell through, it became clear that the retail empire was crumbling. Russian state-owned banks **Sberbank and VTB, which had by that time loaned € 1.4 billion to Agrokor**, reportedly offered Mr. Todorčić a way out: they convert the debts into ownership and take over 51% of the company. He allegedly refused because of pressure from the government, which was trying to stop Russia from taking over the largest company in Croatia.¹¹¹ The holding's failure was nudged forward by the Russian Ambassador, who announced during a press conference in February 2017 that the Russian government expected Agrokor to fully repay its obligations towards Sberbank and VTB.

Croatia's main priority at the time was to save Agrokor, since its collapse would almost certainly trigger another economic crisis in a country that had barely recovered from six years of recession. The government implemented a special law, dubbed "lex Agrokor", according to which the state would remove Mr. Todorčić from the company's management and install a special manager to run Agrokor through a restructuring process. The first special manager favored a group of US venture capital funds led by Knighthead Capital Management to lead the restructuring. But a subsequent conflict of interest scandal removed the initial choice for the management of the restructuring process. The new special manager brought Sberbank back to the negotiating table and the bank even approved an additional credit line for Agrokor. In April 2019, Agrokor was dissolved and its properties transferred to a new company called Fortenova Group. Once the process is fully complete, **Sberbank will own a 39.2% share in Fortenova, with an additional 7.5% owned by VTB**. Knighthead will end up controlling around a quarter of the shares. Fortenova Group will still need to attract fresh capital in order to repay Agrokor's debts and, reportedly, VTB has offered the new company a € 800 million revolving loan.¹¹²

The representatives of Russian state banks have publicly claimed that their only interest in Agrokor is to retrieve the money they have already invested and eventually sell their shares at a profit. But since both Sberbank and VTB have been consistently acting as instruments of Kremlin's influence in SEE, questions about using Agrokor as leverage have arisen in the public discussion. Agrokor and its former owner have been deemed untouchables for years. Even though Mr. Todorčić's fortune was made largely thanks to his ties to the conservative HDZ party back in the 1990s, he had expanded his influence over the country's entire political class. The

¹¹⁰ Sberbank. 2014. "Sberbank and Agrokor announce EUR 600 million syndicated long-term loan facility and plan further activities for CEE retail customers". Online press release. 10 April 2014.

¹¹¹ Bošković, R. 2017. *Ivica Todorčić: Biografija propalog kralja biznisa i politike*. Zagreb: Profil knjiga.

¹¹² Pavlova, I. "VTB in talks on refinancing Croatia's Fortenova 1.2 bln euro roll-up credit – report". SeeNews. 6 June 2019.

TABLE 2. THE PRESENCE OF THE AGROKOR HOLDING IN THE WESTERN BALKANS, 2018

Number of directly controlled companies	159
Businesses which could be indirectly affected	1,500 – 2,000
Assets (€ million)	1,358
Revenues (€ million)	5,223
Net profit (€ million)	192
Number of employees	52,000
Indirect employment (number of workers)	110,000
Ownership	(46.7% Sberbank and VTB) – blocking share

Source: CSD calculations based on statistics from national and international corporate databases.

collapse of his business empire revealed the full extent of the **influence of Agrokor on its local suppliers and business partners**, who were forced into unfavorable credit arrangements whenever Agrokor was short of liquid funds.

Thus, by taking over a company with such a **significant weight in the regional economy**, Russian interests have acquired an enormous potential to exert influence over policy-making in SEE. Russia could take advantage of already well-developed politico-economic networks in Croatia and across the region to acquire political leverage by, for example, stirring social unrest or pushing through legislation that would solidify Agrokor's market share.¹¹³

In **Serbia**, Agrokor owns one of the largest supermarket chains (consisting of three separate brands), a retail credit card company, pastry and ice cream companies, a mineral water and a sun flower oil producer, real estate management companies, and different consultancies. Agrokor employs directly 11,200 workers or one third of all employees in the Russian-controlled or related companies in the country.¹¹⁴ Merkator-S, the main Agrokor brand and the second biggest retailer in Serbia with around \$ 915 million in revenues in 2017, possesses 350 supermarkets of different types and sizes, making it one of the biggest companies in Serbia. The company works with at least 660 domestic suppliers with enormous significance for small town economies.

The Serbian government pledged not to allow Agrokor-owned companies to suffer any direct damages from the failure of their parent firm. Belgrade announced that it could protect these firms with the introduction of temporary measures by commercial courts and by not allowing Croatia's Lex Agrokor to have jurisdiction in Serbia.¹¹⁵ As a result, Sberbank filed a request to the Serbian commercial courts to block the sale of company assets related to Agrokor. This is consistent with the Serbian law that prevents the parent company from a foreign state to guarantee its loans with the property of their subsidiaries in Serbia. The courts decided to introduce the temporary measures and to forbid the alienation of assets

¹¹³ Agrokor and its former owner, Todoric, also have a significant influence over the media. Agrokor was not only the most important media advertiser in the country but also the owner of the press distribution chain Tisak d.d.

¹¹⁴ "Seratlić poručio Ljajiću: Mercator S plaća sve na vreme". *SEEBiz*. 23 March 2017.

¹¹⁵ "Vučić o Agrokoru: Evo šta možemo da uradimo". *Mondo*. 19 April 2017.

in favor of creditors looking to claim their loans via the shares of Agrokor companies. After the settlement and the general overhaul of the holding, **all parts of Agrokor in Serbia remained in the hands of Sberbank**.¹¹⁶ Therefore, Sberbank and the Russian government will continue to have a direct control over one of the biggest retail chains in Serbia and indirect influence over hundreds of small and medium-sized businesses in the country.

In **Bosnia and Herzegovina**, there are four companies, which ownership has been transferred to the new owner of Agrokor, Fortenova group. Furthermore, the ownership of four other companies in BiH was transferred through daughter companies in Croatia and BiH (Jamnica Zagreb, PIK Vrbovec, Konzum doo Sarajevo) to Fortenova group.¹¹⁷ The total amount of debt which former Agrokor companies in BiH owe to their suppliers and other debtors is unknown, as the management of Fortenova Group so far has refused to provide this information to the public.¹¹⁸ However, back at the time of Agrokor's collapse in 2017, the Prime Minister of the Federation BiH Fadil Novalić estimated this debt to be around € 230 million.¹¹⁹ At the beginning of the Agrokor crisis in 2017, the company employed directly 5,296 people in BiH, whereas most of them – 4,153 – were employed in Konzum d.o.o. Sarajevo.¹²⁰ By having – through its proxies – a controlling influence of a network of companies with such economic weight in the economy of the region, the Kremlin potentially has a sway over a vast number of small businesses.

Telecommunications

Russian state-owned banks have used their financial muscle to acquire several strategic telecommunications companies in the SEE region. As with Agrokor, Russia has tried to convert these investments into political leverage. A prominent case in this sector has been **the takeover of the Bulgarian Telecommunications Company (BTC)**, the biggest telecommunications company in the country, in a deal seeded with high-level corruption allegations and raiding in a competition among different groups of Russian investors and Moscow-affiliated Bulgarian businessmen.¹²¹ The Russian influence in the sector is amplified by BTC's structural importance for Bulgaria's national security. The telecoms company is the leader in network and internet coverage with a reach of 99.4% of the population as well as in broadband provision in Bulgaria with almost a third of the internet base in the country. It also used to control the backbone of the country's security telecommunications infrastructure.

¹¹⁶ Kankaras Trklja, M. "Agrokor" se gasi. Kakva je sudbina srpskog dela kompanije". *Sputnik News*. 1 March 2019.

¹¹⁷ Super Kartica d.o.o. Sarajevo, VELPRO d.o.o. Sarajevo and PIK Vrbovec d.o.o. Sarajevo are 100%, while Sarajevski kiseljak d.d. Kiseljak is 99.8% owned by Fortenova Group.

¹¹⁸ Tolj Ružić, A. "Šta gašenje Agrokora znači za Bosnu i Hercegovinu". *N1*. 3 April 2019.

¹¹⁹ "Agrokor u BiH ima 5.296 zaposlenih, a dobavljačima duguje 450 milijuna KM". *Hrvatski medijski servis*. 2 April 2017.

¹²⁰ Ibid.

¹²¹ "The Phony Battle for BTC". *Capital*. 15 January, 2017.

Previously controlled by CCB, although highly profitable BTC failed to repay a loan of € 150 million to VTB in 2013. The Russian bank then formed a loan syndicate, effectively taking control over the telecoms company. In 2015, the Russian state bank sold the company to a consortium led by the VTB affiliated Bulgarian businessman Spas Roussev. His links with Moscow date back to the communist regime. Over the past decade, this relationship has continued through his cooperation with VTB. **The auction for BTC lacked transparency and ultimately resulted in the sale of the company at a grossly underestimated valuation.**¹²² Mr. Roussev's winning bid of € 330 million was primarily financed by VTB, further highlighting the Russian bank's interest in BTC. For these reasons, it is believed that Spas Roussev acted as a proxy buyer for VTB and an intermediary for Moscow.

Box 5. Competing Russian interests

BTC's auction exposed the presence of different, sometimes **competing Russian interests** backed by Bulgarian businessmen.¹²³ The deal for the sale of BTC to Spas Roussev has been vehemently opposed (and is still contested) by a competing group of Russian and Bulgarian businessmen. In particular, the former CEO of the bankrupt CCB and fugitive from justice in Serbia, Tsvetan Vassilev, has drawn the support of Russian businessman Konstantin Malofeev who is under US and EU sanctions for his links to the Russia-backed separatists in eastern Ukraine.¹²⁴ They have tried to preserve the ownership of BTC in the aftermath of the failure of the Corporate Commercial Bank in 2014.

The opposition to the BTC sale has been spearheaded publicly by the Russian businessman Dmitry Kosarev. He has claimed to be the rightful owner of BTC, possessing 76% of the company's shares through a subsidiary, Emprevo Ventures Ltd. Tsvetan Vassilev claims that Emprevo has been the rightful holder of BTC shares, as it has been one of the special purpose vehicles of CCB under his watch. Mr. Kosarev began legal action in London against VTB Capital, the UK subsidiary of the Russian bank. He even filed a complaint before the US Office of Foreign Assets Control. Mr. Kosarev and Mr. Vassilev claim, that they had offered to re-finance the VTB bank loan to BTC, which led to the company's sale, but their offer was never considered. The lawsuit against VTB was for the illegal capture and sale of Vivacom (BTC's commercial brand) to a VTB affiliate, with VTB granting a loan without collateral because at the time BTC's shares were under arrest and could not serve as collateral. Hence, Mr. Kosarev asserted that VTB acted as both a seller and a buyer in the transaction. Not only did VTB hold the majority stake, but the bank also provided the bulk of financing to Spas Roussev through a € 240 million credit facility for the buyer, Viva Telecom.¹²⁵

¹²² Ibid.

¹²³ Ibid.

¹²⁴ Vladimirov, M. and Stefanov, R. 2019. "Bulgaria: State capture unplugged". In: Shentov, O., Stefanov, R. and Vladimirov, M. (Eds.) 2019. *The Russian Economic Grip in Central and Eastern Europe*. Abingdon: Routledge: 125-126.

¹²⁵ "UK Subsidiary of Russian State Bank VTB Reported to Serious Fraud Office Over Vivacom Sale". *GlobeNewswire*. 8 February 2016. However, most recently, the England and Wales High Court has ruled against Dmitry Kosarev's claims. Stoyanov, N. „ЛОНДОНСКИ СЪД ОТХВЪРЛИ ПРЕТЕНЦИИТЕ НА ДМИТРИЙ КОСАРЕВ КЪМ ТЪРГА ЗА БТК“. *Capital*. 5 July 2019.

Russia's control over BTC provided Moscow with enormous reach into Bulgaria's **strategic communications infrastructure**. BTC owns and manages the country's digital transmission broadcast through one of its subsidiaries – NURTS.¹²⁶ NURTS enjoys de-facto monopoly over the digital transmission broadcasting of national and regional TV and radio signals. Initially financed by the Corporate Commercial Bank, NURTS was eventually purchased by BTC itself with a majority stake in 2013. This allowed the telecoms giant to control both the digital and analogue broadcasting in Bulgaria and to lease to the other telecoms for collocation the transmission stations spread around the country.¹²⁷ In addition, BTC owns a major part of backhaul networks and even larger part of intra-city passive networks. BTC is also last-mile provider of fixed, mobile and internet telecommunication services, and its fixed service is used by the bulk of local and central government authorities.

Box 6. Seeking a regional footprint

VTB's interest in the telecommunications sector could be part of a **regional strategy** as the consortium which bought BTC has expanded abroad with the acquisition of **Telekom Albania** by Spas Roussev.¹²⁸ In the meantime, Mr. Roussev put up BTC for sale at a four times higher price than its acquisition, though the deal is likely to be overshadowed by the ongoing ownership dispute.¹²⁹ The BTC saga has been a prime example of how easy it is for Russia and its proxies to get access to critical national security assets in the Balkans, with unforeseen consequences for the overall security of the region.

Mining and metallurgy

Russian businesses have also targeted the region's heavy industry during a wave of investments by some of the largest Russian mining oligarchs abroad. In most cases, Russia has exploited **rigged privatization procedures** to acquire largely bankrupt companies at a very low price. The objective of these new investors has not been to turn the previously failed state companies in successful businesses but rather to use them as cash cows siphoning profits abroad or using assets as collateral to obtain loans for their activities. Russian companies have also systematically exploited governance gaps such as poorly defined privatization agreements that impose obligations on the state to implement social programs, provide subventions, cover the costs of production, forgive tax obligations, take over debts, and pay benefits for current and retired employees long after the change in ownership. Public oversight of privatized companies has been virtually non-existent, and privatization contracts that were not fulfilled remained in effect (as opposed to being terminated as stipulated by the agreements). Many privatization deals were marred by allegations of high-level corruption and conflicts of interest.¹³⁰

¹²⁶ Vadimirov, M. and Stefanov, R. *Russia's Economic Influence in the Balkans: Tackling Kremlin's Sharp Power*, Policy Brief No. 89. Sofia: Center for the Study of Democracy.

¹²⁷ „КЗК разреши на БТК да купи „НУРТС“ България”. *Dnevnik*. 8 June 2015.

¹²⁸ „Виваком” на Вуйчо Спас купи „Телеком” – Албания”. *Faktor*. 8 June 2015.

¹²⁹ Fildes, N., Espinoza, J., Seddon, M. “Bulgarian telecoms group Vivacom eyed in buyout battle”. *FT.com*. 29 September 2019.

¹³⁰ MANS. “Kako je propala crnogorska privreda”. *MANS*. 13 March 2015.

One of the most notorious examples has been the 2005 acquisition by the Russian businessman, Oleg Deripaska, of the state-owned **Podgorica Aluminum Plant (KAP)** and the Niksic bauxite mine just before the proclamation of Montenegrin independence.¹³¹ At the time, KAP's importance for the Montenegrin economy was enormous. The plant's output made up more than 50% of the country's total exports,¹³² and contributed approximately 15% to the country's GDP and 2.3% of total employment.

However, the global economic crisis had an enormous adverse impact on Mr. Deripaska's businesses, reportedly leading to billions in losses.¹³³ The aluminum industry, including KAP was especially hard hit. The Montenegrin smelter had generated around € 280 million in losses by the end of 2008,¹³⁴ and continued accumulating debts to the state-owned electricity company, EPCG. It also failed to fulfill its investment obligations worth € 55 million over a five-year period as part of the privatization agreement with the government. As a result, in 2013 the government filed a request with the Commercial Court to start a bankruptcy procedure for KAP, after the plant's total accrued debt reached more than € 360 million. Following the introduction of the bankruptcy procedure, a firm called Uniprom, which is owned by Veselin Pejović, a local businessman who reportedly has close ties to the government,¹³⁵ bought the plant for € 28 million. Yet, the bankruptcy procedure is still ongoing due to the heavy load of cases being reviewed by the country's Commercial Court.¹³⁶ The Central European Aluminium Company (CEAC), Mr. Deripaska's main vehicle of operation in KAP was the second-largest creditor of KAP at the start of the bankruptcy procedure. However, CEAC was deleted from the list of KAP trustees by a decision of the Commercial Court in February 2018, after it had transferred its claim worth € 50 million to another offshore company also owned by Mr. Deripaska.¹³⁷

After the start of the bankruptcy procedure, Mr. Deripaska brought three international arbitrations and many lawsuits at domestic courts against Montenegro. CEAC has lost two arbitration cases against Montenegro – one at the arbitration tribunal of the United Nations Commission on

¹³¹ Vladimirov, M. et. al. 2018. *Russian Economic Footprint in the Western Balkans. Corruption and State Capture Risks*. Sofia: Center for the Study of Democracy.

In 2005, the controlling stake in KAP was purchased by Deripaska's Salomon Enterprises Limited, later renamed Central European Aluminum Company – CEAC Holdings Limited, which was established to manage the assets of the EN + Group in Eastern Europe.

¹³² Agency for Competition Protection of Montenegro. *Zaključak od Komisija Za Kontrolu Državne Pomoći*. 11 March 2016.

¹³³ Belton, C. "Faces of the Crisis: Oleg Deripaska", *Financial Times*. 29 December 2008.

¹³⁴ Montenegro State Audit Institution. *Izveštaj o reviziji: Državne garancije Vlade Crne Gore izdate u 2010. i 2011. Godini*. 29 April 2013.

¹³⁵ Korać-Perović, M. "VESELIN PEJOVIĆ, REŽIMSKI KANDIDAT ZA TRINAESTOJULSKU NAGRADU: Crnogorski san", *Monitor*. 18 June 2015.

Radulović, Z. "VESELIN PEJOVIĆ: DRŽAVNI ČOVJEK ZA PRIVATNE POSLOVE: Najbolji je kad bije". *Monitor*. 18 March, 2016.

¹³⁶ "Još se ne zna kada će biti okončani stečajevi u u KAP-u i Boksitima". *Bankar.me*. 10 December 2018.

¹³⁷ This is Shasta Universal Inc, a company that is headquartered on the British Virgin Islands. "CEAC Više Nije Povjerilac Kombinata Aluminijuma". *Bankar.me*. 26 February 2018.

International Trade Law (January 2017)¹³⁸ and one at the International Center for Settlement of Investment Disputes (July 2016).¹³⁹ In May 2017, Mr. Deripaska withdrew the lawsuit against Montenegro that was filed at the Cypriot court in Nicosia.¹⁴⁰ From these unsuccessful legal claims, CEAC owes Montenegro approximately € 1.5 million of fines and litigation costs, which Mr. Deripaska has refused to pay.¹⁴¹ Media reported that a third arbitration has started in November 2018¹⁴² at the Permanent Court of Arbitration at the Hague.¹⁴³

Box 7. US sanctions

In April 2018, the US Treasury Department imposed sanctions under the Countering America's Adversaries Through Sanctions Act (CAATSA) on United Company Rusal and Oleg Deripaska. Amongst other things, **US Treasury's Office of Foreign Assets Control justified the sanctions** with the claim that Mr. Deripaska purchased KAP in 2005 as part of Kremlin's plan to increase its influence in the Mediterranean. Mr. Deripaska's office denied this claim saying that the plant was purchased for commercial and not political reasons, and that KAP has never been central to the economy of Montenegro.¹⁴⁴

The KAP case has shown how **one major strategic investment** could lead to an attempt by private and foreign interests to overpower and **capture small countries' economies** and their government institutions. After acquiring KAP, Oleg Deripaska attempted to take control of power production in Montenegro by bidding to purchase via his En+ Group the thermal power plant and the coal mine in Pljevlja, the key electricity supplier to the aluminum plant. The acquisition was stopped at the very last moment by the Montenegrin parliament in June 2007. MPs of a small governing coalition member, the Social-Democratic Party, joined with opposition MPs to vote against the agreement. The MPs argued that Montenegro must keep control over its most important energy resources, and that this takeover would be both economically and politically harmful to the country.¹⁴⁵

The 2013 State Audit Institution (SAI) report heavily criticized state loan guarantees provided to KAP between 2010 and 2011. The guarantees were issued without a detailed risk and cost/benefit analysis, and despite KAP's

¹³⁸ Government of Montenegro. "Arbital Tribunal in Vienna rules: All CEAC claims against Montenegro rejected", Online press release. 13 January 2017.

¹³⁹ Government of Montenegro. "CEAC loses arbitration against Montenegro, has to bear arbitration costs", Online press release. 27 July 2016.

Ministry of Economy of Montenegro. "SAOPŠTENJE: Potvrđena ispravnost postupanja Crne Gore: Arbitražni tribunal u Parizu u potpunosti odbio zahtjev CEAC-a". Online press release. 4 May 2018.

¹⁴⁰ "En+Group povukla tužbu protiv KAP-a pred sudom u Nikoziji". *Bankar.me*. 29 May 2017.

¹⁴¹ Ministry of Economy of Montenegro. "Deripaskina Centralnoevropska aluminijaska kompanija (CEAC) ne poštuje odluke više arbitražnih tribunala", Online press release. 25 July 2018.

¹⁴² Gudović, I. "Crna Gora u Hagu počela bitku sa Deripaskom". *Vijesti.me*. 24 November 2018.

¹⁴³ PCA/2017-07 (05.12.2016): *Mr. Oleg Vladimirovich Deripaska (Russian Federation) v. the State of Montenegro*.

¹⁴⁴ Aris, B. "Deripaska Slams U.S. Treasury Memo Accusing Him of Playing Politics". *The Moscow Times*. 29 May 2019.

¹⁴⁵ "DPS izgubio bitku ali se ne predaje". *Vijesti*. 13 June 2007.

difficult financial situation, culminating in the plant's default on its bank debt and subsequent bankruptcy. SAI determined that the Montenegrin Economy and Finance ministries, as well as the State Aid Regulatory Commission, did not conduct a proper due diligence of KAP, and did not consider the findings of private auditors. SAI's report claimed that financial indicators demonstrated that KAP could not pay back the loans from its own resources, already at the time of the approval of state loan guarantees. All guarantees that the government gave to KAP were eventually paid by taxpayers. The lack of a detailed financial assessment of the foreign investor's capacity to purchase the largest company in the country and implement the investment requirements specified in the initial agreement contributed to the later controversies surrounding the renegotiation of the contract between the state and KAP's Russian owner.¹⁴⁶ This provided the Russian company and the Kremlin with opportunities for leverage, which could have resulted in a diversion of the country's Euro-Atlantic course.

Real estate and tourism

One of the most visible aspects of the Russian economic presence in the SEE region has been the heavy influx of Russian tourists and buyers of property. While individual investments are small to affect the economy, in their totality they provide the Kremlin with a potential **tool for leverage and a useful cover for penetrating local communities** and building Russia-centric narratives. This trend has affected the region's most attractive tourist destinations including Bulgaria's Black Sea and mountain resorts, as well as **Montenegro's and Croatia's Adriatic coast**. Numerous investments in the tourism sector are underway, with luxury hotels being built by investors such as oligarchs Viktor Vekselberg and Mikhail Fridman in Croatia. Russian politicians and high-ranking officials have also been entering the regional real estate market¹⁴⁷ and acquiring dual citizenship. In Montenegro, during the peak era of Russian investment of 2006 – 2013, Russian nationals bought numerous apartments and houses on the coast. One estimate claims that Russian citizens owned around 70,000 properties in 2014.¹⁴⁸ Although there have been claims that Russians have been selling their real estate property in the country following the deterioration of political ties in 2016, the Montenegrin central bank data shows that real estate accounted for a significant part of the Russian FDI in Montenegro in 2017 and 2018. Russian investment in real estate reached € 80.8 million, or over 60% of Russia's total investments in Montenegro in these two years.¹⁴⁹

Although not of the same degree of structural significance for the economy, in **Bulgaria**, Russian real estate investments have also been one of the ways in which Russia's economic presence has expanded. According to the Russian general consulate in Sofia, Russians own 500,000 properties in Bulgaria. Most of them are located at the seaside, where many Russians invest in holiday homes to rent out or use for the summer.

¹⁴⁶ Montenegro State Audit Institution. "Izveštaj o reviziji: 'Državne garancije Vlade Crne Gore izdate u 2010. i 2011. Godini'". 29 April 2013.

¹⁴⁷ „Тайная жизнь иностранного агента”. Navalny.com. 11 November 2019.

¹⁴⁸ Lajović, V. "Rusi su u Crnoj Gori kupili 70.000 nekretnina". *Vijesti.me*. 17 May 2014.

¹⁴⁹ Central Bank of Montenegro. "Balance of payments". April 2019.

Another independent study claimed that the number of Russian-owned properties in the country is around 400,000.¹⁵⁰ Assuming an average property size of 50m² and a market rate of around € 650 per sq. m., this would mean assets of around € 13 billion.

More than 10,000 Russians live permanently or semi-permanently in Burgas, which is the second largest seaside city in Bulgaria.¹⁵¹ A similar trend is visible among owners in Bulgaria's largest ski resorts. Some long-term Russian residents have also begun to develop small businesses or rent out their properties on Russian internet platforms. Official national statistics put the overall number of Russian citizens permanently residing in Bulgaria at almost 18,000, making Russians the single largest group of foreigners in Bulgaria. An additional 5,000 Russians have received Bulgarian citizenship over the last 15 years.¹⁵²

Box 8. Dual-use real estate

Much of the real estate investment in Bulgaria is driven by Bulgaria's appeal as a favorite holiday destination for many Russians. Bulgaria is also a price competitive destination for real estate investments and traditionally has imposed a relatively few obstacles for foreigners trying to buy property. However, some suspect the surge in property purchases by Russian individuals is also related to money laundering schemes and brings in Russian criminal money into the Bulgarian economy.¹⁵³ Russian-funded gated resorts have sprung out all along the Black Sea coast. The biggest one – **Kamchia resort**, which has a **broadcasting license** and is located in close vicinity to an on-shore naval facility – is owned by the City of Moscow. At the end of 2019, the resort was a matter of discussion at the upper chamber of the Russian parliament. The idea that it might be federalized was floated as a **matter to be considered by the Security Council** – a consultative body of the Russian President that works out the President's decisions on national security affairs – thereby betraying the **way in which the Kremlin considers Russian property abroad**. In Finland, investigative journalists have identified a rapid increase in the number of houses bought by Russians in the vicinity of Finnish army bases.¹⁵⁴

The increase in permanent Russian residents in Bulgaria has followed more or less the trend in Russian short-term visits to the country. Since 2008, they have jumped from around 300,000 to a peak of around 700,000 in 2013 before sliding down to around 522,000 in 2018. Despite the relatively high numbers, Russian visitors make up only a small share of the total number of visitors (4.2%). The expectation is that due to the shrinking purchasing power of the Russian population and the growing competition

¹⁵⁰ Hope, K. "Russians find the good life in Bulgaria". *Financial Times*. 30 November 2014.

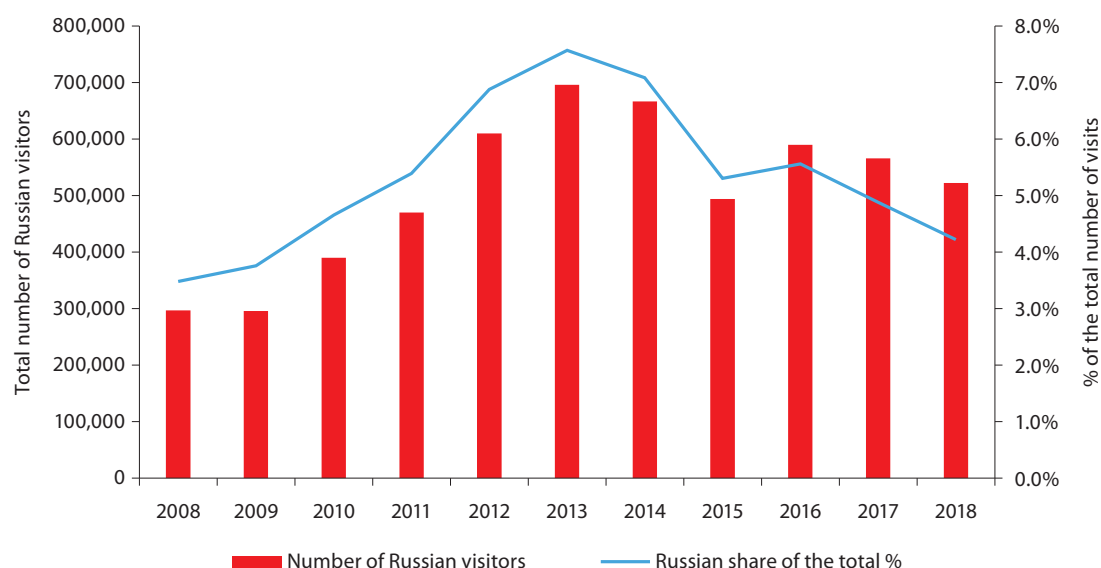
¹⁵¹ Zhekova, S. „Какви са тези руснаци, които се заселват в България“, 24 Часа.bg. 14 July 2014. Based on a statement by Russia's honorary consul in Burgas, Tonko Fotev.

¹⁵² Around 90% of all real estate deals at the Black Sea involve Russian citizens and Bulgaria remains the most competitive destination for Russian real estate investment in the EU. Amid the depreciation of the ruble, Bulgaria remains more affordable vis-à-vis more expensive destinations like Spain, Cyprus and Croatia, according to the Bulgarian real estate association. Its expectation is that despite the economic crisis and the EU sanctions, property sales to Russians would continue growing in the near future. A strong evidence is that there are around 35,000 real estate agencies in the commercial registry with partial or full participation of Russian companies or natural persons.

¹⁵³ Tsekov, N. „Какво търсят руснаците в България“. DW.com. 8 June 2014.

¹⁵⁴ Braw, E. "Back to the Finland Station". *Foreign Affairs*. 18 June 2015.

FIGURE 17. RUSSIAN TOURISTS IN BULGARIA



Source: CSD, based on data from the National Statistical Institute.

from other tourist destinations in the vicinity, the number of Russian tourists will probably stagnate or decrease slightly in the coming years. However, since the tourism sector makes up around 13.6% of the Bulgarian GDP, the role of Russian visitors (90% of whom are tourists) is crucial for the industry as they are also among the biggest spenders in the Bulgarian resorts. This is why the introduction of sanctions has been seen as particularly painful for the Bulgarian hotel owners vulnerable to short-term changes in the size and structure of tourist flows. It has also resulted in short-lived protests from hotel owners in Burgas in the summer of 2014.

In Montenegro the tourism industry is by far the most important economic sector. In 2018, tourism made up 21.6% of Montenegrin GDP and 57.1% of total exports of services, according to the World Travel & Tourism Council.¹⁵⁵ Russian tourists make up a large share of the total volume of foreign tourists. They used to be the largest group of visitors to Montenegro, amounting to almost 1/4 of the total.¹⁵⁶ In 2017, Russians made 18.7% of all foreign tourists in Montenegro, while in 2018 that share shrank to 16.3%.

Since 2006, the number of Russian tourists in Montenegro has jumped five-fold, to 350,468 in 2017, spending a total of 3.06 million nights.¹⁵⁷ At an average price per night of around € 70,¹⁵⁸ one could estimate that in

¹⁵⁵ World Travel and Tourism Council. *Country Data for Montenegro*.

¹⁵⁶ "Četvrtina turista u Crnoj Gori su Rusi". *Bankar.me*. 20 May 2017.

¹⁵⁷ MONSTAT. *Arrivals and overnight stays*. Statistical Office of Montenegro.

¹⁵⁸ The estimate is based on the average revenue per room rate in the 2014 *Horwath Hotel Industry Survey Montenegro*, commissioned by the Montenegrin government.

2017 alone, Russian tourists spent over € 200 million on accommodation, which was around 5% of GDP. Although Russians accounted for the second largest group of tourists in Montenegro in 2017 and 2018 after Serbs, they still make up the biggest share in the number of nights (26.7% in 2017 and 25.1% in 2018).¹⁵⁹

Prior to Montenegro's accession to NATO, there was a visible effort by Russia to exploit the Montenegrin dependence on Russian tourist inflows. Russian media started a negative campaign describing Montenegro as dangerous for Russian citizens with the goal of discouraging them from spending their holidays in Montenegro. Russian media reports went as far as to exaggerate increased crime rates, filthy beaches, and a difficult tourist season in the Adriatic country.¹⁶⁰ The Russian Foreign Minister, Sergey Lavrov, even threatened in March 2017 that Montenegro is sacrificing its economic relations with Russia by joining NATO.¹⁶¹ However, it seems that the **deterioration of political ties has had only limited influence on the flow of Russian tourists** to Montenegro, according to the official data. The total number of Russian tourists in Montenegro in 2018 fell by just 12,000 in comparison to 2017.

Russian investors own some of the largest and most popular hotels in Montenegro. While there is no comprehensive analysis of the entirety of Russian investments in tourism, local media and independent civil society organizations have worked to document attempted Russian investments that sought to use Montenegro's governance deficits to facilitate deals.^{162,163} In several cases, Russian firms which appeared to be shell companies with little capital won large **privatization tenders without** being able to fulfill the government's **requirements for modernization**, as agreed in the privatization deals. In several notable cases, despite failing to implement the privatization agreements, there have been little or no consequences for the Russian investors involved.¹⁶⁴ Despite the worsening of the political relations with Russia, the announcement of the largest Russian investment in the Budva Riviera so far – about € 250 million for the construction of the tourist complex Smokvica¹⁶⁵ – suggests that **Russian investors will continue to expand their presence in this market**.¹⁶⁶

¹⁵⁹ MONSTAT. *Arrivals and overnight stays*. Statistical Office of Montenegro.

¹⁶⁰ „Криминал, минные поля и столбняк: почему Черногория становится опасной для туристов”. *TV Zvezda*. 15 March 2017.

¹⁶¹ “Unclear How Montenegro NATO Accession to Boost Alliance's Security – Lavrov”. *Sputnik*. 13 March 2017.

¹⁶² “Studija slučaja ‘Zavala’”. *MANS*. 21 January 2009.

¹⁶³ “Na temeljima korupcije: Kako su investitori zarobili državu”. *MANS*. 5 June 2010.

¹⁶⁴ Examples include the unsuccessful privatizations of hotel Lido in Ulcinj that was sold in 2006 for € 10.8 million, with a promise for € 37.9 million in additional investments – the old hotel was demolished but a new building has not been completed yet. A similar example is Hotel As in Petrovac that was sold to Russian investors in 2002 for DEM 5 million with an obligation to invest another DEM 22 million, yet remains an abandoned construction site. The promised post-privatization investments also never materialized in the exclusive tourist resorts of Maljevik in Bar and Skočidevojka in Budva.

¹⁶⁵ The Russian companies V.A.S. Invest and Boticelli Land Development bought 13 hectares of land in locality Smokvica in Budva for over € 25 million in 2007. Spatial plans for the area were adopted in 2017, and the start of the construction is announced for 2019. Estimated value of the investment is € 250 million.

¹⁶⁶ “U aprilu počinje izgradnja rizorta ‘Smokvica’ u Budvi, vrijednog 250 miliona”. *Bankar.me*. 15 March 2019.

POLITICS AND SHARP POWER

Russian influence in SEE follows **two primary tracks of state capture instruments** that can be generally described as **economic** and **political**. The first is aimed at preserving the Kremlin's core business interests such as the quasi-monopoly on oil and gas markets by buying out strategic energy companies, exploiting governance loopholes to manipulate top-level decision-making and capturing regulatory institutions to prevent market liberalization and competition. The second seeks to undermine the established liberal-democratic consensus in Europe, and in this way elevate the Russian "vertical of power" as an acceptable alternative. Russia attempts to sow mistrust in the sustainability of democratic institutions by deepening political divides and cultivating relationships with aspiring autocrats, political parties (especially radicals, nationalists, populists, and Eurosceptics), and pro-Russian civil society organizations.

In the identification of a distinct sets of drivers, tactics, and instruments, a clear commonality emerges: both systems of **economic and political capture rely on corruption** as the conduit through which **Russian influence is channeled into the local environment and ultimately expanded**. The drivers of Russian influence seek to exploit existing deficiencies within the democratic fabric of the state.

There is a need to better understand how the bilateral political relationships that Russia has developed with each of the countries in the region and the associated sharp power instruments such as media disinformation and support for religious and civil society organizations have amplified Russian economic influence to an outsized role that allows for the capturing of strategic decision-making.

OPERATING POLITICAL NETWORKS OF INFLUENCE

The presence of pro-Kremlin agenda in party politics in the SEE countries is hard to miss. But it is formed through a complex interaction between direct influence from Moscow and parties' own interests in attracting voters and the support of key domestic businessmen through pro-Russian policies. For its own part, **Moscow has utilized political opportunism and a flexible strategy towards direct political influence with shifting patterns of support for parties**. Russia tries to influence parties from the whole political spectrum in SEE. Yet, its influence is most visible among far-right and far-left political parties. They usually play a fringe role in domestic politics but serve to augment existing social tensions based on ideology or values.

A staunch political ally of Russia in Bulgaria is the Ataka party, an ultra-conservative, yet economically leftist formation with an assertive anti-

Western, pro-Russian stance. The party attracted considerable public support before 2014 and secured the needed one critical vote for the functioning of the Bulgarian parliament during the short-lived socialist-led government of Prime Minister Oresharski in 2013 – 2014. Despite a steady decline in its public support since then, Ataka joined PM Borissov's third government after 2017 as part of the Patriotic Front coalition of nationalists. Ataka has thus been able to get involved in the appointment of several key policy-makers including the country's economy minister.

Box 9. The Russian affiliations of Serb parties

In **Serbia**, several small nationalist parties have struck cooperation agreements with Russian counterparts including with the ruling United Russia party:

- The Democratic Party of Serbia, which was the first party to sign an official cooperation agreement in 2007.
- The Serbian National Movement of Nenad Popović (Minister without portfolio of Serbia in charge of innovation and technological development in the government of PM Ana Brnabić).
- Third Serbia (former ruling coalition partner of the Progressive Party in the city of Novi Sad) – a splinter extreme-right party from another Russophile movement, Dveri.
- Dveri, also a far-right party, which seems to be in the slow process of transforming itself into a pro-European right-of-center party, has had some contacts with United Russia in the past, including with Sergei Zheleznyak, member of the Russian Duma, and United Russia envoy for cooperation with Serbia.
- The extreme-right movement Zavetnici, notorious for their actions against civil society organizations throughout Serbia.
- The Progressive Party (SNS) of President Vučić signed an agreement with United Russia in 2010, though SNS officials have insisted that for them a much more important framework for cooperation is their membership with the European People's Party.¹⁶⁷
- Srpska List (a Serb minority party in Kosovo supported by the Progressive Party) signed a cooperation agreement with the ruling party in Russia in the summer of 2017.

Pro-Russian parties in Serbia signed a cooperation declaration for the "creation of a militarily neutral territory in the Balkans" with Putin's United Russia at the Russian ruling party's 15th congress in 2016.¹⁶⁸ A number of other smaller Serbian parties have developed an active cooperation with their Russian counterparts (like the Serbian Radical Party with A Just Russia and the Liberal Democratic Party of Russia) or actively advocate cooperation with this country (like Serbian Right, Serb-Russian Bloc and others).

The key instrument of leverage of the Russian political influence in Serbia has been the backing of the latter's **position on Kosovo and the rejection of its self-declared independence in 2008**. It should be

¹⁶⁷ Čongradin, S. and Lukač, J. "Ko su saveznici Putinove partije u Srbiji?". *Danas.rs*. 27 May 2016.

¹⁶⁸ BIRN. "Putin's Party Signs 'Military Neutrality' Agreements with Balkan Parties". *BalkanInsight*. 29 June 2016.

noted that four EU member states, including Romania, continue to refuse to recognize Kosovo, too. This provides further credibility and leverage of the Russian position in the region. **Russia has used its position on Kosovo as a leverage to gain control of most of Serbia's oil and gas industry** a decade ago, and then to effectively sabotage Serbia's Euro-Atlantic integration process by pushing the government to proclaim military neutrality in 2007. Russian support for Serbia over Kosovo has also been used since 2014 to slow down the country's EU accession progress. To continue securing Russia's backing on Kosovo, on issues such as the sanctions on Russia, the annexation of Crimea, the conflict in eastern Ukraine, Georgia, etc., Serbia has aligned its foreign policy not with the EU but with the Kremlin. This situation is unlikely to change before the resolution of the Kosovo issue.¹⁶⁹

Russia has also supported a small right-wing party in **North Macedonia** called United Macedonia, which has been openly pro-Russian and has sought to actively attract Kremlin's attention to itself. The party has been spearheading efforts by nationalist and anti-EU and anti-NATO civil society organizations to derail the agreement between Greece and North Macedonia resolving the decades-long name dispute between the two countries.¹⁷⁰ Like evidenced by the expulsion of several Russian diplomats from Greece in 2018, Russia has sought to actively stoke and exploit the divisions between the Greece and North Macedonia to derail the latter's accession into NATO and the EU.¹⁷¹ President Putin and Foreign Minister Lavrov tried a similar tactic by using highly divisive rhetoric to suggest that Bulgaria wants to dismember North Macedonia¹⁷² and purposefully misrepresenting sensitive historical facts.¹⁷³

While Russia backs the growth of political parties on the extremes of the political spectrum, **the main thrust of Kremlin's political meddling operations aims at the structurally important political forces**, including the governing or the main opposition parties. The successor of the Bulgarian Communist Party, the Bulgarian Socialist Party is the most popular Moscow-inclined party in Bulgaria and it is the biggest opposition group in parliament. Despite its inclination towards Moscow, BSP is not Eurosceptic and is generally sticking with Bulgaria's Euro-Atlantic foreign policy orientation. Yet in tandem with other smaller but very influential parties such as the king-maker Movement for Rights and Freedoms and the Alternative for Bulgaria, BSP has worked consistently to promote the Russian economic agenda in Bulgaria. They have been particularly active in lobbying for the large-scale Russian-led infrastructure projects

¹⁶⁹ In June 2019, both President Aleksandar Vučić and Prime Minister Ana Brnabic confirmed this. At the Plenary Session of the National Convention on the EU in the Parliament of Serbia on June 10, 2019, Vučić said that Russia "wants (to maintain) a frozen conflict on Kosovo." Ana Brnabic said in Chatham House (it was free for quoting) in London the following: "Hopefully, once the Kosovo issue is resolved, Russia will lose the excessive political leverage it enjoys now, so our relations will be more balanced."

¹⁷⁰ Marusic, S. J. "Right-Wingers Call for Macedonia 'Name' Referendum Boycott". *BalkanInsight*. 6 August 2018.

¹⁷¹ "Greece 'orders expulsion of two Russian diplomats'". *BBC.com*. 11 July 2018.

¹⁷² "Bulgaria rejects Russian claim that it wants to dismember Macedonia". *Euractive.com*. 21 May 2015.

¹⁷³ Cheresheva, M. "Putin's Homage to Cyrillic Makes Bulgarians See Red". *BalkanInsight*. 25 May 2017.

in the country. Even the ruling Citizens for European Development of Bulgaria (GERB) and its coalition partner, the Patriotic Front, have in fact embraced most of the Kremlin-driven energy projects since 2016 despite the party's nominal position of pursuing the country's strategic Euro-Atlantic objectives.

Domestic political support for Russia in Bulgaria is shaped by state capture networks formed of Russian and domestic oligarchic circles which hold considerable sway over political parties. However, the extent of direct Russian influence in decision-making remains unclear in part due to its opaque nature and in part as the result of weak public oversight institutions.

As in Bulgaria, **Russia's key mainstream political partner in Serbia is the Socialist Party (SPS).**¹⁷⁴ The party's vice-president, Dusan Bajatović, and its president and Serbia's foreign minister, Ivica Dačić, fervently advocate for stronger cooperation with Russia (but mostly in practical matters – the ideological aspect is not present like among the extreme nationalist groups). High-level SPS party officials have maintained close relations with the Kremlin, and have met on a number of occasions with the Russian president. SPS links with Russia have also helped the party preserve its coalition partner status after the elections in 2014 when Mr. Dačić¹⁷⁵ and the current President, Aleksander Vučić, flew immediately after the vote to Moscow to meet with President Putin, who allegedly facilitated the formation of the new coalition. In this new government, SPS reclaimed not only the energy ministerial position but preserved the foreign ministry, despite less convincing showing at the polls.

Russian political influence over a ruling party in SEE has been most evident in Republika Srpska (RS). In the Serb entity of Bosnia and Herzegovina Russia's role has been built up on the basis of the historically close links between Russians and Serbs and the Russian support for the government of RS after the return to power of Milorad Dodik, leader of the Alliance of Independent Social Democrats (SNSD).¹⁷⁶ In the following years, Mr. Dodik and Russia established strong bonds which benefited both sides – they helped Mr. Dodik to remain in power in RS, while also enabling Russia to steadily increase its popularity and influence over the entity. **The weakening of the EU appeal in the RS** in recent years has also significantly **contributed to the strengthening of the Kremlin's posture** in BiH as Mr. Dodik saw Russia as an alternative tool for the fulfilment of his nationalist goals. This also fits with the Russian strategic agenda in the region to fuel instability by re-awakening inter-ethnic tensions that would keep the Western Balkans further away from

¹⁷⁴ Ibid. Officially, SPS has a cooperation agreement only with the party A Just Russia.

¹⁷⁵ In the 2012 – 2014 period, Mr. Dačić was the Prime Minister and the Minister of Interior of Serbia.

¹⁷⁶ A semi-professional basketball player, businessman and moderate local politician before the war, Mr. Dodik during the war became known for his strong criticism of Bosnian Serb nationalists. After the war in 1996 he established SNSD and was appointed RS Prime Minister in 1998. He stayed in power until 2001, mainly thanks to the strong support from the US and EU, but was eventually toppled by the nationalist Serb Democratic Party, SDS. In 2006 he came back to power and was elected Prime Minister again, but on a different political platform, one which included nationalist rhetoric and separatist ideas. He ruled RS ever since, as Prime Minister, later RS President and now Serb member of the state presidency.

Euro-Atlantic integration, while presenting new economic and political opportunities for the Kremlin.

Box 10. Kremlin's support for Milorad Dodik

Russia has publicly supported Mr. Dodik's separatist ideas including ahead of a referendum on the announcement of a Day of Republika Srpska, which Mr. Dodik held in September 2016, despite international criticism. Even Serbia's President Vučić criticized the idea, warning that it is most probably an unconstitutional act. Mr. Dodik eventually decided to go ahead with the referendum only after Russia publicly defended the vote saying that its non-binding character made it legal. However, as Mr. Dodik's ambitions emboldened after the successful referendum, and as he publicly threatened to hold another referendum – this time on RS's independence – Russian diplomats claim they privately pressed him to refrain from provocation.¹⁷⁷

The political marriage between Mr. Dodik and Moscow has also created a significant imbalance in RS politics since Russian backing has given him significant advantage over other Bosnian Serb politicians and has boosted his popularity in the entity. This advantageous position in turn also emboldened Mr. Dodik to pursue more radical policies.¹⁷⁸

Kremlin's favoring of Mr. Dodik is shown also in the fact that he is among those politicians in the region, who meet Russian President Vladimir Putin very often. In addition to at least nine meetings with Mr. Putin over the last four years, Mr. Dodik is also a regular guest of many other international political, business or cultural events organized by the Kremlin. Mr. Dodik's control over most of the RS media, allows him to aggrandize and to further capitalize on these meetings. Russian political support for the RS President has been very visible in the 2018 general elections. Moscow is believed to have helped in creating a large number of accounts on social media that targeted BiH's elections urging voters to go out and cast their ballot for SNSD candidates.¹⁷⁹

In BiH, Russia has also begun to gradually engage Croat officials including the Bosnian Croat leader Dragan Čović, who on his side has made efforts to improve his ties with Russian diplomatic representatives in the country. The warming-up of **ties between the Bosnian Croats and Russia** could be a by-product to the **growing role that Russia has in Croatia** both economically and increasingly politically. Croatian President Grabar-Kitarović, whose election campaign in 2015 was financed by a loan from the energy company PPD and whose husband Jakov Kitarović has been employed at Russian-owned AD Plastik d.d. since 2016,¹⁸⁰ has publicly called for closer economic ties with Russia.¹⁸¹ Ms. Grabar-Kitarović met with President Putin and Sberbank's CEO, German Gref, in 2017 to subscribe Russian support for the struggling Agrokor company.¹⁸²

¹⁷⁷ Interview with a Russian diplomat, 2018.

¹⁷⁸ Interview with a senior RS official, May 2019.

¹⁷⁹ "Ekosistem Ruskepropagande". *Oslobodjenje*. 22 August 2018.

¹⁸⁰ Bohutinski, J. "Jakov Kitarović zaposlio se kao savjetnik u AD Plastik". *Večernji list*. 24 February 2016.

¹⁸¹ President of Croatia – Kolinda Grabar-Kitarović (November 19, 2017), "Održan Rusko-hrvatski poslovni forum (Russian – Croatian Business Forum)".

¹⁸² Hina. "Ruski Mediji Otkrili Nove Detalje Sastanka U Sočiju 's Putinom i Grabar-Kitarović o Agrokoru su razgovarali i Cvitan i direktor Sberbanka". *Jutarnji.hr*. 19 October 2017.

Mr. Putin's first and so far only visit to Croatia was back in 2007 but he accepted Ms. Grabar-Kitarović's invitation to visit Zagreb during her current mandate, which expires in February 2020. Diplomatic sources claim that Mr. Putin would only come to Zagreb to talk about concrete Russian investments in the Croatian energy sector.¹⁸³ At the same time, Croatia is still part of the EU sanctions towards Russia in the wake of the annexation of Crimea.

Despite the warming ties, the only openly pro-Russian political party in Croatia is Živi zid, a protest party which wants to nationalize banks and take Croatia out of NATO and the EU. Even though their policies led them to be portrayed as facetious in the mainstream press, Živi zid has seen a surge of popularity since 2016. A former party member claimed Živi zid was secretly financed by an arms dealer who had been importing Russian weapons into Croatia during the 1990s.¹⁸⁴ But an increased turnout and the appeal of new populist candidates led Živi zid to get just 5.6% of the vote at the European Parliament elections in 2019. This worse than expected result has contributed to in-fighting between party leaders which resulted in a split, with some of the most prominent members leaving to form a new party.

Where Russian political meddling has made the domestic situation most combustible has been **Montenegro**. Russia was one of the key international supporters for the Montenegrin independence in 2006. Paul Manafort, who has been sentenced in the US for facilitating Russian election meddling, confessed that Oleg Deripaska had hired him to help with the organization of the Montenegrin independence referendum campaign.¹⁸⁵ Also, recently leaked audio recordings indicate that Montenegrin officials have been using Oleg Deripaska's contacts to lobby Russia in supporting the country's independence.¹⁸⁶ On the back of the growing Russian investments in the country, political ties culminated with the Montenegrin Democratic Party of Socialists' signing of a cooperation agreement with United Russia in 2011.

The political ties between the two countries continued strengthening until the Montenegrin government decided to shift to a Euro-Atlantic geopolitical course amid the investment dispute with Mr. Deripaska over the future of KAP. In 2014, Montenegro aligned with the EU sanctions against Russia after the annexation of Crimea. In early 2015, the country committed to join NATO. The government also rejected a Russian request to use the Montenegrin port of Bar for military purposes despite the fact that Russia had allegedly proposed payments worth at least half of the country's annual GDP.^{187,188} This prompted

¹⁸³ Kvarantan, T. "Putin će u Hrvatsku samo na dobar poslovni mamac". *Express*. 10 June 2019.

¹⁸⁴ Godeč, Ž. "Otkrivamo: Što Je Odmetnuti Član Živog Zida Rekao Uskok-u Kuverte s desecima tisuća eura u stranku su stizale više puta". *Jutarnji.hr*. 21 September 2016.

¹⁸⁵ Shuster, S. "Exclusive: Russian Ex-Spy Pressured Manafort Over Debts to an Oligarch". *Time*. 29 December 2018.

¹⁸⁶ "Razgovor Ročena i Deripaske: Tražio od Putinovog tajkuna da apeluje kod Amerikanaca za referendum". *Vijesti.me*. 21 June 2019.

¹⁸⁷ Rudović, N. "Rusija uzalud tražila vojnu bazu u Baru". *Vijesti.me*. 19 December 2013.

¹⁸⁸ "Borović, G. "POBJEDA: Rusi 2013. tražili luke Bar i Kotor za vojne brodove". *Portal Analitika*. 29 January 2015.

TABLE 3. MODES OF RUSSIAN COOPERATION WITH POLITICAL PARTIES IN SEE

	Serbia		Bulgaria		Croatia		BiH		Montenegro		North Macedonia	
	Main-stream	Fringe	Main-stream	Fringe	Main-stream	Fringe	Main-stream	Fringe	Main-stream	Fringe	Main-stream	Fringe
Cooperation Agreement with Russian pro-government parties	Progressive Democratic Party, Serbian National Movement	Srpska Lista, Third Serbia, Dveri	Socialist Party, Alternative for Bulgaria	Ataka	N/A	N/A	SNSD (Ruling in RS)	N/A	Democratic Front	Socialist People's Party	N/A	Democratic Party of Serbs
Public support from the Kremlin	Socialist Party	N/A	Socialist Party, Rusofili	Socialist Party, Alternative for Bulgaria, Rusofili	N/A	N/A	SNSD (Ruling in RS)	N/A	Democratic Front	N/A	VMRO-DPMNE	United Macedonia
No formal ties but cooperation on specific issues	Socialist Party, Progressive Party	N/A	Bulgarian Socialist Party, GERB, Patriotic Front, Movement for Rights and Freedoms	Ataka, ABV, Rusofili, Volya	Croatian Democratic Union	(Croatian Human Shield) Živi zid	HDZ BiH	N/A	DPS Democratic Party of Socialists	N/A	VMRO-DPMNE	United Macedonia

Source: Center for the Study of Democracy.

Russia to seek new Montenegrin partners among the country's opposition parties.

In September 2015, the Democratic Front – part of the opposition – started street protests demanding the creation of a transitional government establishing conditions for free and fair elections. However, due to the timing and messaging approach, the ruling party alleged that the real goal of the protests was to prevent Montenegro from receiving an invitation to join NATO, and that protesters enjoyed Russian support. During the first couple of months, the Democratic Front was trying to disprove these accusations. Yet, by the end of 2015 they had completely changed their strategy – and started to promote their cooperation with Russian authorities, organizing meetings, signing memorandums on cooperation,¹⁸⁹ declarations,¹⁹⁰ etc.

¹⁸⁹ "Deklaracija DNP-a i Jedinstvene Rusije". *IN4S*. 6 May 2016.

¹⁹⁰ Popović, A. "SISOJEV: Nejasna saradnja Jedinstvene Rusije i DF-a". *Portal Analitika*. 30 June 2016.

During the 2016 election campaign, their political opponents and the media accused the Democratic Front of being financially supported by Russia, as they failed to justify the sources of their expensive campaign.¹⁹¹ Allegedly, the party used funds of criminal origin, provided largely by Russia through offshore accounts, then split into small installments and sent to individuals, who then officially donated the money to the party.¹⁹² The Special State Prosecutor's Office inquiry about the financing of the Democratic Front has resulted in charging the party leader and MP, Nebojša Medojević, and a number of party activists of facilitating illicit funding flows into party accounts. The trial, which started in December 2018, however, did not link the suspicious money to Russian sources. Around the same time, the US Treasury announced that Mr. Deripaska and former Russian intelligence officer Victor Boyarkin were involved in providing Russian financial support to a Montenegrin political party ahead of Montenegro's 2016 elections.¹⁹³

Montenegro has also accused the Russian Federation of meddling in the 2016 parliamentary elections by attempting to violently overthrow the government through the Democratic Front. On election day (16 October 2016), the Montenegrin security services arrested 20 Serbian nationals who were suspected of organizing a plot to prevent the election of a pro-NATO government, and possibly assassinate then Prime Minister Milo Đukanović. The former Serbian Prime Minister and now-President Aleksandar Vučić himself later acknowledged the plot, presented further evidence about it, and offered his cooperation to the Montenegrin Special Prosecution.¹⁹⁴ Mr. Đukanović publicly accused Russia of instigating Montenegro's anti-NATO protests, some led by the right-wing Democratic Front coalition, and plotting the coup through its Serbian connections in an attempt to destabilize the country.¹⁹⁵ Both the Russian government and the Democratic Front have denied these claims. The opposition coalition claimed the coup d'état attempt was staged by the ruling party, and that all the charges against it were politically motivated.

In the investigation of the coup d'état attempt, the Special Prosecutor indicted 14 persons, including two Russian nationals, Eduard Shishmakov and Vladimir Popov, a retired police general from Serbia, and a former commander of the Serbian Gendarmerie, Bratislav Dikić, as well as two leading politicians and MPs from the Democratic Front, Andrija Mandić and Milan Knežević. It was reported that the Russian plotters, who were tried in absentia, were members of the Russian military intelligence.

¹⁹¹ Vasovic, A. "Montenegro PM accuses Russia of financing anti-NATO campaign". *Reuters*. 13 October 2016.

"Montenegro 2016 parliamentary election: Voting in favour or against NATO and EU membership". *IFIMES*. 4 October 2016.

¹⁹² "Money laundering probe into Montenegro's pro-Russian Democratic Front extended". *Intellinews*. 31 August 2017.

¹⁹³ Riley-Smith, B. "Russian oligarch Oleg Deripaska accused of interfering in Montenegro's elections". *The Telegraph*. 19 December 2018.

¹⁹⁴ Higgins, A. "Finger Pointed at Russians in Alleged Coup Plot in Montenegro". *The New York Times*. 26 November 2016.

¹⁹⁵ Recknagel, C. "Pro-Russian Parties Seek To Derail Montenegro's NATO Bid". *Radio Free Europe/Radio Liberty*. 28 November 2015.

Borger, J. "Montenegro's PM quits after suggesting Russia had role in election plot". *The Guardian*. 25 October 2016.

Eduard Shishmakov, also known as Eduard Shirokov, was former deputy military attaché in the Russian Embassy to Poland, subsequently declared persona non grata and expelled from Poland on espionage charges.¹⁹⁶ Vladimir Popov was later identified as a senior GRU officer Vladimir Moiseev.¹⁹⁷ After 19 months of trial all accused were found guilty at the first instance court in May 2019.

The trial was broadcast live and attracted enormous media attention. However, the battle in the political arena was more important than the one in the courtroom – the information space was polluted with propaganda and disinformation coming from different sides, thus **leaving Montenegrin public divided on what really happened in October 2016**.

The Special Prosecutor's Office has kept investigating the coup attempt, including seeking the extradition of the retired US intelligence officer, Joseph Assad, for his alleged role to extract the conspirators after the coup plot.¹⁹⁸ In July 2019, the Special State Prosecutor extended the investigation to Israeli political consultant and chief adviser to the Democratic Front Aron Shaviv, who is being suspected of involvement in the plot along with former CIA agent Joseph Assad and eight other foreign citizens.¹⁹⁹ The Prosecution claims there is a money trail linking a Russian owned company based in Prague to Shaviv's company registered in Cyprus. Allegedly, money was used to pay for Democratic Front's campaign costs and other services including those performed by Joseph Assad.²⁰⁰

SHARP POWER: INSTRUMENTALIZING RELIGION, CIVIL SOCIETY AND MEDIA

The Kremlin has sought to increase its presence in the social and cultural life of SEE countries over the last decade by augmenting through the media the close cultural, linguistic and religious ties between Russia and the Slavic nations in the region. Alternatively, it has sought to dissuade, disorient and manipulate communities, voters, and the population of non-Russophile nations. The tools Russia has used to expand its sharp power influence are not new to the region. Leveraging historical, religious, and ethnic symbols and narratives, **Russian international media presence and local media ownership**, organizing massive media campaigns, have combined economic and political levers to form a potent Russian government toolbox for influence in SEE. These instruments have often sought to augment existing divisions in society and create social tensions

¹⁹⁶ Bunkall, A. "Russia 'linked' to election-day coup plot in Montenegro". SkyNews. 21 February 2017.

¹⁹⁷ Bellinacat Investigation Team. "Second GRU Officer Indicted in Montenegro Coup Unmasked". *Bellingcat*. 22 November 2018.

¹⁹⁸ Barnes, J. E. "Ex-C.I.A. Officer's Brief Detention Deepens Mystery in Montenegro". *New York Times*. 23 November 2018.

¹⁹⁹ "SDT: Šaviv osumnjičen za stvaranje kriminalne organizacije". *Vijesti.me*. 31 July 2019.

²⁰⁰ Čadenović, I. "Šaviv i Asad sa Sejšela, ruskim parama, finansirali "državni udar"?". *Vijesti.me*. 8 August 2019.

that contribute to political instability. By trying to control the intensity of internal conflicts in SEE, Russia-supported groups could leverage their position to change government decision-making on strategic issues. Even without direct intervention in specific decisions, the very atmosphere of uncertainty and instability prevents policy coherence and sows doubt in the credibility of democratic institutions.

The church

One of the channels for Russian influence in SEE is the Orthodox Church. It plays the role of a spiritual intermediary for the Russian ideological agenda by organizing various initiatives and preaching the Kremlin's narrative under a religious veil. This is **especially visible in Serbia** where there is well developed cooperation between the Russian²⁰¹ and local churches. There is widespread exchange of activities including joint pilgrimages to the most important shrines, translations of religious books, etc. Russia has financed the reconstruction of several Serbian churches in Kosovo similar to the Russian financing of church rebuilding efforts in other Orthodox countries including Greece and Bulgaria. Gazprom has donated significant funds for the completion of the interior of the St. Sava Cathedral in Belgrade, one of the biggest Orthodox buildings in the world. The Russian company's donation has been widely covered by mainstream and pro-Russian media in Serbia amplifying the effect on the popular perception of Serbs about **Russia as the protector of Orthodox values**. During Vladimir Putin's 2019 visit to Belgrade, one of the most important parts of his schedule was his speech at the St. Sava Church together with President Aleksandar Vučić.

The **Serbian Orthodox Church** (SOC) has gone out of its way to emphasize the importance of Russia for the future of Serbia, sometimes even claiming that Russia is the most important partner for Serbia. The Serbian church has also supported its Russian counterpart during the latter's conflict with the Orthodox Church of Ukraine, which was recognized by the Ecumenical Patriarchate of Constantinople but not by the Russian church. SOC has also used Russian support to exert influence over the two non-canonical churches (and indirectly over the respective congregations) – the Macedonian Orthodox Church and the Montenegrin Orthodox Church. The Montenegrin Orthodox Church which claims succession to the autocephalous Montenegrin Church was established in 1993 and is not canonically recognized by the other Eastern Orthodox Churches. In June 2019, the Montenegrin President Đukanović expressed hope that Constantinople would grant autocephaly to the Montenegrin church and announced that he will work on autocephaly renewal.²⁰²

SOC has been one of the most important facilitators of Russian narratives in Montenegro. It is the most influential religious community, with significant political sway too. SOC ranks amongst the institutions with the

²⁰¹ All references here are to the Moscow Patriarchate, as there are Russian orthodox churches outside Russia.

²⁰² Mandić, S. "Đukanović: SPC pokušava da čuva infrastrukturu "Velike Srbije". *Vijesti.me*. 8 June 2019.

highest public trust. Recent polls show that 47.8% of Montenegrins have confidence in the SOC, and only the education system is more trusted.²⁰³ SOC in Montenegro is subordinate to the Belgrade Patriarchate. Financial support for the church's charitable works can often be traced back to Russian ultra-nationalist oligarchs with close political and financial ties to the Kremlin, such as Konstantin Malofeev.²⁰⁴ SOC has openly defied the Montenegrin government on a number of occasions,²⁰⁵ by building on historical, cultural, and archeological sites, and by restructuring old churches without permits and against the law, as well as engaging in tax evasion.²⁰⁶ Also, the church leadership has been frequently accused of discrimination and hate speech towards other ethnicities, sexual minorities, women's and human rights in general.²⁰⁷ **SOC has also been a vocal opponent of Montenegro's NATO integration.**²⁰⁸ SOC's leader in Montenegro, Archbishop Amfilohije Radović sharply criticized the Montenegrin government for imposing sanctions on Russia in 2014.²⁰⁹

Similar to Montenegro, the **Macedonian Orthodox Church** has become an enabler of sharp power projection and propaganda by Russia. The SOC has been working hard to prevent the Macedonian Church from breaking away from its dominion following the split between the Russian Orthodox Church and the Ecumenical Patriarchate of Constantinople over its recognition of the autocephaly of the Ukrainian church.²¹⁰ In addition, Russian investors have donated significant funding for the restoration of churches and other religious buildings. For example, Sergei Samsonenko announced in 2014 that he would build a church in the Municipality of Aerodrom within the City of Skopje as a present to the Macedonian people. Yet as the local elections in 2017 produced a new mayor from the opposition SDSM party, he decided to stop the construction of the church.²¹¹

In **Bosnia and Herzegovina**, more specifically in the RS entity, Russian sharp power presence relies also heavily on the close links between the Russian and Serbian orthodox churches operating in Serbia and BiH.

²⁰³ Center for Democracy and Human Rights. *Political Public Opinion Montenegro*. July 2019.

²⁰⁴ Conley, H. and Melino, M. 2019. *Russian Malign Influence in Montenegro: The Weaponization and Exploitation of History, Religion, and Economics*. Center for Strategic and International Studies. Policy Brief, May 2019.

²⁰⁵ Kosić, S., and Pavićević, T. "Mitropolija u Herceg Novom divlje gradi i vodi restoran". *Vijesti.me*. 5 January 2011.

²⁰⁶ Kern, I. (Series of Articles during the 2017 – 2018 period), "Feljton: Hronika jedne devastacije", Portal Analitika; Pavićević, T. "SPC zarađuje, a porez ne plaća". *Vijesti.me*; Janković, S. "Koliko SPC zarađuje od Ostroga". *Radio Slobodna Evropa*. 4 June 2013.

²⁰⁷ Janković, S. "Amfilohije proglašen krivim zbog govora mržnje". *Radio Slobodna Evropa*. 19 November 2012; Koalicija protiv diskriminacije. "Govor mržnje Amfilohija Radovića". *Peščanik.net*. 15 October 2010.

²⁰⁸ "Amfilohije: NATO je stid i sram crnogorske vlasti". *Vijesti.me*. 25 March 2018; "Plamenac pozvan da se u roku od 15 dana javno izvini LGBT zajednici" (May 13, 2016) *Vijesti.me*; "Ateisti Srbije: Amfilohije svojim govorom mržnje prema ženama prekršio zakon". *Novi Magazin*. 24 October 2017.

²⁰⁹ "Whoever is not faithful to a one-lingual, one-blooded Russia, let God make the living flesh fall off them, and let them be damned three times and 3000 times from me", he cursed. "Amfilohije: Ko izda Rusiju sledi Strašni sud". *Radio Slobodna Evropa*. 29 April 2014.

²¹⁰ Synovitz, R. "Will Macedonia's Orthodox Church Also Break Away?". *Radio Free Europe/Radio Liberty*. 18 October 2018.

²¹¹ Balkan Energy Group. *Official commissioning of the new lightning of the Millennium cross*. 27 January 2015.

The pinnacle of the Russian cultural and religious involvement in RS is expected to be the construction of the Russian cultural and religious center in Banja Luka, which is being financed by the Russian government and church. The construction of the center started in September 2018, just a few days ahead of BiH's 2018 general elections. The official laying of the cornerstone of the complex was attended by senior RS officials and representatives of the Russian church.

Media misinformation

The set of tools available to Russia in the socio-cultural arena is rather diverse, including influence in the media, historical narratives, education, and academia among others, resulting in the development of narratives that change common public perceptions. While the Russian economic and political leverage has its limits, Russia's sharp power in the social, cultural and media arena has become pervasive in the past decade despite the lack of direct and significant financial investment by the Kremlin in this area. **Russia has exploited problems in content provision** (lack of own sources of information and easily available content on the local language, especially on international news) **and the low level of media freedom in SEE to disseminate Russia-originating propaganda narratives**. These are reflected in the patterns of ownership, economic dependency and (in)formal political links of media outlets to pro-Russian groups and interests.²¹²

Outsized Russian sharp power influence in SEE has been facilitated by the lack of transparency of **media ownership**, weakly enforced legal provisions, media dependence on large commercial advertisers in small advertisement markets, and the **oligarchization of the media markets** in the region (whereby oligarchic networks exhibit close ties to Russian businesses). Moreover, the coupling of media ownership with strong political relations to senior government officials and political leaders in SEE has had two important spillover effects. First, such a nexus has supported the **concentration of both public and private funds in chosen media companies, often linked to Russian foreign policy** or pro-Russian private interests.²¹³ Second, the coupling of media ownership with politics has offered to the national governments a major tool for effective **control over editorial policy** in favor of local and foreign (in this case Russian) political or economic interests, even though the official position of the government might appear balanced and neutral regarding the same issues.²¹⁴ Within the wider cultural-educational environment, Russian influence in the SEE media has been pushed in such a way as to tilt public discourse in favor of the reinforcement of pro-Russian historical narratives and the dissemination of Kremlin-sponsored messages, such as for example propagating "traditional" family and social values. Efforts to distort historical truths in the region have included pushing

²¹² Filipova, R. et al. 2018. *Russian Influence in the Media Sectors of the Black Sea Countries: Tools, Narratives and Policy Options for Building Resilience*. Sofia: Center for the Study of Democracy.

²¹³ Ibid.

²¹⁴ Ibid.

FIGURE 18. ELEMENTS OF THE RUSSIA-BASED MEDIA CAPTURE IN SEE



Source: Center for the Study of Democracy.

one-sided interpretation of historically disputable events by obstructing the opportunity for public debate and consideration.

Pro-Russian media have successfully used the weak enforcement of transparency measures in SEE countries in order to **hide their ownership and funding**. This is most clearly visible in the case of the **online media**, which remain the opaqueness by far. It is subject only to general regulations regarding legal entities in the respective country but because of the specifics of the internet it features the highest degree of anonymity and opportunities for hiding ownership and decision-making structures. The use of foreign web-servers and services which

allow for full anonymity of both the owner and the content creators and editors (if different), make online media the most non-transparent part of the sector. At the same time, the possibilities for publishing, aggregating, processing and re-publishing of information, including through the use of automated artificial intelligence-based systems, have boomed in the last decade and offer practically unlimited opportunities for content creation and dissemination, even without considerable initial investment.

Russia has been expanding its direct and indirect support to both Russia-owned and domestic pro-Russian media in SEE since the mid-2010s. The media has played an important role in Kremlin's hybrid warfare, as it has very high impact and importance on the political process and on the institutional checks and balances in EU democracies. The Kremlin-affiliated media outlets are used to both control coverage of events domestically and disseminate information abroad, especially in regions where the Russian narratives feed a broader political agenda. This strategy, labeled "**diffusion proofing**,"²¹⁵ does not necessarily aim to prevent certain events or pieces of information from reaching domestic or foreign audiences. Instead, it is a carefully crafted strategy of counter-balancing Western coverage with a pro-Russian twist. To achieve its strategy of diffusion proofing not only internally in Russia but also at global, European, and country level, Russia supports a media apparatus that includes international and in-country formally and informally Kremlin-controlled media outlets and information channels that interact and reinforce one another.²¹⁶ Russia operates in the SEE region through its propaganda-

²¹⁵ The term was coined by Karrie Koesel and Valerie Bunce. See: Karrie J. Koesel, K. J. and Bunce, V. J. 2015. "Diffusion-Proofing: Russian and Chinese Responses to Waves of Popular Mobilizations against Authoritarian Rulers". *Perspectives on Politics*, Vol. 11, Issue 03: 753-768.

²¹⁶ Filipova, R. et al. 2018. *Russian Influence in the Media Sectors of the Black Sea Countries: Tools, Narratives and Policy Options for Building Resilience*. Sofia: Center for the Study of Democracy.

spreading state-owned channels Rossiya Segodnya, the international TV channel RT (formerly Russia Today), and the Sputnik International online platform as the international replacement of RIA Novosti news service and the international radio service Voice of Russia.

As cash-strapped media in the region have been looking for access to content, these **Russian state-owned channels have provided such content free of charge**. This has allowed them to easily spread disinformation narratives through seemingly mainstream channels in SEE. This is especially visible in **Serbia, which has become a hub for Russian propaganda** for the whole Western Balkans region. Widely-read tabloids in the country such as *Informer*, *Alo*, *Kurir*, *Srpski telegraf* and others have become echo machines beaming the same Russia-supported narratives as Russia's state-supported media. They usually spread EU-sceptic and anti-NATO content, sow distrust in Western values, promote and support political agendas of both extreme anti-EU left and far-right political parties, and praise Russian involvement in Serbia and in the neighborhood. In Serbia, Sputnik has engaged as associated contributors widely recognizable Euro-sceptic journalists such as Miroslav Lazanski (expert on military issues, former SNS MP and the new ambassador of Serbia to Russia), Boris Malagurski and Nikola Vrzic, to name a few. Sputnik provides free content for the local media, and many of them re-broadcast Sputnik's news in their entirety, instead of producing their own content.²¹⁷

Outside the state-owned Russian channels, there are a number of other websites that appear to be directly controlled by Russia such as *Ruski Ekspres*, *Vostok*, *Ruska Rec*. They are not particularly influential or visible, but the impact of their published material, often taken directly from Sputnik or other pro-Russian outlets is amplified through the use of social networks.

Russian state-sponsored media outlets have become active all across the Balkans region with the goal of encouraging popular perceptions critical of the West, its involvement with the region and its values. For example, the Croatian edition of the Russia Beyond the Headlines portal operates a national news website and used to be published as an insert to *Večernji list*, Croatia's largest daily newspaper, known for its conservative leanings. Sputnik actively spreads propaganda in Bosnia and Herzegovina, where many of the mainstream RS media outlets under the tight control of Mr. Dodik frequently use its freely-disseminated content. This is especially evident in the media coverage of regional and international affairs²¹⁸ by RS's two media organizations with greatest public penetration – RS's main news agency SRNA and its public radio and television broadcaster, RTRS. In recent years these two media organizations have based much of their regional and international affairs' coverage on news reports from Russian agencies, such as Sputnik or Tass. This way, RS public's views on regional

²¹⁷ Center for the Study of Democracy. (January 2018), *Assessing Russia's Economic Footprint in Serbia* Policy Brief No. 72: 16.

²¹⁸ "Počinju zajednički manevri Rusije i Srbije". *PTPC*. 11 September 2019; "Лавров: НАТО не би добио ништа уласком Србије у алијансу". *PTPC*. 26 September 2019; "Rjabkov: Odgovor Alijanse – razočaravajući". *PTPC*. 1 October 2019; "Уставна комисија резултат сарадње Москве, Техерана и Дамаска". *PTPC*. 24 September 2019.

and international developments are – unknowingly to most RS citizens – being directly shaped by the Russian media machinery. The impact of this media campaign is even greater having in mind that many smaller media organizations, web portals, newspapers, local radio and TV stations pick up and republish such news on a daily basis. This kind of message amplification is not only contributing to Russia's popularity but also to increased criticism of and animosities towards key Western actors.²¹⁹

Sputnik News is also home to a popular show made by one of the most effective Russian propagandists in the region, the Serbian documentary filmmaker Boris Malagurski. He is known for a series of films promoting the theory that the collapse of Yugoslavia was the result of a conspiracy between the US and global corporations. In Croatia, Mr. Malagurski directed a campaign spot for the pro-Russian populist party *Živi zid*. He is followed by almost 315,000 people on Facebook and 28,000 on Twitter.

Similarly, Montenegro is sometimes described as a media colony – outlets from neighboring Serbia, BiH and Croatia have extensive operations in the country.²²⁰ The small Montenegrin media market has been of less interest for Russian investment. Yet, due to the common language and cultural similarities with Serbia, the **Montenegrin audience has been targeted by the Serbian language branches of the major Russian media outlets that have emerged in Belgrade** the last several years. Pro-Russian media in Montenegro regularly reuse content produced in Serbian by Russian media – especially by Sputnik and Russia Beyond,²²¹ but also from other Serbian and Republika Srpska outlets. Sputnik has a correspondent for Montenegro and regularly publishes articles that are reproduced by the pro-Russian outlets in the country. The mainstream media in Montenegro does not proliferate Russian narratives and anti-Russia media coverage does not resonate with the pro-Russian sentiments in the general public.²²² However, there is no coordinated effort in countering disinformation campaigns, either. Overall, the commonality of languages in the former Yugoslav republics has facilitated the reach of pro-Russian narratives across SEE.

In **Bulgaria**, the other major target of Russian media influence in the region, several smaller TV networks (Alfa and Channel 3), and at least three newspapers (Duma, Zemlja and Ataka) have direct ties to Russia, either via ownership or in terms of influence over their content. Russia is also behind some local and online-based news outlets, where its influence can be traced primarily in terms of editorial content. For example, the South Stream/Turkish Stream pipelines have received extensive coverage in Russia-affiliated media which universally supported their construction.

²¹⁹ “Лавров: НАТО не би добио ништа уласком Србије у алијансу”. *РТРС*. 26 September 2019.

²²⁰ “Montenegro profile – Media”. *BBC News*. 12 September 2015.

²²¹ Tomović, D. “Pro-Russian Montenegrins Publish New Anti-Western Media”. *BalkanInsight*. 18 October 2017.

²²² National Democratic Institute. *Western Balkans. between East and West, Public Opinion Research in Bosnia and Herzegovina, Macedonia, Montenegro, Serbia*. November 2018.

Indirectly, similar to the case of Serbia, most of the widely read Bulgarian dailies have been streaming pro-Russian propaganda with distinct focus on the righteousness of the Russian foreign policy in Europe, the Middle East and Latin America and the importance of Russia-led energy projects for Europe, Bulgaria and the SEE region.²²³ What is common among all of these outlets is that they are all linked to networks with close business ties to Russia, such as the one of Bulgarian media mogul and MP Delyan Peevski. The Russia-influenced media has also become a platform for a nexus of pro-Russian politicians, journalists and intellectuals, who coalesce in propagating the Kremlin-sanctioned discourse of conservatism and traditional values, whenever relevant issue areas arise in the public debate, particularly related to gender, LGBTQ and the traditional family.²²⁴

In **North Macedonia**, the whole set of Russian media disinformation narratives has been employed to influence the outcome of the political crisis in the country in the period 2014 – 2017. The Russian account of the mass street protests against the government of Prime Minister Nikola Gruevski as part of a Western plot for toppling legitimate governments in the region was taken aboard by the Gruevski government and supported by the Russian foreign ministry.²²⁵ Russian media has also reawakened ethnic rifts in the country (similarly to its narratives in Serbia, Bosnia and Herzegovina, and Kosovo) first claiming that the political instability is the result of a push by the Albanian minority in the country to revive the project for a Greater Albania. Later, during the resolution of the name dispute between the government of Prime Minister Zoran Zaev and Greece, Russian media in combination with the protest activities of VMRO-backed nationalist civil society activists stoked anti-Greek sentiments aiming to derail the resolution of the conflict, and hence, sabotage the Euro-Atlantic path of the new government.

²²³ E.g. *Anti-Democratic Propaganda in Bulgaria*. Human and Social Studies Foundation. Sofia, 2017.

²²⁴ For instance, Russia-friendly political figures and activists on both the left and right of politics vociferously denounced the Council of Europe's Istanbul Convention (aimed at combating domestic violence against women) on the grounds that the use of the term "gender" in the document supersedes biological distinctions between men and women with purely social characteristics, thus opening supposedly infinite possibilities for self-definition. This was argued to lead to the introduction of a "third gender" and same-sex marriage, which ostensibly militate against Bulgarians' traditional understanding of family relations.

²²⁵ Vladimirov, M. et. al. 2018. *Russian Economic Footprint in the Western Balkans. Corruption and State Capture Risks*. Sofia: Center for the Study of Democracy.

CAPTURE-PROOFING SOUTHEAST EUROPE

While Russian economic power in SEE has visibly declined since the imposition of EU and NATO sanctions in 2014, its **overall ability to influence domestic politics in the region has remained potent and has even gained effectiveness**. Russia has preserved its sway over the decisions of governments in the region regarding large-scale energy projects and the control over oil and gas markets. Meanwhile, Russian intelligence officers and local intermediaries have intimidated governments in halting the construction of alternative energy transport routes that would create more competition to traditional Russian energy suppliers.²²⁶ Although falling in size, especially relative to the whole economy, the Russian economic footprint has included some of the biggest companies in the region such as refineries, wholesale fuel and natural gas distribution networks, telecommunications companies and retail chains. Their strategic importance for the national economies in SEE has elevated Russia's role in the national decision-making process.

To exploit persistent governance deficits in SEE, Russia's strategy has been to recruit powerful local brokers by providing them with government-sponsored business opportunities at premium returns. Another common way is to use former security officials with significant influence over parties, businesses and institutions to act as intermediaries boosting Moscow's interests where necessary. The reverse has also been happening in the region when local **powerful economic groups develop or use their existing Russian links to secure capital and political backing to get themselves included in large governmental projects** or the acquisition of strategic assets. Sometimes domestic interests have vied for and received economic and political support from Russian companies to engage in rent seeking with the national governments, exploiting the lack of oversight and rule of law. In exchange for providing their brand name or capital (fronting), Russian companies have taken nominal share in lucrative domestic businesses, gained access to strategic assets in telecommunications, finance, and most often in energy.

The experience on the ground in the past decade has demonstrated that there are **different mechanisms that Russia uses in order to amplify its economic influence** in the SEE region including:

- exploiting structural economic vulnerabilities in individual countries;
- creating and exploiting governance deficits, e.g. in state-owned enterprises, regulatory bodies, the judiciary, the tax authorities, etc.;
- engaging influential power brokers through corruption or intimidation;

²²⁶ Security Information Service of the Czech Republic. *Annual Report of the Security Information Service for 2014*.

- leveraging corporate profits and presence through layering and dynamic shifting of gains towards helpful local actors;
- conscripting the remnants of Soviet era security service networks;
- sharp power instruments such as media propaganda, leveraging cultural and religious ties and sponsoring of civil society activities;
- engaging with the local political parties, both mainstream, which may rely on strong Russophile feeling, or fringe formations with serious disruptive potential.

On the surface, the group of sharp power tools can appear harmless as they entertain specific exchange of ideas about the role of Russia in Europe and in SEE, but in practice they have successfully changed socio-cultural narratives in many countries of the region. With seemingly little resources and only a handful of actors, **Russia has been able to transform popular perceptions about Western values, national policy objectives, cultural realities, and historical truths.** In a social environment devoid of profound analysis and in a time of globalized spread of (mis)information, the scope for wide-scale manipulation has been successfully exploited by pro-Russian forces with spill-over effects on the domestic political space.

Understanding the processes and actors enabling Russian economic influence in Europe as well as how it relates to the other aspects of influence, such as soft power, intelligence, cyber presence, military capabilities, etc., is the first step of **devising proper response mechanisms to address potential related vulnerabilities.**

Kremlin's strategy of penetration and disruption is made possible by severe deficits in public governance in SEE countries. Addressing these deficits requires a number of actions to be implemented by both national champions of reform and international partners:

- **SEE governments**, in coalition with civil society and international partners, need to design and enforce **strategies to counter state capture.** A key element in these should be the implementation of regular **state capture assessment diagnostics** that would measure the level of capture (risks) in strategic economic sectors and identify key governance deficits which allow excessive market concentration. These diagnostics should be carried on a regional basis so as to identify trends in the whole region.
- SEE countries should **diversify foreign capital inflows** away from the overreliance on capital from authoritarian countries targeting structurally important sectors through non-competitive means. Foreign direct investment exposure should be assessed adequately by central banks and financial regulators, which need to regularly assess the true size and potential impact of capital inflows from Russia.
- In a related measure, anti-trust authorities, tax inspectorates, financial market regulators and national security agencies should work to **establish final beneficial ownership of FDI** so as to avoid market concentration, prevent money laundering, and the acquisition of critical assets by companies linked to authoritarian states.

- SEE governments should improve their countries' **energy security** through the following policy measures:
 - full natural gas market liberalization in line with the EU energy and competition laws;
 - completion of the regional market integration through the construction of pipeline interconnectors, gas storage facilities and underground storages, as well as the diversification of supply routes and sources;
 - renegotiation of long-term natural gas contracts with Gazprom in order to abolish destination and take-or-pay clauses, as well as to remove the oil indexation from the pricing methodology.

SEE countries should reconsider their involvement in large-scale energy projects pursued by the Kremlin, such as the **Turkish Stream** gas pipeline, in light of the risks they pose to energy security and their role in reinforcing Russia-backed state capture networks.

- Fiscal and anti-trust authorities should increase their efforts to prevent Russian companies from engaging in **tax avoidance and abuse of monopoly power** by:
 - implementing the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations in bilateral government-to-company tax negotiations, so as to limit the amount of profits shifted to offshore-registered subsidiaries;
 - dismantling the oligopolies in fuel retail and wholesale in the region which allow Russian oil majors to extract excessive rents.
- **Privatization and post-privatization procedures** need to be further streamlined and overseen to ensure that Russian attempts to take over large-scale strategic companies, which could be used for political leverage be curtailed. Similar efforts need to be taken in the areas of concessions and public procurement. EU regulations on state aid and public procurement should be upheld in all cases, including also inter-governmental agreements between SEE and third (non-EU) countries.
- **Political party financing** regulations should be more strictly enforced in order to prevent subversive foreign funding. National security bodies should regularly publish assessments of foreign interference threats.
- **National media regulators' independence** should be strengthened and continuously upheld, allowing them shed light on media ownership, prevent market concentration and uncover under-the-radar online media outlets that serve to spread disinformation and propaganda.
- The **European Union** should reinforce its economic and political engagement with the Balkans through the enlargement process (for non-EU countries) and through its cohesion policy (for EU members). In particular, it should seek a more **active engagement in the areas of rule of law and anticorruption**. In addition, it could follow the US example of appointing a **special envoy** for the region with direct access to Brussels, Berlin and Paris. The EU should be assertive in its political engagement on rule of law issues.

- The EU should include the Western Balkans in its Multiannual Financial Framework planning, providing a stronger basis for the integration of the region and encouraging private EU investments. In particular, the **EU should aim to engage directly with civil society** in SEE, including through Brussels-managed programs on rule of law, justice, etc.
- The European Commission and the European Central Bank should enhance efforts to enforce **anti-money laundering** legislation and close loopholes in the corporate ownership and foreign direct investment regulatory frameworks. There is a strong need for a dedicated EU AML institution that would oversee the cooperation of national institutions and would have the capacity to conduct independent cross-border investigations within Europe. The US Treasury Department should increase its efforts to counter money-laundering transactions in the region.
- The **United States** should use more aggressively the **Foreign Corrupt Practices Act** as well as expand the scope of the **Global Magnitsky Act** to investigate high-level corruption in Europe and in SEE, in particular such that furthers Russian strategic interests.
- To build up regional demand for natural gas in SEE, the United States should work together with the European Commission and the European Energy Community on the development of **a regional platform** and the necessary, associated energy infrastructure **for the joint purchasing of LNG** from the global natural gas market.
- The US Agency for International Development should reinstitute instruments and platforms for supporting **good governance initiatives on a regional level**, which would be the most effective delivery mechanism for enabling policy change. A regional approach will improve the likelihood for peer pressure among national governments.
- The US Department of State should enhance multilateral exchange programs such as the **technology and media corps** that can mobilize civil society and volunteer engagement to support the region's reform agenda.

APPENDIX: METHODOLOGICAL NOTES

The study focuses on assessing Russia's economic presence in SEE after 2005. It covers eight see countries, including Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Kosovo, Montenegro, North Macedonia and Serbia. The Russian economic influence in each of the eight countries is calculated through estimating key indicators of economic vulnerability of SEE countries, including:

- bilateral trade deficit with Russia;
- Russian direct investment;
- corporate footprint (revenues, assets and employment of Russia-controlled companies as a share of total for the economy);
- accounting for politically-driven investments including state-to-state loans.

These individual factors have been measured against the GDP/total turnover of the respective economy and have been used as a proxy of Russia's economic footprint in the respective country. The corporate footprint analysis, is based only on companies with at least 25% Russian ultimate beneficial ownership.

The report relies on: (1) publicly-available data from national statistics, commercial registries and the stock market, including the Orbis database of the Bureau van Dijk; (2) information and analysis provided by a network of local partners in SEE with economic and media background; (3) in-depth media content research in the key economic sectors of the each country. Official data has been accurately included. However, because of the very nature of some aspects of external economic presence, certain assumptions and approximations have been made.

To quantify the Russian economic footprint in the eight, SEE countries, the study investigated four categories of economic activity: corporate presence, direct investment, trade, and private investment.

Corporate footprint

Based on information from public commercial registries, the study gathered a database of all active companies in each case study country. Then the analysis compared this list with a separate list (gathered through the research of the Orbis corporate database and the national commercial registries of the eight SEE countries) of all firms that have partial (over 25%) or majority (50%+) Russian ultimate ownership. It was often the case that some of the biggest companies with Russian origin would not be registered in Russia but in other jurisdictions. When unclear, the experts from the region assisted in determining the actual ownership through conversations with local insiders and verification on

the ground. This process was instrumental in directly confirming the Russian origins for some of the companies included. Apart from summing their revenues, the authors explored their subsidiary tree of ownership to evaluate on a case-by-case basis how deep in the economy, these companies' influence went. The study critically assessed the influence of the largest of the identified Russia-controlled companies in the structure of their specific sectors.

The indirect economic influence of these companies can also be analyzed via their trading and investment partnerships with local subsidiaries, distributors, suppliers and contractors. For the largest Russian-controlled or dominated firms, the analysis tried to analyze the full network of ownership throughout the economy. The companies were selected based on an expert assessment of their relative importance for strategic sectors of the economy, such as energy. In this way, the full market penetration of a company and its overall market share in a number of sectors was determined. Finally, for each of the countries, the research included the energy and finance sectors, which are not only strategic for the overall economic development of the region, but are also where the Russian economic footprint seems most pronounced. Other sectors of analysis were chosen after an assessment by the national experts.

Direct investment

The study analyzed the size of direct investments for each of the selected countries in the post-2005 period. The size was presented in euro values and included:

- foreign direct investments (by sector);
- mergers and acquisitions on a case by case basis;
- bank and direct government loans in strategic sectors such as energy, finance, transportation, chemical and construction.

The information used came from official FDI statistics such as data from the national central banks, the United Nations Conference on Trade and Development (UNCTAD), the statistical institutes or the investment promotion agencies in each country; media content and research by local experts. Special emphasis was placed on Russian investments in key sectors such as energy, finance, metallurgy, construction, transportation and real estate.

It was important to trace the FDI information not only from Russia, but also from other countries including offshore destinations, preferred for registration from Russian companies. Based on information from media sources, company websites and interviews with insiders, the authors tried to determine what share of such offshore investments could be included in the Russian corporate footprint assessment. The mergers and acquisitions included major equity and other kind of financial investment in large economic sectors such as energy, telecommunications, finance, construction and transportation. The study investigated how gaining control of strategic public or private assets had changed the structure of

the market, and whether market concentration could be observed in the hands of few economic circles with close ties with Russia.

Trade

The size of bilateral trade balance between Russia and each of the selected countries was included. Euro values of deficits/surpluses was presented for each year after 2005. In addition to calculating the overall trade deficits, where possible, the study analyzed economic exposure by sector. In the analysis of trade relations, the report outlined persistent dependencies in the product value chain such as in the oil and gas sectors. The impact of a potential energy supply shocks was analyzed. The report distinguished between real and perceived energy security risks in order to show how pro-Russian groups have tried to present Russia as unavoidable oil and gas supplier.

Private assets and investment

As backchannels can be used to obfuscate the ultimate beneficial ownership of an investment, the study conducted a limited (on a case by case basis) investigation of non-governmental investment including in soft power initiatives such as religious and cultural donations. Such data included known/traceable euro values of:

- real estate ownership by Russian citizens;
- religious and cultural/sport donations and endorsements included as case studies;
- cases of Russia-affiliated NGOs and related grants and donations;
- high net-worth individuals' investments/endorsements.

