

Russian Economic Footprint and State Capture Risks in Serbia

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Dear Mr. Hand, Dear Guests,

Thank you for the opportunity to appear before the Commission today. Allow me to thank also the Center for International Private Enterprise and the National Endowment for Democracy for their support and the opportunity to present our views here in Washington. We very much appreciate the interest of the Helsinki Commission in issues that are of great importance for the stability and future prosperity of the Balkans.

- Serbia is one of the key countries where Russian influence is most obvious. Since 2008, it has been based on two pillars. First is the issue of Kosovo (Russia is perceived as the main supporter of Serbia in the international arena). Second is the Russian engagement in Serbia's energy sector, which dates back to the South Stream construction deal and the (below price) purchase of the oil industry of Serbia (NIS).
- Furthermore, following particularly the global economic downturn and 2014 Ukraine crisis, the Russian influence has spilled over to the other key economic sectors, such as the financial sector and infrastructure (railways). The economic engagement, high-level political visits, and strengthened cultural and religious ties mutually reinforce each other.
- While most research has focused on the outright political influence, it often disregards the sophisticated networks in nations economies that exploit and exacerbate the democratic deficits in Serbia and throughout the Western Balkans.
- Despite the fact that the South Stream was discarded, Russia still dominates Serbia's oil and gas sector. Through NIS, Russia almost completely runs oil production, refining, and retail. Next, Serbia imports more than 70 percent of its crude oil consumption and close to 65 percent of its natural gas needs from Russia. What's more, Russia is the only importer of gas to Serbia and it favors inflexible long-term deals. Through those deals, it has gained control over a state-owned wholesale gas supplier, Srbijagas, which has, as a result, accumulated debt effecting Serbia's financial health. Srbijagas, the state-controlled Serbian company, holds a dominant position on the national gas market. An intermediary (Yugorosgas), which is owned by Gazprom, receives around a 4 percent premium on the

¹ These findings are part of the project implemented by the Center for Study of Democracy, Sofia, Bulgaria, and a group of Balkan experts. The findings and opinions expressed are those of the CSD and experts and do not necessarily reflect the views of experts' employers.

gas it resells to Srbijagas. Besides Srbijagas, Russians generally do a lot of business with state-owned companies and those with close connections to politics. That is why the country needs to advance the reform of its public administration as soon as possible. Gas diversification is long-overdue. Furthermore, steps are needed to tackle the restructuring and privatization of Serbia's enterprises. Based on our analysis, lowering the budget deficit and reducing the high public debt level, including debt generated by companies of strategic importance also remain a challenge.

- With regard to the private sector, Russians fully or partially own approximately 1,000 companies in Serbia. They control revenues of close to EUR 5 billion, or 13 percent of the total revenue generated by the country's economy. Russian companies are also amongst the major employers in the country, directly employing approximately two percent of the total labor force and indirectly employing around 5 percent. What is important is that such employment is concentrated in just a few industrial enterprises.
- Export to Russia have become an important aspect of the economic relationships between Russia and Serbia, particularly following the expansion of the free trade agreement (in 2009 and 2011). Russia's 2014 embargo on the imports of EU agricultural and food products has provided a boost to exports in non-EU countries in the Western Balkans. Nowadays, Serbia's export to Russia is the highest by volume in the Southeastern European region after Greece.
- Russian foreign direct investment (FDI) remained relatively small, amounting to 4 percent of all FDI stocks in Serbia according to date available for the period from 2005 to 2016. Should we account also for investment flowing from third states but still attributable to Russians along with their reinvestment from profit (the total Russian FD) would be around USD 2 billion, or 6 percent of the country's GDP.
- During Serbia's fiscal crisis, Russia further deepened its engagement with the Serbian economy by adding loans to the array of other tools deployed to promote its interests. Some of these loans reportedly stipulated less favorable conditions than those of the international economic institutions and even granted preferential status to Russian state-owned contractors for the infrastructure modernization projects. While Russia's presence in the finance sector is somewhat limited (through three banks that occupy a small portion of the market), borrowing loans from Russian banks may involve risks as shown by recent Agrokor crisis. Relying heavily on bank loans, this retail has recently expanded into almost all countries of the Western Balkan, including Serbia. In early 2017, not only Agrokor employed some 60,000 people throughout the region but also accumulated debt totaling around USD 6.4 billion or six times its equity. Sberbank owns around 18 percent of it. Despite the debt, Agrokor remained relatively stable until a statement of Russian Ambassador to Croatia sent shockwaves through the market. Again, in Russia's mind, the economic engagement and other tools mutually reinforce each other. Russia attempts to wield influence also through initiatives in the spheres of media, culture, church, non-profits, and academia. It provides support, including financial, to organizations, groups, and individuals that promote Russian interests in foreign countries, including in Serbia. In Serbia, Russia has supported development of several media enterprises and information initiatives of major Russian media outlets. For example, the

state-owned news agency Sputnik opened its regional editorial office in Belgrade in 2015. They seek to disorient the local audience by offering narratives that exploit Serbia's weak spots in and promote the Russian interests.

To conclude, I would like to stress that all relevant actors, whether Serbian, regional or international, need to recognize the potential costs of the inflow of corrosive capital the region is facing. They should press for real democratic progress, which is the real key to regional security, long-term stability, inclusive growth, and countering malign foreign influence. Based on the analysis I conducted together with a Research Director of ISAC Fund Igor Novaković and in addition to the regional report presented by the Center for Study of Democracy we would like to make the following country-specific recommendations:

- Serbia should ensure that infrastructure projects funded by foreign governments are not exempt from the EU's and national laws on public procurement and transparency and are in accordance with relevant international rules. Hence, Serbia's energy infrastructure projects should follow the country's obligations on the European level, including in the areas of ownership of gas transmission, supply, and production.
- Serbia should explore its the possibility of completing its natural gas interconnections with Bulgaria and Croatia to allow for diversification of the gas supply.
- Commission for Protection of Competition should prevent the concentration of ownership in strategic sectors such as the oil and gas sector and monitor possible market collusion that hinder competition and lead to monopoly.
- There needs to be a clear separation of the management of state-owned energy companies and politics. Government's nominations of professional management should be considered by the parliament to ensure its independence from external pressure.
- Serbia should ensure that the sale of distressed companies and assets is transparent and should be careful about potential concentration of capital in the hands of a small number of politically-connected businesses.
- Media and communications regulators, the Republic Broadcasting Agency and the Republic Telecommunications Agency, should investigate ultimate beneficial ownership of media and alert counterintelligence in cases of foreign covert operations involving disinformation campaigns in the country.
- Finally, the media should play a critical role in objectively informing (even educating) the public about how strategic economic sectors, such as energy, function to debunk existing misconceptions and expose those decisions that harm Serbia's public interest. In this respect, the government should ensure that media outlets operate in a safe environment and are granted full access to public data and information.