



## ASSESSING RUSSIA'S ECONOMIC FOOTPRINT IN BOSNIA AND HERZEGOVINA

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### Overview

Russia has been one of the key political players in Bosnia and Herzegovina since the Dayton Accords brought the 1992 – 1995 war to its end. According to the peace agreement, Bosnia and Herzegovina consists of two entities – the Federation of Bosnia and Herzegovina (FBiH) and Republika Srpska (RS) with roughly equal territories – and the Brcko District. It is in RS, the entity with a Serb majority, that Russia has gained the most traction. Russia has particularly backed RS's opposition to the Transatlantic integration of Bosnia and Herzegovina, as well as RS secession initiatives.<sup>1</sup> Many regional observers feel that the secessionist aspirations of RS could potentially lead to a new regional conflict.

Russia holds a permanent seat on the Peace Implementation Council (PIC) and the Steering Group of the PIC, thus guiding the work of the High Representative in Bosnia and Herzegovina involved in interpreting the Dayton Peace Accords. In addition, the leadership of the RS has developed its own independent foreign policy vis-à-vis Russia, including the establishment of a quasi-diplomatic mission in

<sup>1</sup> Knezevic, Gordana (2016). "Russia's Fingers in Bosnia's Pie," Radio Free Europe. 28 September, 2016.

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### KEY POINTS

- Most of Russia's economic footprint in Bosnia and Herzegovina is concentrated in Republika Srpska. Russia has consistently been the largest foreign investor in the entity and the fourth largest in Bosnia and Herzegovina, with around EUR 547 million of foreign direct investment (FDI) in the country over the 2005 – 2016 period.
- The revenues of Russian enterprises in RS make up 42 % of the total revenue of all foreign companies in the entity, while the combined turnover of EU-based firms is only 27 %. Russia's corporate footprint in the country as a whole grew more than twice over the past decade, from 2.6 % in 2006 to around 5.7 % in 2015 in an otherwise shrinking economy.
- Bosnia and Herzegovina is completely dependent on Russian gas supplies. Russian companies also control the country's two refineries, both located in Republika Srpska.
- Russia has backed the Republika Srpska leadership in its increasingly antagonistic relationship with the FBiH and the central government.



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Russia outside Bosnia's official diplomatic representation in 2006.<sup>2</sup> The President of RS, Milorad Dodik, has used Russia's support to preserve his political credibility in the eyes of the RS electorate and to gain significant leverage in decision-making on the state level.

In exchange for the political support of RS, Russia has reciprocated economically via a number of economic interventions. Most of Russia's economic footprint in Bosnia and Herzegovina is concentrated in RS. Russia has consistently been the largest foreign investor in the entity and the fourth largest in Bosnia and Herzegovina, with around EUR 547 million of foreign direct investment (FDI) in the country over the 2005 – 2016 period.<sup>3</sup> The revenues of Russian enterprises in RS make up 42 % of the total revenue of all foreign companies in the entity, while the combined turnover of EU-based firms is only 27 %.<sup>4</sup> Russia's corporate footprint in the entity is concentrated in only five companies, which are all in the energy, banking, and pharmaceutical sectors, making up a significant part of the regional economy's value-added.

Similarly to many countries in Central and Eastern Europe, Russia's economic footprint is channeled primarily through the oil and gas sectors. Bosnia and Herzegovina is completely dependent on Russian gas supplies. Although the country imports oil not only from Russia but also from Croatia and Serbia, Russian companies control the country's two refineries, both located in RS. Russia has been exerting significant pressure on Bosnia and Herzegovina utilizing the short-term nature of its gas supply agree-

ment (the contract is renegotiated every year), gas debts of local central heating plants, and one of the highest gas import prices in Europe charged by Gazprom. In addition, a Russian pipeline project, South Stream,<sup>5</sup> dominated the energy policy agenda of the government for years, derailing Bosnia and Herzegovina from pursuing alternatives for diversification of supply via Croatian liquefied natural gas (LNG) or a planned Ionian-Adriatic Pipeline (IAP), which would connect the country to the Trans-Adriatic Pipeline (TAP) and, thus, to Caspian and Middle Eastern gas.

Foreign investment deals, privatization tenders, and many other intergovernmental economic agreements with Russia have been marred by allegations of high-level corruption and money laundering operations, primarily, it is claimed, to sustain a powerful group around President Dodik. Through financial support to the leadership in Banja Luka, the capital of RS, Russia has increased its ability to influence the entity's institutions. This, in turn, has bottlenecked decision-making processes at the central level and delayed the country's progress in making reforms needed to pursue a Euro-Atlantic path. Additionally, Russia has backed the RS leadership in its increasingly antagonistic relationship with FBiH and the state government. A vivid example was Russia's support for a September 2016 referendum organized by the RS leadership on the recognition of a controversial national day for RS. Russia has sought to amplify secessionist sentiments in RS, thus stirring tensions in Bosnia and Herzegovina, which could pull the whole Western Balkans away from integration into the Euro-Atlantic institutions.

<sup>2</sup> RS also has trade representations in Washington, Brussels, Vienna and other cities around the world. The opening of separate trade offices has convinced the state government that RS is trying to pull away from the Federation, see Latal, Srecko (2009). "Republika Srpska EU Office Triggers Dispute," *BalkanInsight*. 13 February, 2009.

<sup>3</sup> CSD calculations based on an analysis of a commercial corporate database.

<sup>4</sup> According to the structural business statistics published in the statistical agency of RS accessed at [http://www.rzs.rs.ba/front/category/28/?up\\_mi=12&left\\_mi=41&add=41](http://www.rzs.rs.ba/front/category/28/?up_mi=12&left_mi=41&add=41)

<sup>5</sup> A controversial project aiming to transport natural gas from Russia to Southeast and Central Europe via Black Sea, from Serbia to RS.

## Russia's Economic Footprint in Bosnia and Herzegovina<sup>6</sup>

Russia's economic footprint in Bosnia and Herzegovina is among the largest in Southeast Europe, trailing only Montenegro, Bulgaria, and Serbia. Russia's corporate footprint, in terms of revenue controlled by Russian entities, grew more than twice over the past decade, from 2.6 % in 2006 to around 5.7 % in 2015 in an otherwise shrinking economy. In absolute figures, Russian companies had a turnover of around EUR 1 billion in 2016. However, looking at RS alone, Russia plays a much more significant role. In 2014, Russian companies made up close to 39 % of entity's total foreign-controlled revenues, while EU-based companies had only a 33 % share.<sup>7</sup> This is a reflection of the fact that EU-based companies are wary of investing in RS for a range of reasons, including because of potential corruption-related costs. The share of Russian companies in the entity's economy reached more than 8 % in 2014, as Russians filled the gap following the withdrawal of some Western investors, in part due to the poor rule of law and economic stagnation.

Russia's FDI increased from USD 235 million<sup>8</sup> in 2008 to around USD 547 million in 2016, which made up 8.1 % of the country's total FDI and 3.3 % of gross domestic product (GDP). Most Russian investment is concentrated in oil processing, fuel and gas distribution, and financial services. This, however, does not include purported direct government loans from Russia to RS. The President of RS was reported to have negotiated a EUR 270 million loan from Moscow in April 2014, in

an attempt to push the state government to abandon a previous agreement with the International Monetary Fund (IMF). It implied that structural reforms<sup>9</sup> were impossible to implement due to a lack of political consensus among the political parties.<sup>10</sup> Months later, President Dodik said that Russia had pledged between EUR 500 and 700 million, which would cover the government's expenditures in case the IMF did not disburse a new loan following the expiration of the Fund's lending agreement in 2015.<sup>11</sup> There were, however, no reports confirming the actual disbursement of these Russian funds.

In October 2015, President Dodik discussed a USD 300 million loan to finance the entity's budget deficits in 2015 and 2016 from a California-based investment fund called Global Bancorp Commodities and Investments, Inc. (GBCI), implementing waste management technologies in Russia. According to several media sources, this company is also linked to a Russian citizen – Alexander Vassilev.<sup>12</sup> The loan negotiations with Russia came only a few months after the country was hit with devastating floods that paralyzed the economy and left the authorities with little cash to continue their operations. Again, no reports ever confirmed that this loan materialized. The terms of the potential loans also remained confidential, not only to the public but also to relevant government institutions, as these loans were not discussed in public or in RS Parliament.

Apart from three large mergers and acquisitions in the oil, banking, and pharmaceutical sectors, Russia and Bosnia and Herzegovina do not have close economic relations. Their trade turnover is marginal

<sup>6</sup> In quantifying the Russian economic footprint, the analysis derived from available data of national statistics on bilateral trade and foreign direct investment (FDI) stocks. For calculating the corporate footprint, the study utilized a commercial corporate database, which contains information on ultimate beneficial ownership and financial information on companies in Bosnia and Herzegovina, allowing the authors to identify all Russian-owned companies active in the country. The data on the Russian companies' revenues was cross-checked with statistics of the entities' statistical agencies. To quantify the Russian economic footprint, the authors compared imports and Russian FDI to GDP, and the revenues of Russian-owned and indirectly-controlled companies in Bosnia and Herzegovina to the country's total revenues in the economy.

<sup>7</sup> According to structural business statistics from a 2016 statistical yearbook of the RS.

<sup>8</sup> FDI statistics before 2008 were not available.

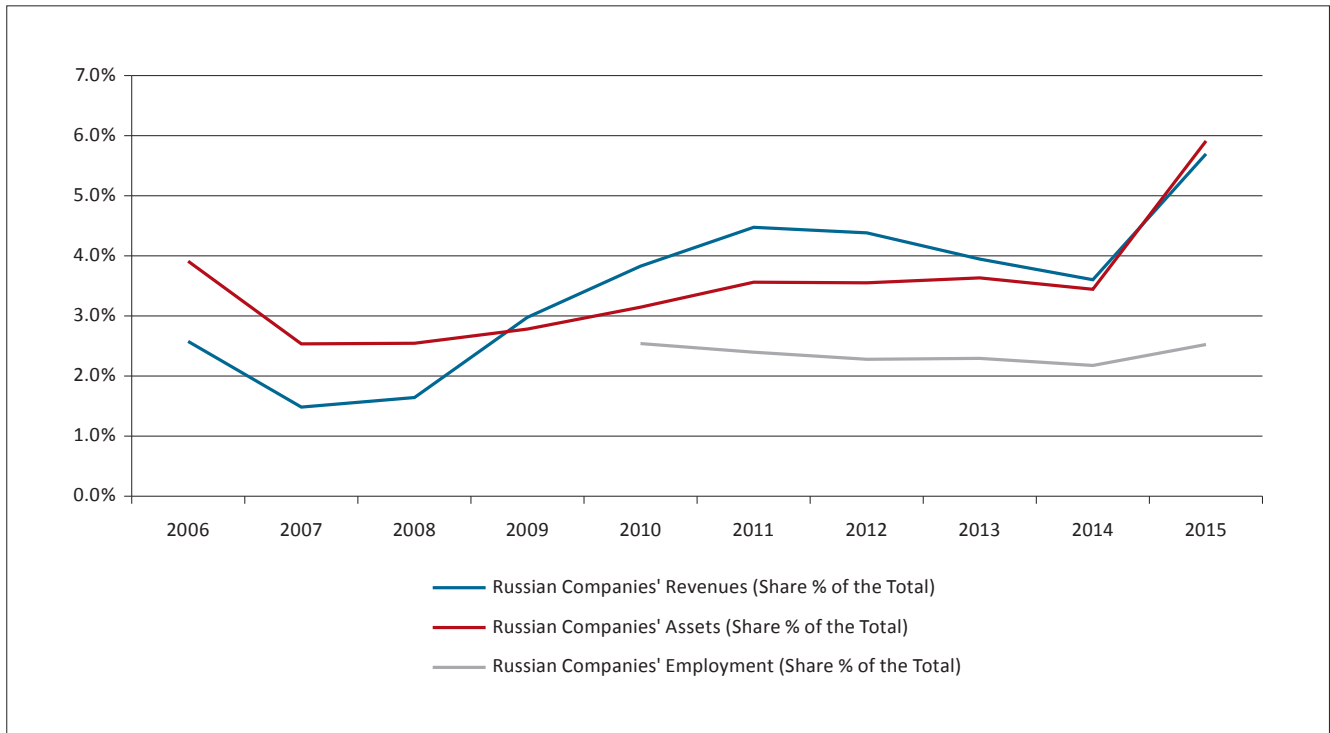
<sup>9</sup> Latal, Srecko (2016). "Bosnia Clinches New €550m Deal With IMF," *BalkanInsight*. 25 May, 2016.

<sup>10</sup> Jukic, Elvira (2014). "Bosnian Serbs Seek Russian Loan to Replace IMF," *BalkanInsight*, 3 April, 2014.

<sup>11</sup> "Bosnian Serb leader says Russia will loan region 500-700 mln euros," *Reuters*. 19 September, 2014.

<sup>12</sup> Mukova, Denitsa (2015). "Mystery investor lends \$300mn to Republika Srpska," 16 October, 2015.

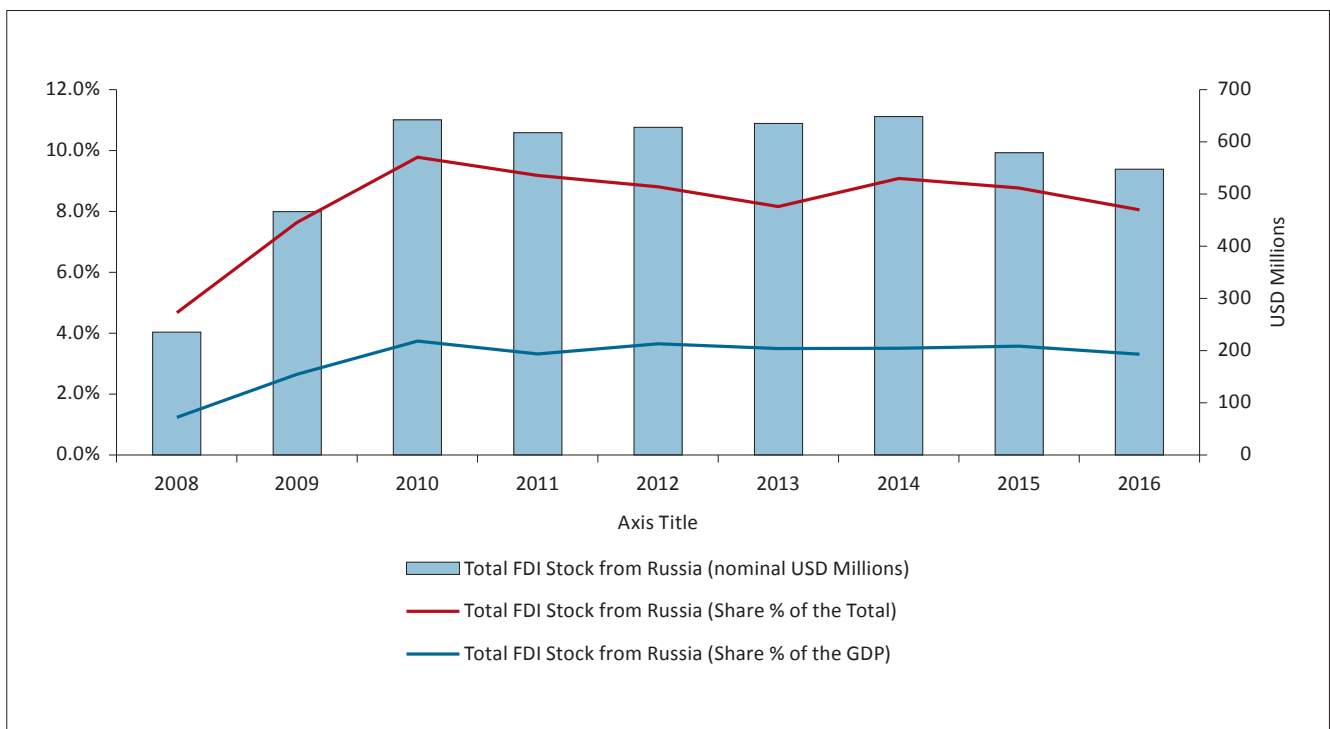
**Figure 1. Russia’s Corporate Footprint\***



\* Data for employment in Russia-owned companies is missing for the years 2006, 2007, 2008, and 2009 due to the lack of national or international statistics.

Source: CSD calculations based on analysis of a commercial corporate database, using ultimate beneficial ownership as research criteria.

**Figure 2. Stock of Russian Foreign Direct Investment**



Source: CSD calculations based on data from the Central Bank of Bosnia and Herzegovina and the United Nations Conference on Trade and Development (UNCTAD).

compared to Bosnia's overall trade, and the country's trade with the EU. In 2016, Bosnia and Herzegovina imported close to USD 5.775 billion from the EU – more than 20 times more than from Russia. However, Bosnia and Herzegovina is running a significant bilateral trade deficit with Russia, which in 2016 was over USD 250 million, or 3 % of GDP. Russia has never been among Bosnia's top 10 trading partners, and most of the trade deficit is due to the country's oil and gas imports, which have halved since 2013 due to falling energy prices. Exports to Russia began rapidly increasing since 2014, albeit from a low base, from USD 39 million in 2013 to USD 55 million in 2016. This is thanks to the expanded export of agricultural products to Russia following the embargo on EU goods.

The concentration of a deficit in the energy sector is an acute risk for a country heavily dependent on Russian energy. The role of oil and gas dependence in relations with Russia is even more significant because of the engagement between Moscow and RS President Dodik, and the RS's role in these economic sectors. The precarious situation of the country's finances, coupled with the fact that state-owned energy companies are conducting business with Russia, magnifies the potential risk that the trade deficit poses to the country's national security. This report analyzes how Russian capital has expanded its presence in some of the most strategic sectors of the country's economy, while exploiting governance gaps on the part of the administrations of the various entities of Bosnia and Herzegovina.

## Vulnerable Sectors

### Energy

The Bosnian electricity sector is quite diversified, and the country is among the biggest power exporters in the region. According to 2015 data from the International Energy Agency,<sup>13</sup> close to 64 % of the country's

power is produced by burning domestic and imported coal; the rest comes from its abundant hydropower reservoirs.<sup>14</sup>

In the natural gas sector, though, the country is fully dependent on Russian imports. Natural gas covers around 25 % of the needs of the central heating utilities (the rest comes from fuel oil), but is otherwise insignificant for the country's energy sector. In 2015, natural gas made up only around 4 % of the total final energy consumption, and in absolute numbers, has not gone beyond 220 million cubic meters per annum. Despite the limited use of natural gas in Bosnia and Herzegovina, Russia has sought to take advantage of the country's import dependence to exacerbate divisions between the country's entities. Typical examples of this, as described below, are the management of the South Stream pipeline project and the resolution of a gas debt dispute.

Crude oil derivatives play a bigger role in the energy sector because they are used not only in transportation but also in central heating. Russia is not the only supplier of oil and oil products to Bosnia and Herzegovina. Croatia has also exported final oil products directly to the retail market in Bosnia and Herzegovina. However, the Bosnian refineries, all located in RS, are controlled by Russia's Optima Group, which imports only Russian crude via a pipeline from Serbia. Gazprom's NIS, registered in Serbia, is also one of the biggest fuel distributors in the country, together with Lukoil's Bulgarian branch.

### Natural Gas

Bosnia and Herzegovina does not have any domestic natural gas production and is entirely dependent on Russian imports coming from one route, from Ukraine through Hungary and Serbia. It was one of the countries in Southeast Europe worst hit by a cut in Russian gas transit through Ukraine during a dispute between Gazprom and Naftogaz in 2009, when 50 % of the contracted gas supply to the country was interrupt-

<sup>13</sup> IEA (2017). Bosnia and Herzegovina: Balances for 2015, <https://www.iea.org/statistics/statisticssearch/report/?country=BOSNIAHERZ&product=balances&year=2015>

<sup>14</sup> International Energy Agency – Country Statistics: Energy Balances – 2015.

ed.<sup>15</sup> Authority over the regulation and management of the gas sector is vested in the two entities, which have constantly obstructed necessary cooperation on possible joint projects. State-owned BH Gas and Russian-controlled Energoinvest LTD (both supplying gas to FBiH), and the RS-based, Serbian-owned GAS RES have separate contracts with Gazprom. The contracts with Gazprom are renewed on an annual basis, while the gas transit agreements with Hungary and Serbia are for 10 years, and will expire at the end of 2018 and 2017, respectively.<sup>16</sup> Bosnia and Herzegovina paid the second-highest gas import price in 2013 at USD 515/1,000 cubic meters, trailing only Macedonia at USD 564.<sup>17</sup> The gas contracts of the two entities with Gazprom, similar to deals in most of the countries of Central and Eastern Europe, are linked to the price of crude oil, which has fallen precipitously over the past three years, alleviating the pressure on gas suppliers in Bosnia and Herzegovina. Yet, the relationship with Gazprom remains largely asymmetrical, in which the Russian supplier often uses its monopoly position to play the two entities against each other.

For example, in February 2015, the head of RS's GAS RES gas supplier and the CEO of Gazprom signed a new agreement for direct gas supply to the entity, bypassing one of FBiH's gas suppliers – namely BH Gas – at preferential pricing terms, after talks between the CEO of Gazprom and President Dodik in September 2014.<sup>18</sup> The contract stipulated that Gazprom would deliver 106 million cubic meters of gas to RS from July 1, 2015, to December 31, 2016.<sup>19</sup> The agreement was tied to a newly created joint company (60 % for Gazprom and 40 % for the RS), as compared to 51 %

to 49 % in Serbia and 50 % and 50 % in Bulgaria, to construct an offshoot of South Stream from RS to FBiH. The state government was not consulted on this issue at all, though. Although energy sector governance is within the competencies of each entity, RS, due to its geographic advantage thanks to its proximity to Serbia's infrastructure, has yielded significant power over the gas supply to FBiH.

The leverage that Russia has gained over Bosnian gas policy and its implications for the country's energy security is probably most visible in the management of the country's section of South Stream. Both FBiH and RS expected that South Stream would resolve their problems with gas shortages due to bottlenecks on the existing pipeline network caused by disputes between the two entities. The goal of the RS leadership was to construct 280 km of gas pipelines to the capital of the entity, Banja Luka, and 46 residential areas in the RS. This is in an RS gasification plan dating to 2002. That is when the company Slavija International from Laktasi, Dodik's birthplace and a stronghold of his Alliance of Independent Social Democrats (SNSD), was awarded a concession contract for construction of a 480 km-long gas pipeline along the Sava river.<sup>20</sup> South Stream would follow exactly the same route with a capacity of between 1.5 bcm/yr to 1.7 bcm/yr. In concluding the South Stream agreement, the RS however circumvented FBiH and the state government, effectively blocking any access to the planned pipeline beyond the RS-operated gas distribution network. According to RS estimates, direct and indirect losses for Bosnia and Herzegovina from the cancellation of South Stream exceeded EUR 2 billion.<sup>21</sup>

<sup>15</sup> Ralchev, Stefan (2009). "Russian Gas Supplies to Bosnia Cut by Half." See News, 6 January, 2009, accessed on 13 November, 2017 at <https://seenews.com/news/update-2-russian-gas-supplies-to-bosnia-cut-by-half-239252>

<sup>16</sup> European Energy Community (2017). Annual Implementation Report. 1 September, 2017, Energy Community Secretariat.

<sup>17</sup> Gazprom's Grip: Russia's Leverage Over Europe. RadioFreeEurope – Infographics on the Russian gas dependence in Europe by country, accessed on 9 November, 2017 at <https://www.rferl.org/a/gazprom-russia-gas-leverage-europe/25441983.html>

<sup>18</sup> Posaner Josh (2014). "Gazprom's gas deal in Republika Srpska provides South Stream stop-gap," LSEE Southeast Europe Research Blog, 16 September, 2014, accessed on 13 November, 2017 at <http://blogs.lse.ac.uk/lsee/2014/09/16/gazproms-gas-deal-in-republika-srpska-provides-south-stream-stop-gap/>

<sup>19</sup> Gazprom Export Press Release, 27 February, 2015 accessed on 13 November, 2017 at <http://www.gazpromexport.ru/en/presscenter/press/1531/>

<sup>20</sup> Pavlova, Iskra. (2002). Serbian, Russian Firms Eye Gas Pipeline Construction in Bosnia – Media. SeeNews. October 19, 2009, accessed on 28 January, 2018 at <https://seenews.com/news/serbian-russian-firms-eye-gas-pipeline-construction-in-bosnia-media-251148#sthash.PfRhLH7q.dpuf>

<sup>21</sup> Article of Deutsche Welle of 4 December, 2014: <http://www.dw.com/hr/i-bih-ostala-bez-milijunskih-investicija/a-18109661>



On the part of FBiH, Gazprom concluded supply contracts with BH Gas and Energoinvest on an annual basis, with the latest valid until the end of 2017. BH Gas is the single wholesale supplier and one of two gas system operators in the entity (the other one is Gas Promet). In RS, there is another gas transmission operator, Sarajevogas Istocno Sarajevo. Between FBiH and RS, there is only one connection with a domestic transmission system at Zvornik, located in RS. Constant ethnic political infighting and the fact that there are three different transmission operators have contributed to the system's underperformance and supply shortages.<sup>22</sup> The fact that there are two different gas sector laws and regulations for transmission system operators means that gas suppliers face significant difficulties in shipping gas from one entity to the other, as capacity booking rules differ and limited cooperation between operators means that physical gas bottlenecks often halt the gas supply.

Internal squabbles between the two entities and among the many layers of authority in the gas sector have aided Russia's efforts to prevent gas diversification projects, including a link to Croatia that would provide FBiH's access to future LNG, Croatian domestic gas, and potential Azeri supply via the IAP.<sup>23</sup> In August 2016, the Minister of Foreign Trade and Economic Relations of Bosnia and Herzegovina, Mirko Sarovic, signed a Memorandum of Understanding (MoU) with his Montenegrin, Albanian, and Croatian counterparts on the construction of the IAP, which stipulated that the pipeline would pass through the Neum corridor on the Adriatic coast on FBiH's territory.<sup>24</sup>

Russia has pursued different strategies vis-à-vis FBiH and RS, which can be explained by its geopolitical priorities. Another example of RS's preferential treatment by Gazprom is an agreement signed with Russia in 2017. According to this agreement, GAS RES is not obliged to participate in a repayment of the USD 98 million gas debt accumulated by Bosnia and Herzegovina for gas supplies from Russia during the 1992 – 1995 war, and only BH Gas from FBiH should be responsible.<sup>25</sup> In May 2017, Russia sought through official means full repayment of the debt, following a March 2017 deal between Bosnia and Herzegovina and Russia on the settlement of the USD 125.2 million outstanding debt of the USSR to Socialist Yugoslavia.<sup>26</sup> FBiH was to receive 58 %, or USD 72.6 million, from the debt; RS – 29 % or USD 36.3 million; the Bosnian state institutions – USD 10 % or 12.5 million; and the Brcko district – 3 % or USD 3.8 million.<sup>27</sup>

Bosnia and Herzegovina was the last of the states of the former Yugoslavia to resolve its debt dispute with Russia, doing so only in 2017. Additionally, Bosnia and Herzegovina was the only Balkan country to receive its post-Yugoslav share of the clearance of the Russian debt in cash. The BH Gas company complained that the settlement of the gas debt issue was purposefully mismanaged to the benefit of RS.<sup>28</sup>

As a consequence of the redistribution of the debt burden entirely to FBiH, the financial situation of BH Gas has become precarious, which may potentially endanger Sarajevo's supply in the winter of 2017-18. After receiving the cash reimbursement from Moscow, it still owes Gazprom USD 25.4 million. FBiH has also expressed concerns that the RS could use

<sup>22</sup> European Energy Community (2017). Annual Implementation Report. 1 September, 2017, Energy Community Secretariat.

<sup>23</sup> Anastasios Giamouridis and Sprios Paleoyannis. "Security of Gas Supply in South Eastern Europe," The Oxford Institute for Energy Studies. July 2011.

<sup>24</sup> Pavlic, Vedran (2016). "Ministers Sign Memorandum of Understanding on Ionian-Adriatic Gas Pipeline," CroatiaNews. 27 August, 2016, accessed on 1 December, 2017 at <https://www.total-croatia-news.com/item/13806-ministers-sign-memorandum-of-understanding-on-the-ionic-adriatic-gas-pipeline>

<sup>25</sup> Garaca, Maja (2017). "Russia seeks repayment of \$98 mln gas debt from Bosnia," 16 May, 2017, accessed on 13 November, 2017 at <https://seenews.com/news/russia-seeks-repayment-of-98-mln-gas-debt-from-bosnia-report-568868#sthash.WBIIPSFd.dpuf>

<sup>26</sup> Garaca, Maja (2017). "Bosnia's BH Gas confirms Russia seeks repayment of gas debt," 18 May 18, 2017, accessed on 13 November, 2017 at <https://seenews.com/news/bosnias-bh-gas-confirms-russia-seeks-repayment-of-gas-debt-569151>

<sup>27</sup> Ibid.

<sup>28</sup> Ibid.

its geographic position as a transit region for the gas pipeline via Zvornik, in RS, and cut the gas supply to FBiH under pressure from Gazprom. RS has already cooperated with the Russian supplier to circumvent FBiH in the South Stream negotiations and disrupt the construction of new pipelines to alternative sources of gas. The full control of the natural gas supply to the whole territory of Bosnia and Herzegovina by the RS would create a risk for gas consumers in FBiH, which accounts for half of the total gas demand in the country.

Furthermore, RS has worked to prevent the opening of a new gas supply route to FBiH from Croatia, so that RS can maintain its monopoly over supply to FBiH. To achieve this, RS has limited the scope and size of a low-pressure gas pipeline that is planned to be built exclusively for the needs of the Oil Refinery in Brod (a company privatized with Russian capital in a deal brokered by RS authorities). For full-scale gas diversification in FBiH to succeed, there is a need for a high-pressure gas pipeline such as the previously proposed Brod-Zenica interconnector from Croatia (the North-South pipeline). This gas pipeline built by BH-Gas and financed by the European Bank for Reconstruction and Development (EBRD) would have provided not only FBiH but the whole country with access to an alternative source of supply. The North-South pipeline would also diminish the use of fuel oil for heat generation in district heating plants across the country, a major source of pollution.

RS has always objected to a North-South pipeline project,<sup>29</sup> instead proposing the Sava pipeline (also known as the East-West pipeline), which would also reach the Croatian border shipping Russian gas. Sava was conceived by Gazprom and the Serbian gas supplier, Srbijagas, in 2002, but did not advance. The

project appears to be dead, especially after the cancellation of South Stream, which would have supplied Sava with Russian gas. For now, only the North-South pipeline can potentially be revived if RS does not continue to sabotage the project.

Another associated problem with small pipeline projects such as Sava and North-South in the Balkans is the lack of investment interest in a small gas market with poor prospects for significant expansion. Despite this fact, Gazprom has continued to develop new concepts for expanded gas supply to RS, most recently in mid-December 2017, when the Russian company and RS signed an agreement on a 70 million EUR liquefied gas plant in Zvornik. This is at a border crossing point where RS receives its Russian gas supplies from Serbian territory.<sup>30</sup> The new project could be interpreted as an attempt to replace South Stream.

Croatia and FBiH took steps to revive the North-South pipeline in 2017. In April, Plinacro (a Croatian Gas Company) and BH Gas agreed to cooperate in connecting a gas transmission network through Croatia and Bosnia and Herzegovina through a EUR 80 million, 160-km pipeline, so that FBiH could be connected to a planned Krk LNG terminal on the Adriatic coast.<sup>31</sup> The gas pipeline would, according to this agreement, connect Zagvozd, Imotski, Posusje, and Travnik/Novi Travnik. Adding this alternative would help Bosnia and Herzegovina fulfil the requirements of the Energy Community, according to which the country must have more than three sources of gas supply.<sup>32</sup> The planned new pipeline network connecting Bosnia and Herzegovina and Croatia represent a part of the Energy Community initiative to complete a Gas Ring within the Western Balkans, which would connect to the IAP pipeline along the Adriatic coast and eventually to TAP in Albania. Although RS would also benefit

<sup>29</sup> Pavlic, Vedran (2017). "Bosnian Serbs Reject Croatian Gas," 5 March, 2017, accessed on 13 November, 2017 at <https://www.total-croatia-news.com/business/17230-bosnian-serbs-reject-croatian-gas>

<sup>30</sup> JutarnjiVijesti (2017). "Milorad Dodik Signs a Milestone Agreement with Gazprom," 16 December, 2017, accessed on 5 January, 2018 at <https://www.jutarnji.hr/vijesti/svijet/milorad-dodik-s-gazpromom-potpisao-ugovor-za-milijunsku-investiciju-ruski-plinski-div-u-republici-srpskoj-gradit-ce-tvornicu-ukapljenog-plina/6850335/>

<sup>31</sup> "Bosnia, Croatia: New cross border gas pipeline," SEE Energy News, 18 May, 2017, accessed on 14 November, 2017 at <https://serbia-energy.eu/bosnia-croatia-new-cross-border-gas-pipeline/>

<sup>32</sup> The Energy Community ensures the implementation of the EU energy acquis in the member-countries. The Regulation Concerning Measures to Safeguard Security of Gas Supply (994/2010/EU) stipulating the three-sources rule is part of the acquis.



from receiving diversified gas supplies, the entity decided to focus on Russia-led gas pipelines originating in Serbia instead.

In general, the lack of gas demand makes it difficult to justify the large investment costs. It has been difficult for Bosnia and Herzegovina to reconcile the importance of diversification for the security of supply with its limited economic viability. Demand has been low because gasification rates are among the lowest in the region, and household gasification has not been attractive due to high prices caused by inefficiency and regulatory fragmentation.

### Oil Sector

Russia's engagement in the oil sector of Bosnia and Herzegovina dates back to the privatization of two of RS's oil refineries, Rafinerija Nafta Brod and the Modrica motor oil processing facility, in 2007. They were privatized by a newly-created company, Neftegazinkor, for a total of EUR 125.8 million, far below the initial price of EUR 285 million through a process which widely judged non-transparent.<sup>33</sup> Neftegazinkor is 100 % owned by the Russian state-owned oil company Zarubezhneft, which took a loan from a Russian state-owned development bank to buy the two refineries.<sup>34</sup> Russian officials described the project as both politically and economically part of a broader strategy for strengthening alliances with countries of the Western Balkans.<sup>35</sup> The refineries and the fuel distribution business contribute up to 25 % of the RS budget revenues, making them the largest taxpayer in the country. In 2011, Optima Group, as Zarubezhneft in Bosnia and Herzegovina is known, was also responsible for 19 % of Bosnia and

Herzegovina's GDP, according to a statement in the company's annual report.<sup>36</sup> There have been some press reports that Optima Group may have engaged in tax evasion worth more than EUR 5.8 million, and even that it has not repaid RS in full for the refineries and the gasoline stations.<sup>37</sup> Zarubezhneft also acquired an 80 % share in a wholesale and retail fuels supplier, Nestro Petrol, which has become the largest gas station chain in Bosnia and Herzegovina. Nestro Petrol operates 87 fuel stations and controls more than a quarter of the market in RS, according to its 2012 annual report.<sup>38</sup>

Optima Group controls roughly 35 % of Bosnia and Herzegovina's wholesale fuels market (down from 60 % in 2011), which is a 6 % decline year-on-year due to increasing competition from Croatia's INA and the entry of smaller traders, including the Russian-owned, Serbia-based NIS, with a 7 % share of the market.<sup>39</sup> Optima also sells around one-fourth of its output abroad, to maximize profits from higher-price markets in Croatia and Serbia. On average, the Brod refinery has produced between 850,000 tons and 1 million tons of fuel derivatives in the past five years, with a steady decline in output in the past three years due to more competition on the wholesale market from Croatian suppliers.

The Modrica motor oil refinery, the third major company in Optima Group, is the only such facility of its kind in the country, producing 220 types of products, and is among the 10 largest in Europe. The plant has experienced a significant decline in oil distillate refining, with volume falling from 70,000 tons in 2013 to a little over 40,000 tons in 2016, due to diminishing demand and low profit margins.

<sup>33</sup> BalkanInsight (2008). Russia-owned Bosnian Oil Refinery Reopens. 27 November, 2008, accessed on 5 January at <http://www.balkaninsight.com/en/article/russia-owned-bosnian-oil-refinery-reopens>

<sup>34</sup> Sito-Sucic (2009). "Bosnian refinery reopening shows Russia's hand," The New York Times, 6 January, 2009, accessed on 15 November, 2017 at <http://www.nytimes.com/2009/01/06/business/worldbusiness/06iht-bosoil.4.19127279.html>

<sup>35</sup> Ibid.

<sup>36</sup> 2011 Annual Report of Zarubezhneft. This figure significantly exceeds the Russian corporate footprint as analyzed by the turnover method, which estimates the share of the Russian companies' turnover from the total turnover of the economy.

<sup>37</sup> Čigoja, Marina (2016). Exclusively: Russians have evaded millions of stamps in the Oil Refinery. Capital.ba, 5 August, 2016, accessed on 5 January, 2018 at <http://www.capital.ba/ekskluzivno-rusi-utajili-milione-maraka-poreza-u-rafineriji-nafte/>

<sup>38</sup> 2012 Annual Report of Zarubezhneft.

<sup>39</sup> 2016 Annual Report of Zarubezhneft. Back in 2011, the company controlled close to half of the whole market.

Again, the privatization of the two refineries was conducted without a tender and without any public debate.<sup>40</sup> It was completed quickly, possibly to rescue three bankrupt state-owned companies with debts of over EUR 72 million. Zarubezhneft pledged to pay off the arrears and invest an additional EUR 600 to 700 million in modernizing the facilities.<sup>41</sup> An independent audit by Deloitte in 2015 showed that Optima Group was facing a severe debt crisis, with short-term debts exceeding assets by EUR 20 million (the company's total debt was over EUR 320 million in 2016), and that a number of suspicious transactions had been conducted by the holding's management.<sup>42</sup> These transactions were alleged by opposition leaders and some experts as potential sources for money laundering operations by the leadership of the RS as well as to channel Russian political support.<sup>43</sup> Another theory is that Russia threatened to cut the crude oil supply to the Brod refinery unless it came under the ownership of a Russian company.<sup>44</sup>

RS did not enforce the refineries sale's conditions, which included investments in the modernization of the facilities. By 2016, Optima Group invested barely EUR 120 million in modernizing the production facilities and raising the output capacity of the refineries (representing six times less than the initial pledge of at least EUR 675 million).<sup>45</sup> Since then

there have been a number of high-level meetings involving the management of Zarubezhneft and President Dodik, during which it was reported that the Russians promised millions in further investment. Most recently, in June 2017, Zarubezhneft announced its construction plans for a low-pressure gas pipeline from the Brod refinery to Croatia that would alleviate the high levels of air pollution in both Croatia and RS's Brod valley.<sup>46</sup> The announcement came less than a month after a meeting of the foreign ministers of Russia and Croatia on the pollution issue in Slavonski Brod. BH Gas objected to this construction project, claiming that it would block an alternative gas interconnector from Bosnia to Croatia supplying both entities, as well as the Brod refinery.<sup>47</sup>

The accumulation of a debt of around EUR 300 million by the Brod refinery has also affected its production levels and has prompted its management to begin selling some non-essential assets. According to one of the leaders of the People's Democratic Movement (NDP), Dragan Cavic, this is not consistent with the privatization contract.<sup>48</sup> The auditing company KPMG stated in a 2016 report that Optima Group would not survive without a bailout from the parent company.<sup>49</sup> Continued negative financial results have however not prompted the sale of the whole business, and some experts claim that Optima Group

<sup>40</sup> "Russia-owned Bosnian Oil Refinery Reopens," *BalkanInsight*, 27 November, 2008, accessed on 15 November, 2017 at <http://www.balkaninsight.com/en/article/russia-owned-bosnian-oil-refinery-reopens>

<sup>41</sup> *Ibid.*

<sup>42</sup> Panic, Katarina (2015). "Ailing Bosnian Oil Firm Flogs Assets to Raise Cash," *BalkanInsight*, 26 June, 2015.

<sup>43</sup> *Ibid.*

<sup>44</sup> RWR Advisory Group (2016). *Economic and Financial (E&F) Threat Assessment for Bosnia and Herzegovina: Assessing the Activities of Russian State-Owned Enterprises in Bosnia and Herzegovina*. RWR, 4 March, 2016.

<sup>45</sup> Optima Group website page accessed on 15 November at <http://optimagrupa.net/en/o-nama/>  
Pavlova, Iskra. (2010). *Bosnian Oil Refinery Bosanski Brod To Absorb 103 Mln Euro in Investment in 2010 – Media*. SeeNews. March 22, 2010, accessed on 25 January, 2018 at <https://seenews.com/news/bosnian-oil-refinery-bosanski-brod-to-absorb-103-mln-euro-in-investment-in-2010-media-194596#sthash.w4q3YfNy.dpuf>

<sup>46</sup> See Energy News (2017). "Zarubezhneft interested in the construction of low-pressure BiH-Croatia gas connection," See Energy News, 14 June, 2017.

<sup>47</sup> *Ibid.*

<sup>48</sup> Panic, Katarina. (2015). *Ailing Bosnian Oil Firm Flogs Assets to Raise Cash*. *Balkan Insight*. 26 June, 2015, accessed on 25 January, 2018, at <http://www.balkaninsight.com/en/article/russian-owned-bosnian-serb-oil-industry-struggles-for-survival>

<sup>49</sup> Garac, Maja (2017). "Future of Bosnian oil refinery Brod uncertain without aid from Russian parent", SeeNews, 11 April, 2017, accessed on 15 November at <https://seenews.com/news/future-of-bosnian-oil-refinery-brod-uncertain-without-aid-from-russian-parent-kpmg-564876#sthash.x7isjvaW.dpuf>

has preserved its position in the country for political reasons.<sup>50</sup>

Non-transparent and non-competitive privatization processes have been used systematically to acquire strategic assets in the region. In a similar fashion, Russia has acquired oil, gas, minerals, and manufacturing assets in Serbia, Bulgaria, Macedonia, and Montenegro. These agreements often undervalue the assets, and the new owners often fail to implement agreed-upon investment plans, while managing the companies into losses and decapitalization. There is often also a substantial indirect effect on the states themselves, as these large loss-making companies typically do not pay corporate taxes and fail to create new jobs, which can generate fiscal and socio-economic vulnerabilities.

### Oil Exploration and Production

Russia has also been interested in expanding its upstream activities in the Western Balkans since GazpromNeft purchased NIS, a Serbian oil and gas giant, in 2009. The company has aggressively expanded into the wholesale and retail fuel markets of Serbia, Romania, Bulgaria, and Bosnia and Herzegovina, currently operating 400 fuel stations in the region. In Bosnia and Herzegovina, NIS currently operates 37 gas stations, placing it among the top four largest retailers (11 % of the total fuels market) in the country.<sup>51</sup>

In 2011, RS granted a Zarubezhneft-NIS<sup>52</sup> joint venture, Jadran Naftagas, a 28-year exclusive concession for its oil and gas exploration and production on the entity's territory.<sup>53</sup> Jadran Naftagas had planned to

invest USD 41 million in exploration during the first three years and 188 million for the next 25 years. So far, some oil reserves have been discovered in several places, which could potentially lead to an increase of Russia's economic presence in the country. As a consequence of lower prices that the Russian company may be able to afford to offer for its product, third parties could be eliminated from market competition.

### Banking

While Russia's presence in the banking sector of Bosnia and Herzegovina is small compared to that of Italian and Austrian financial institutions (the four largest banks in the country are Austrian and Italian, with combined assets of more than EUR 5.6 billion), Sberbank has grown notably in the past five years.

Russia has entered the Bosnian market following the takeover of Austrian Volksbank by Russian state-owned Sberbank in 2012. Sberbank now controls all of the former Austrian bank branches in Central and Eastern Europe, including in Bosnia and Herzegovina, where it has 51 offices. According to an assessment of the banking sector by the IMF published in 2015,<sup>54</sup> Sberbank is the sixth-largest financial institution in the country by assets. It has around 100,000 clients and EUR 593 million of assets (5 % of total bank assets). In other words, this is almost twice its assets compared with 2012, when Sberbank entered the market.<sup>55</sup> Its loans and deposit portfolios have also been steadily rising, to around EUR 473 million and EUR 390 million in 2016. Sberbank's interests are primarily in corporate finance and energy projects.

<sup>50</sup> Djurdjevic, Maja (2016). "Russia's Political Interests Drive Investments in Bosnia," 4 July, 2016 accessed on 15 November, 2017 at <http://www.balkaninsight.com/en/article/russia-s-political-interests-drive-investments-in-bosnia-06-30-2016>

Panic, Katarina. (2015). Ailing Bosnian Oil Firm Flogs Assets to Raise Cash. Balkan Insight. 26 June, 2015, accessed on 25 January, 2018, at <http://www.balkaninsight.com/en/article/russian-owned-bosnian-serb-oil-industry-struggles-for-survival>

<sup>51</sup> NIS 2016 Annual Report.

<sup>52</sup> NIS is majority-owned by Gazprom.

<sup>53</sup> <http://ir.nis.eu/en/news/single-news/jadran-naftagas-presented-preliminary-results-of-oil-and-gas-exploration-at-the-territory-of-the-republic-of-srpska/>

<sup>54</sup> Report available on: <https://www.imf.org/external/pubs/ft/scr/2015/cr15213.pdf>

<sup>55</sup> 2016 Sberbank Bosnia & Herzegovina Annual Report, accessed at [https://www.sberbank.ba/upload/docs/sb\\_en\\_online\\_ZOG.pdf](https://www.sberbank.ba/upload/docs/sb_en_online_ZOG.pdf)

Sberbank is more active in RS, where it is the fourth-largest bank. It also services Optima Group and an energy company, EFT. EFT is owned by offshore companies in the UK that are reportedly under the ultimate control of a Serbian businessman, Vuk Hamovic. The UK Serious Fraud Office previously investigated Hamovic for international corruption related to the alleged rigging of electricity-trading deals and manipulation of foreign aid payments, though the case was dropped.<sup>56</sup> In 2014, Sberbank financed EFT's 21.2 million purchase of coal processing and transportation equipment for a Stanari coalmine. The mine was intended to supply coal to EFT's 300-MW Stanari thermal power plant, constructed with a 350 million EUR loan provided by the China Development Bank.<sup>57</sup>

The bankruptcy scandal of Agrokor has shown the growth of exposure to Sberbank's funding across the region. This Croatian retail giant, the owner of which, Ivica Todoric, has been reported to have close ties to the Croatian government, has operated as a highly centralised and unreformed fashion. Relying heavily on bank loans, the company has expanded into almost all of the countries of the Western Balkans. In the beginning of 2017, Agrokor had 60,000 employees throughout the region, with income around 15 % of Croatia's GDP. The company has simultaneously accumulated large debts of around USD 6.4 billion, or six times its equity.<sup>58</sup> Sberbank owns around 18 % of its debt, and VTB has provided around EUR 300 million in

loans (5.4 % of the total). As Agrokor began defaulting on its debt, it was taken over by the Croatian state, which has tried to recover some of its assets in order to repay the holding's enormous debt.

The restructuring of Agrokor would necessarily have an effect on its Bosnian subsidiaries, including one of the largest retail chains, Konzum, which recorded revenue of EUR 434 million in 2015 and employed 4,154 people in Bosnia and Herzegovina. Agrokor has a total of eight subsidiaries in Bosnia and Herzegovina, with a total of over 5,000 employees.

Konzum's potential sale could have a domino effect of failing suppliers. It has more than 100 suppliers, including large meat and dairy plants.<sup>59</sup> Konzum owes them around EUR 66.5 million. So far, the suppliers have agreed to cooperate with Agrokor in a debt-restructuring program that started in September 2017.<sup>60</sup> In May 2017, Agrokor decided to put its Slovenian subsidiary, Mercator, in charge of the holding's business in Bosnia and Herzegovina, amid complaints by suppliers of not receiving regular payments for their deliveries.<sup>61</sup> The deal specifies that Mercator will take over 83 of 253 stores operated by Agrokor in the country.<sup>62</sup> Konzum also received a EUR 120 million injection from its fellow Agrokor subsidiaries in the country, which should be used to restructure the company's debts to suppliers.<sup>63</sup> Agrokor also agreed to restructure the EUR 34.6 million in claims of two other Agrokor sub-

<sup>56</sup> Leigh, David and Evans, Rob. "Fraud office drops Bosnia corruption case". The Guardian, 3 June, 2008.

<sup>57</sup> EFT (2014). "Loan Agreement for the Stanari Mine Signed Today", PR statement from the EFT website published on 16 April, 2014, accessed on 1 December, 2017 at <http://www.eft-group.net/index.php/news/single/68/Loan-Agreement-for-the-Stanari-Mine-Signed-Today>

<sup>58</sup> Ilic, Igor. "Croatia passes law to protect economy from Agrokor-like crisis," Reuters, 6 April, 2017.

<sup>59</sup> 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.

<sup>60</sup> Pavlin, Vedran (2017). "Agrokor's Suppliers in Bosnia Ready to Continue Cooperation," Total Croatia News. 17 April, 2017, accessed on 1 December at <https://www.total-croatia-news.com/business/18266-agrokor-s-suppliers-in-bosnia-ready-to-continue-cooperation>

<sup>61</sup> Garaca, Maja (2017). "Croatia's Agrokor to focus on Bosnia due to problems with suppliers – receiver," SeeNews, 23 June, 2017, accessed on 1 December at <https://seenews.com/news/croatias-agrokor-to-focus-on-bosnia-due-to-problems-with-suppliers-receiver-573396#sthash.dHX6xrKo.dpuf>

<sup>62</sup> Garaca, Maja (2017). "Retailers Mercator, Konzum to operate side by side in Bosnia from August 1," SeeNews, 13 July, 2017, accessed on 1 December at <https://seenews.com/news/retailers-mercator-konzum-to-operate-side-by-side-in-bosnia-from-august-1-575914#sthash.Q0dzM4Ow.dpuf>

<sup>63</sup> Garaca, Maja (2017). "Croatian retailer Konzum's Bosnian unit eyes 15 mln euro capital injection – report," SeeNews, 15 August, 2017, accessed on 1 December at <https://seenews.com/news/croatian-retailer-konzums-bosnian-unit-eyes-15-mln-euro-capital-injection-report-579744#sthash.4sEDnyv6.dpuf>

sidiaries in Bosnia and Herzegovina, Ledo Čitluk and Sarajevski Kiseljak, into Konzum shares. Also, Konzum Sarajevo is set to receive a EUR 15 million loan from the main Agrokor holding.<sup>64</sup>

Apart from Sberbank, the only other bank with Russian ties operating in Bosnia and Herzegovina is MF

Banka a.d. Banja Luka, formerly known as IEFK Bank. It opened its first branch in 2007, thus becoming the first Russian bank operating in the former Yugoslavia.<sup>65</sup> Prior to 2010, it was owned by the Russia-based East-European Finance Corporation, with a little significance for the country's banking sector.

### Box 1. Case Study: Alleged Money Laundering and Questionable Offshore Investment in the Pharmaceutical Industry

A number of reports implicated Sberbank in the alleged facilitation of a suspected money laundering operation in 2012, which involved a majority share acquisition of Bosnia's largest pharmaceutical company, Bosnalijek,<sup>66</sup> by a Luxembourg-registered offshore fund, Haden.<sup>67</sup> Sberbank gave a EUR 4 million loan to Haden to finance the costs of purchasing Bosnalijek shares without reporting the operation to the Department for Combating Money Laundering and the Financing of Terrorism, and the Financial and Intelligence Department of the State Investigative and Protection Agency in Bosnia and Herzegovina (SIPA).<sup>68</sup> The bank supervision agency filed a criminal complaint against Sberbank for not disclosing the loan to Haden and the facilitation of another transfer of USD 5.76 million from Luxembourg to Haden's account in Sberbank's Sarajevo branch. Bosnia's prosecutor's office began an investigation into a possible money-laundering scheme, but after two years of proceedings, no indictments were filed against Sberbank. Some observers felt that the failure to file charges reflected a low level of capacity of investigators in Bosnia and Herzegovina to tackle complex cross-border cases.

Haden has also been associated in some reports with a large Russian pharmaceutical supplier, Imperia Pharma.<sup>69</sup> Haden purchased 52 % of Bosnalijek in two separate transactions through the Bosnian stock exchange for an estimated EUR 20 to 25 million.<sup>70</sup> Following the entry of Imperia Pharma into Bosnia and Herzegovina, Bosnalijek increased its share since 2013 in the Bosnian drug maker to over 50 %. Currently, Bosnalijek sells 150 products in 14 countries in Southeast Europe, Russia, and some former Soviet republics, with revenue of EUR 78 million, close to 90 % of which is generated in Russia.<sup>71</sup> This excessive dependence on the Russian market could prove to be a vulnerability for the largest Bosnian drug maker. For example, following Montenegro's acceptance into joining NATO and decision to align with the EU on sanctions, Russia banned its wine imports from the state-owned Plantaze plant, which had generated most of its sales in Russia.<sup>72</sup>

<sup>64</sup> ESM (2017). "Agrokor To Recapitalise Konzum In Bosnia & Herzegovina," 4 September, 2017, accessed on 1 December, 2017 at <https://www.esmmagazine.com/agrokor-recapitalise-konzum-bosnia-herzegovina/48608>

<sup>65</sup> EMIS (2015). Mf Banka a.d. company report, accessed at [https://www.emis.com/php/company-profile/BK/Mf\\_Banka\\_ad\\_2541530.html](https://www.emis.com/php/company-profile/BK/Mf_Banka_ad_2541530.html)

<sup>66</sup> According to a 2013 IHS Markit study, Bosnalijek is the second largest pharmaceutical supplier in Bosnia and Herzegovina with around USD 21 million out of a USD 366 million market. The company's market position has improved significantly over the last couple of years as its revenues jumped to close to EUR 80 million after its entry into Russia and Turkey.

<sup>67</sup> Center for Investigative Reporting (2016). Fishy Transactions from Russia via Sberbank. CIN, 14 September, 2016.

<sup>68</sup> Ibid.

<sup>69</sup> "Luxembourg Haden increases its stake in Bosnia's largest drugmaker," Pharmaletter, 3 August, 2013.

<sup>70</sup> Ibid.

<sup>71</sup> "Bosnalijek to establish production of drugs in Russia," Pharmaletter, 7 July, 2017.

<sup>72</sup> Associated Press (2017). Montenegro says Russia banned its wine over NATO accession. 27 April, 2017, accessed on 5 January, 2018 at <http://abcnews.go.com/amp/International/wireStory/montenegro-russia-banned-wine-nato-accession-47054642>



Money laundering risks have long dogged the Bosnian banking system. SIPA previously raided several small banks in RS and arrested 10 financiers and bank regulatory officials, accusing them of colluding to facilitate corruption.<sup>73</sup> The affected banks were Bobar, Pavlovic, and Banka Srpske, among others. According to a report of the High Representative, Bobar bank's bankruptcy in 2014 (following the diversion of its funds) affected many public institutions, companies, and individuals.<sup>74</sup> The scandal also involved RS President Dodik, who was accused by Bosnia's Special Prosecutor of borrowing 750,000 EUR from Pavlovic Bank with a fictitious loan to purchase a luxurious villa in Belgrade.<sup>75</sup>

## Political Interference

Russian companies have a significant footprint in several strategic sectors of the Bosnian economy, which has been amplified by the Kremlin's political influence in RS. Russia's support for RS President Dodik (e.g. for a September 2016 referendum on an RS national holiday) has fueled the entity's fierce opposition to the country's Transatlantic integration. Compounding this issue, an expansion-weary EU has not been able to effectively capture the imagination of ordinary Bosnians, who have become disillusioned with the post-war transition, which in turn benefits local elites. Additionally, various soft power tools have been used by Kremlin proxies to foster popular appeal for Russia, which is often based on an exaggerated image of the importance of Russian investment in the country.

Bilateral high-level meetings between Russian and Bosnian officials have rarely amounted to anything more than grand promises of new investment with no real follow-up. RS's delegation to a business forum in Nizhny Novgorod in April 2016 aimed to expand trade and investment relations following Russia's embargo on EU agricultural goods. Of course, President Dodik also publicly endorsed the Crimean referendum and blocked Bosnia and Herzegovina

from joining the EU's sanction regime against Russia.<sup>76,77</sup> However, the Russian Agricultural Inspection Agency banned the import of Bosnian fruits and vegetables in August 2016 for a period of three months, which dented some producers' optimism about entering the Russian market.

Despite promising Dodik hundreds of millions in loans to RS to close the entity's budget gap, there is no evidence that Kremlin ever disbursed any funds to the entity. The media hype created around multiple rounds of loan negotiations with Russia created the false impression that Russia plays an oversized economic role in Bosnia and Herzegovina, nurtured by Dodik himself. He has used this to strengthen his own image, portraying Russia as firmly standing behind his agenda. In an interview with Politico, Dodik said that unlike the EU and the U.S., Russia was not "asking him to do anything impossible" and was instead offering "economic cooperation."<sup>78</sup>

Meanwhile, even if the political in-fighting between the different ethnic groups in Bosnia and Herzegovina does not originate in Russia, Kremlin has sought to exploit and exacerbate existing tensions by inciting conflict over the country's gas supplies, the financing of pipelines, the provision of government loans, and even Bosnia's national holidays.

<sup>73</sup> Nuttall, Clare (2016). "Investigations reveal rotten side of Bosnian Republika Srpska's bank sector," BNE Intellinews, 13 May, 2016, accessed on 16 November at <http://www.intellinews.com/investigations-reveal-rotten-side-of-bosnian-republika-srpska-s-bank-sector-97327/>

<sup>74</sup> Ibid.

<sup>75</sup> OCCRP (2016). Bosnia and Herzegovina: Police Bust Bank Owner Linked to RS President Dodik. 13 February, 2016.

<sup>76</sup> Tanjug (2014). "Serbs won't let Bosnia join sanctions against Russia," 26 March, 2014, accessed on 11 December, 2017 via a copy of the article in B92 opened at [http://www.b92.net/eng/news/region.php?yyyy=2014&mm=03&dd=26&nav\\_id=89781](http://www.b92.net/eng/news/region.php?yyyy=2014&mm=03&dd=26&nav_id=89781)

<sup>77</sup> Bugajski, Janusz (2015). "Moscow Upholds Frozen Bosnian State," Center for European Policy Analysis, 3 August, 2015.

<sup>78</sup> Ibid.

Russia fully supported a September 25, 2016 referendum on to maintain January 9 as the national day of RS, which celebrates its founding during the war, despite a 2015 Constitutional Court ruling to ban this holiday on the grounds that it discriminates against non-Serbs. Two days before the vote, which was protested by the international community, Dodik met with Russian President Putin in Moscow, where he gave his implicit support for the referendum. More than 55 % of voters turned out for the referendum, and 99 % of them approved the motion. Despite strong popular support, Dodik stepped back from his earlier demand for a second referendum – on independence – for the time being.<sup>79</sup> He has, however, not ruled it out, famously stating that his referendum would not lead to bloodshed.<sup>80</sup>

Based on Dodik's actions, the U.S. Treasury Department's Office of Foreign Asset Control sanctioned him for obstructing the implementation of the Dayton Accords and threatening the territorial integrity and sovereignty of Bosnia and Herzegovina in January 2017.<sup>81</sup> Russia immediately criticized the U.S. decision and firmly backed RS' President.<sup>82</sup>

Since September 2017, President Dodik has also re-activated another referendum, with roots that date back to 2015, to negate the legal powers of the courts and prosecutor of Bosnia and Herzegovina, which would de-facto make RS independent from the interference of Bosnia and Herzegovina, pav-

ing the way for RS's secession.<sup>83</sup> Such a referendum could have had the potential to divert public attention away from a Dodik corruption scandal involving his family's real estate development, which unfolded around that time.

In October 2017, Dodik reiterated his objections to NATO accession<sup>84</sup> and vowed to preserve the country's military neutrality, an objective shared by Russia.<sup>85</sup> RS's Parliament also passed a resolution supporting this neutrality and began a procedure to hold a referendum on joining NATO.<sup>86</sup> In 2015, RS opposed also a start of membership talks with the EU. Dodik described the potential of EU membership the greatest act of treason since the conclusion of the Dayton Accords. In January 2016, Bosnia and Herzegovina submitted a membership application anyway. However, the government has yet to submit a response to the EU accession questionnaire evaluating the country's progress on key issues such as the economy and the rule of law. Without submitting official answers to the European Commission, Bosnia and Herzegovina will not be able to proceed in opening accession talks.

In March 2014, the Russian Orthodox Patriarch gave Dodik an award from the International Fund for the Unity of Orthodox Nations in Moscow several months before parliamentary elections in the entity. During the same visit to Moscow, he reportedly received donations for the same election campaign.<sup>87</sup>

<sup>79</sup> Vecernje Novosti, (2017). "Dodik: I want RS to secede, but without any bloodshed," 13 November, 2017, accessed as reprinted in B92 on 6 December, 2017 at [https://www.b92.net/eng/news/politics.php?yyyy=2017&mm=11&dd=13&nav\\_id=102786](https://www.b92.net/eng/news/politics.php?yyyy=2017&mm=11&dd=13&nav_id=102786)

<sup>80</sup> MacDowall, Andrew. "Bosnia's Serb Republic leader: No breakaway vote next year," Politico, 3 July, 2017.

<sup>81</sup> U.S. Department of Treasury Press Centre – *Treasury Sanctions Republika Srpska Official for Actively Obstructing The Dayton Accords*. 1 January, 2017.

<sup>82</sup> Bugajski, Janusz (2015). "Moscow Upholds Frozen Bosnian State," Center for European Policy Analysis, 3 August, 2015.

<sup>83</sup> Kovacevic, Danijel. "Republika Srpska Postpones State Judiciary Referendum," BIRN, 7 November, 2017.

<sup>84</sup> Dodik has not always been consistent. On occasions, he has also made statements that RS would support NATO accession if backed by a referendum.

<sup>85</sup> TASS (2017). "Bosnia and Herzegovina's Republika Srpska unwilling to join NATO," 26 October, 2017, accessed on 16 November, 2018 at <http://tass.com/world/972744>

<sup>86</sup> Ibid.

<sup>87</sup> Bugajski, Janusz (2015). "Moscow Upholds Frozen Bosnian State," Center for European Policy Analysis, 3 August, 2015.

## Policy Recommendations

In general, the Russian strategy of keeping Bosnia and Herzegovina neutral and blocking integration with the Euro-Atlantic community has been successful. EU talks have stalled, while continued economic stagnation in the country has sapped reforms. The negotiations have not progressed not only because of Russia, but primarily because of the lack of political will among nationalistic political elites to speak with one voice, and the lack of democratic and economic reforms. The lack of an efficient coordination mechanism makes all necessary reforms difficult to implement in practice.

However, Russia has used its economic footprint in key economic sectors to put a dent in efforts to centralize authority over the country's economy. The feuds between the entities' governance of key sectors, such as energy, existed before Russia, but the Kremlin has fueled these divisions to its benefit. To achieve its objectives, Russia has used RS leadership, which stands to directly benefit from increased Russian capital inflows. In an environment of glaring institutional weaknesses in the areas of energy governance, bank supervision, and fiscal prudence, the country, and especially the RS, has become vulnerable to corrosive capital. In the meantime, the Energy Community warned both the state and entity authorities in fall 2017 that Bosnia and Herzegovina could fall under sanctions for non-adoption of the previously-agreed commitment to institute a law on a regulatory body for electric energy and gas, transmission, and the electric energy market, which is a condition of the Energy Community's Third Package.<sup>88</sup> As a result, the country is facing financial penalties and, in the long run, possible removal from the Energy Community. However, the energy sector is by far not the biggest obstacle for the completion of EU talks.

Several key policy recommendations have been identified in the analysis of the economic vulnerabilities created by Russia's economic footprint in Bosnia and Herzegovina:

- Bosnia and Herzegovina must ensure fulfilment of its commitments under the Energy Community.
- Bosnia and Herzegovina should reform the governance structure of its energy sector, so that the natural gas sector is regulated at the level of Bosnia and Herzegovina, in order to avoid duplication of authority and competing energy strategies.
- Bosnia and Herzegovina should commit to a gas strategy for the diversification of its supply sources, so that it can fulfill the EU gas supply security requirement to have at least three sources of supply. In this respect, priority should be given to the completion of the Western Balkan Gas Ring with a link to potential natural gas supplies from the Mediterranean.
- The Council of Ministers should work on reaching a compromise between BH Gas and RS on the construction of only one gas interconnector to Croatia that would supply both entities.
- Bosnia and Herzegovina should implement the EU energy acquis, unbundle power and gas suppliers, and ban the practice of individual gas contracts with Gazprom at the entity level.
- BH Gas and RES should begin talks with Gazprom on a long-term (five-year) contract for the delivery of natural gas to avoid the unpredictability of annual negotiations threatening the security of supply.
- RS's Privatization Agency and the Commission for Protection of Competition should investigate the privatization deal with Zarubezhneft for the acquisition of the biggest oil assets in the country, and should insist on the implementation of the investment clauses in the contract.
- The capacity of the State Investigative and Protection Agency (SIPA) should be boosted to probe money-laundering operations through the banking system, and to identify the ultimate beneficial ownership of investments coming from offshore destinations, which might be used by shell companies for money laundering or other criminal practices.
- The government should centralize and improve banking supervision, including by eliminating the

<sup>88</sup> Balkan Green Energy News (2017). "New Energy Community sanctions for Bosnia and Herzegovina?" 31 October, 2017, accessed on 1 December at <https://balkangreenenergynews.com/new-energy-community-sanctions-bosnia-herzegovina/>

two separate entity's regulators, to establish a single controlling mechanism.

- Bosnia's Central Bank and the two entities' business registries and statistical agencies should expand their data on foreign investment and corporate ownership.
- The government of Bosnia and Herzegovina and the entity governments should significantly improve the transparency of their decision-making, primarily in public budgeting, deficit financing, negotiations of intergovernmental and other international loans and agreements, and energy and banking regulations.
- Policymakers should publish online detailed reports stating their motives for decisions affecting key sectors, such as energy, banking, and telecommunications, which have implications for the entire economy. These reports should be followed by public consultations with civil society and the private sector. Regulatory bodies should take into consideration reasoned opinions submitted by independent experts.