Policy Analysis

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Russian Economy and possible implications for the Western Balkans (With focus on Bosnia and Herzegovina)

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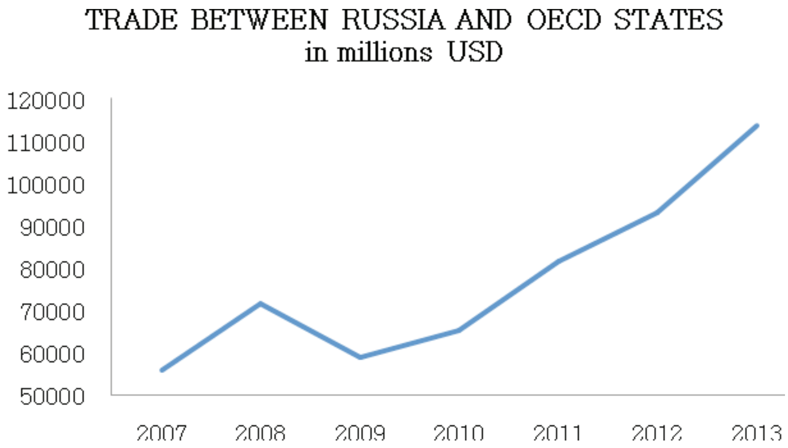
Russian Economy and possible implications for the Western Balkans

(With focus on Bosnia and Herzegovina)

1. Introduction

For long after the fall of the Soviet Union it was believed that Russia[1] wanted to become (or rather remain) a full member of the global political and economic order. This involved participating in the lengthy process of trade liberalisation and active political cooperation with the West, observing borders of its neighbours, as well as engaging in international multilateral forums. That such approach was not a mere wish on the part of the liberals and Western officials is also illustrated by the fact that Russia's trade (both exports and imports) with developed countries has doubled over the past nine years and that Russia was accepted into the World Trade Organisation (WTO) in 2012. For a long number of years Russia was undergoing the process of integration into the global political and economic order led by the United States and the European Union.



Graph 1: Source – Central Bank of Russia

However, in 2008 with the war in Georgia, the Russian authorities announced its unwillingness to accept expansion of NATO alliance into what has traditionally been its interest zone. The annexation of Crimea in March 2014 and escalation of conflict in Ukraine fully laid out in the open the new Russian paradigm of relations with the rest of the world, which appears to have been under preparation behind the scenes of Kremlin for quite some time.

According to political expert Igor Jurgens,[2] in mid 2011 Russian President Vladimir Putin made a strong decision to launch into the "putting the Western liberal project out". There are two aspects to this change of direction: fist one is political – currently manifested through confrontational attitude towards the West, authoritative internal structure (parallels could be drawn with Turkey, Hungary, India and China) and strengthening of Russia's position in it traditional spheres of interest; second aspect is represented

1 Russian Federation (RF).

2 Lipman, 2015 and Lipski, 2014.

by cooling of relations in terms of economy, which emerged after developments in Ukraine and got more serious implications at the moment when the EU and US introduced sanctions on Russia.

Over the past year it proved that it was easier to enter into political confrontation (although without clearly sustainable alternative) than to actually break off economic relations with the West. Despite obvious efforts to establish economic relations with other developing countries (such as China, Brazil, and India), Russian economy in near future will still remain linked to the EU and the West, regardless of the worsening political relations. Such state of affairs brings into question future position of Russia in the Balkans. It is impossible to view its position independently of the Russian internal political turmoil and the Balkans' EU path. On one hand, RF has had significant presence in the Balkans' energy sector, with mutual fostering of historical and symbolic relations; on the other, there is an obvious decrease in economic activity and problems encountered by the Russian economy in 2014. This analysis aims to dispel two myths: the first - that Russian influence and presence in the Western Balkans (primarily in Bosnia and Herzegovina) are monolithic and second based on the assumption that recent sanctions and drop in oil prices constitute insurmountable obstacle for the Russian economy. What is true danger to Russian's positioning globally was there even before escalation of the crisis in Ukraine, and this is represented by long term lack of diversification in Russia's economy.

The first part of the analysis will deal with Russian economic interests in Bosnia and Herzegovina (BiH), primarily focused on the energy sector – more specifically the petrochemical industry. Some of the issues that will be addressed include: quality and impact of Russian investments in BiH and the rest of the Western Balkans; and the relationship between Russia's economic influence and EU influences? The second part of the analysis will focus on the current crisis in Russia, caused directly by Western sanctions and the drop in oil prices at the international market. Several macroeconomic aspects need to be considered to create a genuine picture of the current state and future development of the Russian economy.

After looking into Russian investments in BiH and the rest of the region, the analysis will also look at their political potential and possible long term implications for the BiH's EU path. At the moment, there seems to be likelihood of rifts being created within the EU (Hungary, Greece, Cyprus, etc.), with Russian authorities trying to turn this into their favour. These different positions among the EU member states regarding sanctions are likely to emerge in June 2015, when consensus of all member states will be required to prolong the sanctions. Hence the question: if the only danger in Russian investments entering the Balkans energy sector is linked to this so-called *Trojan horse*[3] theory, does this constitute a threat for the European political elites only or there is also some danger in there lurking the Balkans actors themselves?

2. Russia in BiH – from energy to synergy

Russia's relations with the Western Balkans rests upon three pillars: political, economic and cultural. According to business results of Russian companies and their investments in BiH so far, one could conclude that the purpose of economic and cultural pillars is to obtain greater political influence. Further in this analysis, however, we will try to examine deep-rooted notion that Russian economic presence in BiH serves as a direct lever of power for implementing Russian interests in BiH, Western Balkans and the EU. Although Russia is undoubtedly interested in achieving this, the facts at the moment point to the conclusion that its influence in the Western Balkans is not monolithic and that three pillars of Russia's relations with the Western Balkans, viewed in connection to the recent developments in Ukraine and annexation of the Crimea, are often blown out of the proportion. It is important to stress that critical review of Russia's economic and political influence in BiH and the Western Balkans does not imply disregarding negative scenarios for development of these relations.

3 In this context term '*Trojan horse*' refers to states which could potentially act to protect Russian interests in the EU, which is the role that some of the Balkans states could assume after their successful accession to the EU.

Oil industry

Russian investments in BiH are primarily focused on Republika Srpska (RS), and its petrochemical industry. Russia has invested some EUR 343 million over past 19 years, which makes it fifth largest investor in BiH.[4] Out of this amount the acquisition of the *Republika Srpska Oil Industry* (with *Oil Refinery* in Bosanski Brod, *Oil Refinery* in Modriča and *Petrol* from Banja Luka) got the most media attention. In 2007, it was bought for EUR 120 million by a Russian company *Zarubezhneft* in cooperation with *Vnesheconombank* as an investor. These two companies appointed *NjefteGazInkor*, a company unknown up until that point, to sign the agreement on sale of shares on their behalf. RS Government changed the *Law on privatisation* prior to the sale of company so that the agreement could be implemented directly – without tendering procedure.

Provisions of the annex to the above mentioned agreement on privatisation also provide for the Russian company to have monopoly to all oil resources in almost one half of the territory of BiH, as well as the right to build terminal for oil derivatives in port Ploče, and the *Adriatic Oil Pipeline Terminal* (JANAF d.d. – former *Jugoslav Oil Pipeline* – JUNA), if RS is granted ownership share in that company as part of the succession procedure.[5] The latter item in the agreement and commitment accepted by the RS Government remain disputable in view of the fact that Croatian side does not see *JANAF d.d.* as subject to succession arrangements.

Ownership structure of *NjefteGazInkor*, which is in possession of some 80% share of the *Bosanski Brod* Oil Refinery (the remaining 20% is held by small share owners),[6] is also not entirely clear. Russian state company *Zarubezhneft* owns 40% of *NjefteGazInkor*, while the remaining three private persons in ownership of 60% of shares are not known to the public (namely companies *Invest-tehnologije d.o.o. Moscow*, *Nepata d.o.o. Moscow* and *Junik Development d.o.o. Moscow*, owned by unknown natural persons, have 20% of shares).

Thus, agreement on sale and the ownership structure of the former *Republika Srpska Oil Industry* (NIRS) have not been entirely transparent after the privatisation, which however from the geopolitical perspective should not constitute an obstacle for projecting Russian political influence in BiH. Therefore the following question emerges – what economic pull can investors use in the interest of their countries? In the foreign investments context, potential levers of power largely depend on the type of investment: whether it is *greenfield, brownfield, porftolio* investment or possibly a loan. In any case, basic factors which are important for the receiving state include direct and indirect taxes used to fill the public budget, additional investments into expanding capacities and the number of new workers. If these aspects of a foreign company's business are well developed, changes in business policy of the investor could lead to significant problems, which host states very often try to avoid. One such example would be the privatisation of *Serbia Oil Industry* (NIS), with 51% of its shares bought by Russian *Gazprom* in 2009. Thus due to collection of taxes form petrol and other derivatives sold by NIS as much as 25% of the Republic of Serbia's budget was indirectly under *Gazprom* control.[7] This fact surely influenced state level policies between the two countries.

When it comes to privatisation of *Oil Refinery Brod* none of the listed items can be described as satisfactory in terms of the interests of BiH (or RS), even eight years after the privatisation was completed. The *Oil Refinery Brod* has been accumulating losses for a several years now. According to BiH Indirect Taxation Authority, in 2014 revenues from taxes on oil derivatives and road toll in BiH amounted to BAM 295.2 million, currently distributed to the entity budgets in the following ratio: 31.9% to RS and 64.65% to FBiH. Only a part of BAM 91 million collected from charging excises in RS originates from privatised NIRS' trade in derivatives.

4 Al Jazeera Balkans, 2015.

5 Transparency International BiH, 2009.

6 Brod Oil Rafinery, 2010.

7 Reljić, 2009.

Outstanding taxes in the amount of BAM 133 million, which the new Russian owner agreed to pay in the agreement, have still not been collected in full.[8] According to RS Tax Authority, following extension of grace period for payment of its debts, the Refinery has paid BAM 30 million out of the overall amount in 2014.[9] According to *Transparency International BiH,* [10] the NIRS was to pay off its debts to the RS Government in two tranches of a loan secured by its new owner *NjefteGazInkor* in the amounts of EUR 72.5 million and EUR 40 million, with 12% interest rate (total loan repayment amounts to EUR 144.6 million). Namely, the loans were provided by the Russian *Vnesheconombank* to the *NjefteGazInkor* with low interest rates, in view of the fact that it used the *Russian Development Bank* funds. According to economic analyst Siniša Božić, the final calculation regarding NIRS sale for the RS Government is as follows: some BAM 230 million were charged, but more than BAM 215 million were paid from the budget and escrow privatisation account to cover Refinery's liabilities,[11] – i.e. the balance amounts to BAM 15 million.

In addition, the Refinery has not been very successful in its business over the past eight years. A modest portion at the market, undeveloped sales and distribution network, low volume of raw materials processing and low margins are some of the main reasons behind losses generated by the *Oil Refinery Brod*. According to the report of the audit company *Deloitte* in BiH, accumulated loss of the *Oil Refinery Brod* reached EUR 232 million by 2013, while its debts were ten times higher than value of its core capital.[12] The same report also identified that the ability of the Refinery to continue with its business activities fully depends on the continuous financial support by the mother company *NjefteGazInkor*. If you add to this the fact that *Zarubezhneft* has decided to cut down number of workers (currently there are 1,236 workers with an average salary of BAM 900),[13] it is obvious that Russian levers of economic power are surely limited, even in the otherwise very profitable petrochemical sector.

Furthermore, *Optima Group*, private limited company (Ltd.), was established after NIRS privatisation, with core capital in the amount of BAM 50,000 and exempt from the obligation to conduct financial reports audit, to manage shareholder associations set up as part of former NIRS. *NjefteGazInkor* is the sole owner of *Optima Group* and according to available financial reports this company conducts all lucrative NIRS business, such as procurement of raw materials (raw oil and similar), and controls sales of all final products in the three companies which used make up NIRS. This allows the private limited company owned by *NjefteGazInkora* to get huge income, which in 2014 amounted to some EUR 630 million.[14] According to RS Association of Economists SWOT, although business activity of *Optima Group* is profitable, it is not money-making.[15]

The future of Russian privatised NIRS remains unclear, but one of the potential scenarios would greatly strengthen Russia's position in BiH economy. Namely, since NIS (owned by *Gazprom*) bought a network of 22 petrol stations from OMV in BiH, and in view of the fact that distribution network of the oil refineries *Brod* and *Modriča* is actually their biggest weakness, many deem that *Gazprom* taking over NIRS would be logical, although little likely, next step.[16] This would have twofold effect: *downstream* part of NIRS chain would be made complete and thus its portion of the market increased. At the same time, this would open up space for possible vertical and horizontal integration of *NIS* and *NIRS* via *Gazprom* as their joint owner. In such hypothetical structure Russian economic and political influence would increase significantly not only in BiH, but throughout the Western Balkans.

8 Božić, 2011.

9 Maksimović, 2015.

10 Transparency International BiH, 2009.

11 Božić, 2011.

12 *Poslovni dnevnik*, 2015.

13 Maksimović, 2015.

14 *Capital.ba*, 2014.

15 Association of Economists RS SWOT, 2014.

16 *Energetika-net*, 2013.

Conclusion. Although coming from generally profitable sector, NIRS privatisation did not yield significant results in terms of RS economy as yet. Moreover, non-transparent ownership structure, fragile business operations of the oil refinery, failure to pay its liabilities to the state, and insufficient additional investments indicate that Russian investors have not been trying to create vital and sustainable business model, but get as much short term business gains as possible.

Coal, water and electrical power

There are two other projects in BiH energy sector announced a while ago as part of Russian apparent economic penetration into this country. One is construction of the coal-fired power plant *Ugljevik 3* with the associated coal pits and the other construction of hydroelectric power plant *Mrsovo* on River Lim. Further on this analysis will seek to demonstrate that there are many more reasons for these projects to be viewed through the prism of private interests of the Russian investor Rašid Sardarov and his company *Comsar Energy Limited*, registered in Cyprus, rather than as strategic expansion of the Russian state economic interests in BiH.

Developments that preceded announcement of these investments have indicated that they are of *ad hoc* nature. Initial negotiations on investments into *Mine and Coal-fired Power Plant* (RiTE) *Ugljevik 3* and its associated coal pit started after agreement with Czech ČEZ on investment into *Coal-fired Power Plant Gacko* was terminated. In 2011, RS Government received a letter of intent from Sardarov's company *Comsar Energy Limited* requesting concessions for coal exploitation, as well as construction and usage of two new blocks in Ugljevik that would build upon the existing infrastructure of the public coal-fired power plant.[17] Immediately after sending the letter of intent a joint company *Comsar Energy RS* (CESR) was established, with Russian investor owning 90%, with BAM 10.5 million invested, and RiTE *Ugljevik* 10%. In 2013, *Comsar Energy Limited* invested additional BAM 53 million, thus reducing stake of the public coal-fired power plant in the joint company to some 1.8%; but maintain its right to 10% share in profit.

In an effort to compensate for lost investor for the coal-fired power plant *Gacko*, RS authorities gave relatively quickly concessions to CESR for exploitation of 50 million tons of coal from the *Ugljevik Istok 2* deposit location and research at additional two deposit locations – *Baljak* and *Delići* and *Peljave-Tobut*. In addition, concession was given for construction of coal-fired power plant *Ugljevik 3* and its use for a period of 30 years, and the analysis indicates that sale of power will pay off for the investment in 10 to 11 years with forecasted annual earnings of BAM 81 million.[18] According to RS Ministry of Industry, Energy and Mining, the investor has so far paid BAM 7.5 million in concession fees, and for the duration of concession period RS Government annual revenue will amount to 3.2% of the concession business operations, which is estimated at about BAM 3.8 million.[19] Although the Russian investor also signed construction agreement with Chinese company *China Power Engineering Consulting Group Co.* (CPECC), the works on construction of coal-fired power plant *Ugljevik 3*, estimated by Chinese contractor at about 600 million BAM,[20] was postponed several times already. Currently, it is expected that the works will start in 2016.

Situation with construction of hydroelectric power plant *Mrsovo* on River Lim is similar. In mid 2012, Russian businessman Rašid Saradarov was announced as an investor, but there are several elements in this case which indicate that this is rather a lucrative private investment than a part of synchronised policy of Russian economic domination in BiH. Namely, plans for construction of hydroelectric power plant *Mrsovo* were previously developed by *Elektroprivreda RS* (EPRS), but the project became profitable only after Serbia, RS and Italy signed an agreement on sale of electrical power from renewable sources. In the agreement, Italy agreed to buy electrical power from renewable sources at the price almost four times higher than the market one, thus reflecting the need for greater investment in this technology. At that point, despite the fact that EPRS developed feasibility study on construction of hydroelectric power plant *Mrsovo*, the concession was awarded to *Comsar Energy Hydro,* which by the end of 2014

17 Centre for Investigative Reporting, 2015., p. 17.

18 Ibid., p. 19.

19 Ibid., p. 19.

20 *Klix.ba*, 2014.

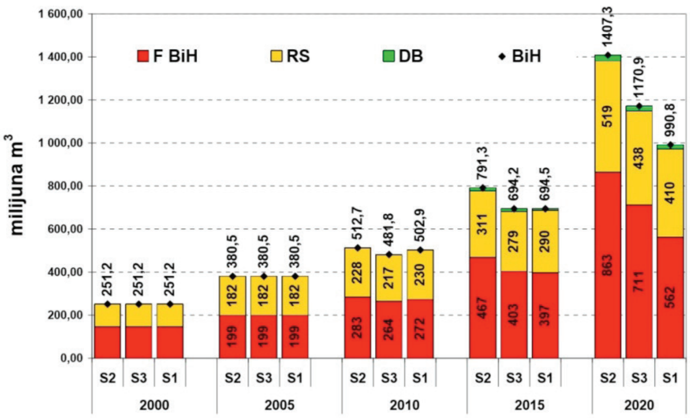
transferred into ownership of the *Comsar Hydro Holding Limited* from Cyprus.

The concessionaire then paid one-off fee in the amount of BAM 123,750 and agreed to payment of 2.6% of annual revenues from sales of electrical power. If the electrical power is to be sold in Italy at the agreed price of EUR 155 per megawatt hour, the hydroelectric power plant will be earning some BAM 40 million per year, with RS getting some BAM 1 million in fees.[21] The works on both these projects have not started as yet.

Conclusion. In this case the projects have not started yet and it is very difficult to judge their potential impact. Based on preparations and steps undertaken so far, their profitability for RS could become questionable. If the investor were to modernise and expand production, these two power plants would become more important; however it remains questionable to which extent they would be used as Russian levers of power in BiH.

Unpredictable natural gas inflow

Another important pull of Russian influence in BiH, as well as the Western Balkans, is the import of natural gas. BiH, the same as the rest of the region has no sources of its own, so it fully depends on the import of natural gas from Russia, coming through Ukraine, Hungary and Serbia. Before the war natural gas was basic energy source for majority of industry in BiH and level of its demand was reaching one billion cubic meters annually.[22] Current demand in BiH, mostly driven by households, is at a relatively low level of 500 million cubic meters annually. The report 'Energy Sector *Study BiH*'[23] has forecasted significant increase in natural gas consumption (see graph bellow), which makes the crisis brought about by suspension of natural gas supply from Russia in January 2009 very important lesson learned for the countries in the Western Balkans area.



Graph 2: Forecast of natural gas consumption in BiH – Source ESSBiH

However, it is important to stress that suspension of the natural gas supply, which would mostly affect citizens in BiH, could hardly be directed only at BiH or any other individual state in the Western Balkans. The reason for this is that natural gas pipeline goes though several states all of which would suffer damages should the sanctions be repeated. This means that Russia's power to repeat 2009 scenario has been limited, and in case it does decide to make such a move, it would have to take into consideration a series of limiting factors. A simple cost-benefit analysis of such policy would likely indicate that such move would pay off politically only if Russia were to suspend natural gas delivery to all Western Balkans states, including Hungary and Ukraine. In economic terms, any sanctions would have significant negative impact on Russian budget revenues.

21 Centre for Investigative Reporting, 2014.

22 Democratization Policy Council, 2014.

23 Energy Institute Hrvoje Požar, Soluziona, Economics Institute BL, Mining Institute Tuzla, 2008, p. VII.

The smell of Ruble in the Balkans

In 2013, Russian investments seriously entered banking sector in the Western Balkans for the first time, when the largest commercial bank in Russia – *Sberbank* group, with state as its majority owner, took over *Volksbank International AG* for EUR 505 million. It is currently present in 11 markets of Central and Eastern Europe, with 282 offices, 77,000 business and 566,000 individual clients. In BiH, this group's business operations include a total of 30 offices, 1,090 business and over 100,000 individual clients and 420 employees.[24]

In this case, reasons behind spread of the Russian capital in the Balkans are mostly immediate objective circumstances and pure economic interest. Namely, acquisition of *Volksbank International AG* occurred in the period of eurozone crisis, with *Sberbank* executive director German Graf stating that expansion of the *Sberbank* into the Balkans, Central Europe and Turkey would not be possible without crisis in the eurozone.[25] Soon after the acquisition, the Russian bank identified irregularities and discrepancies in the reported business operations results of the *Volksbank International AG* which prompted them to announce taking legal action.[26]

In view of the above mentioned parameters, the importance of this Russian acquisition for BiH is primarily reflected in its contribution to creating jobs and revenues collected from taxes by the entity budgets, since the acquisition of an Austrian bank itself together with its business premises in BiH does not represent direct investment into our country.

Based on the previous experience with Austrian and Italian banks, an increase in economic activities of the Russian companies in the region may be expect after arrival of the Russian banks. Certain influence could also potentially be projected through loans to natural and legal persons in BiH, in view of the fact that mother company *Sberbank* has also been put on the list of US sanctions, so that as of September 2014 it can only get short term borrowing at the US financial market.[27] This could cause problems with financing of the mother company *Sberbank*, and also reflect on its subsidiaries in Europe.

As a result of economic crisis caused by sanctions and drop in oil prices, at the end of 2014 Russian *Sberbank* felt increased outflow of capital due to fear from accounts freezing.[28] The response of the *Central Bank of Russia* to the economic crisis in second half of 2014 was met with harsh criticism by executive director of the mother company *Sberbank* German Graf. According to Graf, *Central Bank of Russia* measures, which saw injecting liquidity into Russian banks through buying from them non-marketable securities at relatively high interest rate, will lead to financial crisis.[29] In addition, Graf deems that such move by the Russian Government will result in state having greater stake in the Russian banks, which will be buying industrial companies and thus increasingly transforming themselves into financial and industrial complexes.[30] *Sberbank* obviously intends to expand into Western Europe as soon as economic growth kick starts, and will use its business operations in the Western Balkans and Central European states as the basis for this expansion.

Recently we have witnessed activation of Russian resources globally in an effort to try to reduce or neutralise influence of the International Monetary Fund (IMF) and World Bank (WB), together with other developing countries. Thus Russia, together with Brazil, China, India and South African Republic established so-called *New Development Bank* (also known as BRICS Development Bank) in mid 2014, with the initial capital of USD 50 billion and prospects of increasing it to USD 100 billion. At the end of March 2015, Russia also became one of the founders of the Asian Investment and Infrastructure Bank (AIIB) initiated by China.

24 Sberbank, 2014.

25 Financial Times, 2012.

26 Financial Times, 2013.

27 BBC, 2014.

28 Golubkova et al., 2014.

29 The Moscow Times, 2015.

30 Ibid.

In BiH context, RS Government announced in April 2014 approval of the Russian commercial loan in the amount of EUR 70 million, to be followed by additional loan in the amount of EUR 200 million aimed at stabilising RS budget.[31] According to RS officials, the purpose of this loan was to replace the IMF arrangement. However, after IMF delegation's visit to BiH in May 2014 and its announcement that agreement was reached with both entity governments regarding reforms required for approval of the loan tranche in the amount of EUR 190 million, the Russian loan left the focus and has not been implemented so far.[32]

Conclusion. *Sberbank* in BiH and the region currently does not have very influential position in economic and political terms. On one hand, international sanctions have been identified as a threat to the *Sberbank's* business operations, which could reflect on its position in the Western Balkans. On the other hand, there is a clear plan of expansion of its business in the area of Western Balkans, as well as Western Europe. Increase in number of loans, both to businesses and individuals, has in any case increased the influence of *Sberbank* in this area.

At the time when Russian banks have been encountering financial difficulties due to sanctions and drop in the value of Russian ruble, it is unrealistic to expect strong engagement regarding loans to public spending in the Western Balkans states. Russian economy, however, as we will see further in this analysis, has good chances to recover from the current financial crisis, therefore chances for its renewed engagement as part of an effort to replace IMF role are also strong.

Vetoing political influence

Due to its role in the Steering Board of the Peace Implementation Council (PIC) and Security Council, Russia in addition to economic have also certain political influence in BiH and the region. While representatives of the United States in BiH advocate for Office of the High Representative (OHR) to continue, EU does not have a unified position regarding this issue and Russia has requested for OHR to be abolished and often uses its role in PIC to stress that BiH should also have another perspective in addition to the EU one.[33] In the last communiqué of the PIC Steering Board issued in December 2014, Russian representative opposed the section expressing support to Euro-Atlantic integrations of BiH,[34] while the previous communiqué was in full opposed by Russia.

Another important aspect of Russia's political influence in the Western Balkans is its full membership at the UN Security Council. This fact has been particularly important for Serbia, due to unilateral declaration of Kosovo's independence. However, Russia could still not prevent military intervention by NATO forces in 1999 in SR Yugoslavia, due to war in Kosovo. In terms of BiH, Russian membership at the UN Security Council has reflected in the influence it has over extension of European military forces in BiH – *EUFOR/Althea*. Namely, at the peak of the crisis in Ukraine, Russia for the first time abstained from voting for extension of the EUFOR mandate, noting that it was "unacceptable for BiH to be pushed in the direction of the EU".[35] This has indicated increasing politicisation of the Russian role in BiH.

According to Dušan Reljić, it is disputable "whether BiH will be able to sustain stability without presence of the external military forces and without outside political influencing".[36] However, *EUFOR/Althea* mission at the moment has 600 soldiers primarily focused on training the BiH Armed Forces, supporting demining activities and weapons control. Thus *EUFOR/Althea* mission presence is rather of psychological nature, since it is very unlikely at the moment that any inter-ethnic military conflict could break out in BiH.[37]

31 *Capital.ba*, 2014.

32 Democratization Policy Council, 2014., p. 11.

33 Radio Free Europe, 2014.

34 Office of the High Representative - OHR, 2014.

35 DW, 2014.

36 Reljić, 2009., p. 37.

37 EUFOR/Althea website, 2015.

3. *Russia in the region – the story of Masha and the Bear*

A combination of political, economic and cultural aspects makes the Russian influence on the Western Balkans appear monolithic. However, upon closer inspection, it becomes clear that the Russian presence in the region is not monolithic and that it differs from country to country. In addition to geographic fluctuations, differences are also evident in the structure of this presence. So in some countries the economic factor is more prominent, while cultural and political factors prevail in others. In order to gain a clear insight into this matter, Russian presence in the Western Balkans must be viewed in the context of relations with the European Union. Several facts point to asymmetric positions of Russia and the EU: trade volumes between the six countries of the Western Balkans and Russia are on average 13 times smaller than those with the European Union (4.9% against 66.2% of the total trade volume). Exports from Western Balkans countries to Russia on average do not exceed 0.8% of total exports, while exports to the EU represent around 15.8%.

Country	Export into Russia (% of total country export)	Export into EU (% of total country export)
Albania	0.4	8.0
Bosnia and Herzegovina	0.3	21.7
Montenegro	0.1	3.8
Croatia	0.7	12.2
Macedonia	0.7	27.4
Serbia	2.5	21.9

Table 1: Exports from Western Balkans countries to Russia and the EU
Source: EIU, taken from the LSE-SEESOX Conference Report Russia in the Balkans [38]

Country	Trade with Russia (% of total trade)	Trade with the EU (% of total trade)
Albania	2.0	60.4
Bosnia and Herzegovina	6.3	84.1
Montenegro	0.4	55.3
Croatia	5.7	63.3
Macedonia	0.9	71.8
Serbia	8.5	62.4

Table 2: Trade between Western Balkans countries and Russia and the EU
Source: EIU, taken from the LSE-SEESOX Conference Report Russia in the Balkans [39]

Russian position in **Serbia** by all means seems to be the most stable one, in the economic as well as the political and cultural/historical sense. There are several key aspects of cooperation between Russia and Serbia – privatisation of *Naftna industrija Srbije,* Russian support in the UN Security Council, agreement on construction of the *South Stream* (*Turkish Stream*), the *Free Trade Agreement* and the recently approved loan for modernisation of Serbian railways, as well as considerable historical and cultural ties.

In the political sense, Serbia primarily needs support from a permanent member of the UN Security Council with regard to its territorial integrity, i.e. independence of Kosovo. Although the Russian veto did not succeed in preventing the military intervention by NATO forces in 1999, its role in the Security Council did ensure that "Kosovo's new status remains questionable, not just politically but also in terms of international law".[40]

38 LSEE Research on SEE, SEESOX, 2015., p. 9.

39 Ibid., p. 9.

40 Reljić, 2009., p. 6.

In 2009, Russian *Gazprom* privatised *Naftna industrija Srbije* (NIS), which currently accounts for approximately 17% of GDP and indirectly accounts for one quarter of the Serbian budget. [41] According to expert estimates, the price of EUR 400 million that was paid for 51% of NIS shares was low at the time[42] but it was implicitly tied to an agreement on construction of the *South Stream* gas pipeline through Serbian territory. Even though in itself the investment in NIS, together with additional reinvestments in refineries, gave Russia significant economic leverage in Serbia, the plan to construct the *South Stream*, while it lasted, acted as a multiplier of this influence. Later in the analysis we will discuss the termination of the *South Stream* project and its possible revival in an altered form.

An illustrative example of the theory that the Russian position is significantly weaker than that of the EU - even in Serbia - is presented in Table 2, which shows that even with the *Free Trade Agreement* the percentage of exports from Serbia to Russia remains several times lower than exports to the EU. One of the reasons is the fact that the Russian Duma has still not ratified this agreement, which leaves a number of products still subject to import tariffs.[43] This is the reason why the export of 10 000 *Fiat 500L* vehicles manufactured in Serbia was again delayed mid-April 2015.[44]

Russia's position in Serbia was still strong enough for Serbia to refuse to impose sanctions on Russia during the Ukrainian crisis in 2014, justified by a statement that its official foreign policy implies open relations with both the European Union and Russia. This policy is met with increasing disapproval by EU officials, with some allusions that Serbia will have to choose between these two sides on its path towards the Union.[45]

On the other hand, **Montenegro**, with approximately one third of its registered companies under Russian ownership, imposed sanctions on Russia last year and has greatly diverged from Russia over the recent years. The presence of some 30,000 small and medium Russian investors in tourism and real estate sectors is notable as in 2008 there was a sudden increase in Russian investment in hotels on the Montenegro coast. [46] A good illustration of cooling-off of Russian/Montenegrin relations in the economic domain, also reflecting on politics, is the privatisation and subsequent demise of *Kombinat alumijinum Podgorica* (KAP). KAP was privatised in 2005 for EUR 45 million (plus an additional 50 million in promised investments) by the Russian company *Salomon Enterprises Limited* (later CEAC), fully owned by *En+ Group*. KAP performed very poorly over the last 10 years, leading to bankruptcy in 2009 when the Government of Montenegro effectively expropriated KAP's assets. Pursuant to the 2013 tender for sale of KAP's assets, mid-2014 *Uniprom d.o.o.* from Nikšić bought KAP for EUR 28 million and reduced the number of employees from 730 to 300. The former owner of KAP, En+ Group owned by Oleg Deripaska, initiated an international arbitrage for the above situation, claiming EUR 700 million in damages.[47]

Montenegro representatives are adamant in their efforts to join the NATO as soon as possible. This decision provoked harsh criticism from Moscow, which considers the Montenegrin path towards NATO and calls for quick membership to be hostile towards Russia.[48] Although Montenegro was expected to be invited to join in September 2014, this was delayed due to, according to informal sources, Russian involvement in the intelligence structures in Montenegro. Although the membership invitation is now expected in 2015, the problems may lie even deeper. After the ceasefire agreement in Minsk, NATO members do not seem to be in agreement with regard to enlargement. After the negotiations in Minsk, the French president Francois Hollande stated that France currently refuses any new memberships in the Alliance.[49] Other members such as Turkey, Croatia and Bulgaria insist on enlargement in 2016. In

41 Ibid., p. 29.

42 LSEE Research on SEE, SEESOX, 2015., p. 9.

43 LSEE Research on SEE, SEESOX, 2015., p. 8.

44 Sputnik Serbia, 2015.

45 BalkanInsight, 2014.

46 Reljić, 2009., p. 23.

47 Al Jazeera Balkans, 2014.

48 Jakšić, 2015.

49 Kaminski, 2015.

any case, after imposing sanctions on Russia and seriously undermining economic relations with this country, Montenegro is not left with many options for the foreseeable future - other than continuing to strive towards joining the NATO.

The Russian presence in **Croatia** is much weaker than in other countries of the Western Balkans. Trade exchange with Russia accounts for approximately 5.7% of its total trade, at a level similar to that of BiH and Serbia. Relations exist in many spheres, however without deeper economic integration. So, according to the Croatian National Bank (HNB) data, from 1995 to 2014 Russia invested only EUR 93.2 million in Croatia,[50] which is the lowest investment in the region. An illustrative example of the distanced attitude towards Russian capital in Croatia can be found in the privatisation of *Željezara Split*, acquired in 2007 by the Polish *Zlomrex* despite a very competitive bid from the Russian *Mečelj*. After *Zlomrex* retreated, leaving the ironworks with new debt, in 2010 the Russian *Mečelj* again appeared as one of the leading bidders for this Croatian company[51] but the ironworks was eventually acquired by the German *Techcom GmbH*. According to the Russian Ambassador to Croatia, Robert Vartanovič Markarjan, "...many Russian companies are getting a very strong notion that they are not welcome in Croatia. You are familiar with the majestic project that planned to integrate the oil pipeline into *Družba Adria*. It was absolutely favourable for Croatia. Why did it fail? Because the Croatian side did not want to implement it."[52] Still, when it comes to Croatia's accession to the European Union, Ambassador Makarjan stated that "Russia considers this a normal thing. This is an integration process that we can peacefully observe."[53]

The *South Stream* is dead - long live the *Turkish Stream*!

Until recently, one of the most significant Russian energy projects in the region was the *South Stream* gas pipeline. Initially envisioned as the pipeline that will transport natural gas from Russia, across the Black Sea, Bulgaria, Serbia, Hungary, Austria and onwards into Europe, the project was suddenly halted in December 2014. The pipeline was a major channel for wielding Russian political power over the Western Balkans because it promised energy security, investment growth, employment and budget income from transit taxes. Governments in the Western Balkans were ready for serious compromises with Russia, as demonstrated by the sale of *NIS* below its market price but with a provision that Serbia will become a transit country for the *South Stream*. After official Moscow decided to put an end to this project, governments in the Western Balkans were faced with an unpleasant surprise.

There are several economic and geopolitical reasons behind the Russian decision to terminate this project: the Ukrainian crisis and Western sanctions, opposition from the European Commission and pressures on Bulgaria, and growing costs of pipeline construction. The official reason offered by the European Commission for opposing the *South Stream* was *Gazprom's* disrespect of the so-called *Third Energy Package* (TEP), a new set of European regulations concerning energy. The main provision in TEP stipulates the separation of companies' generation and sale operations from their transmission networks. With regard to the *South Stream* this implies that *Gazprom* cannot be the supplier of natural gas and the owner of the natural gas pipeline. In this context, the European Union put strong pressure on Bulgaria and demanded that as an EU member it should refuse construction of the *South Stream* pipeline in its territory, which it did in August 2014.[54] In the words of Alexei Miller, Director of *Gazprom*, the unofficial cause of termination of the *South Stream* was the West's intention to maintain the transit pipeline through Ukraine, thus maintaining the importance of this country and strengthening its negotiating position in the current crisis.[55] The geopolitical situation, in combination with sanctions and a major drop in value of the Russian ruble, contributed to already increasing cost of construction of the *South Stream*. Therefore the estimated cost, even before the devaluation of the ruble, went up by 45%

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50 Croatian National Bank, 2015.

51 Slobodna Dalmacija, 2010.

52 tportal.hr, 2012.

53 Ibid.

54 BBC, 2014.

55 Russia Beyond the Headlines, 2015.

in 2013.[56] According to an evaluation by the Oxford Institute for Energy Studies, the cost of construction of the *South Stream* amounted to USD 40 billion by 2014.[57]

Shortly after termination of the *South Stream,* Russian president Vladimir Putin announced in a meeting with Recep Tayyip Erdoğan, Turkish president, the construction of a natural gas pipeline called the *Turkish Stream*, of the same capacity, with an alternative route over Turkey and an interconnector at the Turkish-Greek border. At the same time, *Gazprom* purchased shares for the onshore portion of the *South Stream* from its previous European partners - *ENI, EDF* and *Wintershall* – for EUR 1 billion,[58] which made it the sole owner of the terminated project. It is assumed that this move was result of *Gazprom's* wish to maintain good relations with ENI, owner of the company *Saipem* which is licensed for installation of pipes in the Black Sea.[59]

If Russia and Turkey reach final agreement on the pipeline under the Black Sea (Russia actually prefers expansion of the existing *Blue Stream*, while Turkey prefers a route through the European part of Turkey), on European soil this pipeline would essentially follow the route planned for the *South Stream,* and just bypass Bulgaria. This fact becomes increasingly important in view of the meeting of the Foreign Affairs Ministers of Greece, Macedonia, Hungary and Serbia which took place in Budapest in early April 2015, to discuss potential for inclusion of these countries into the *Turkish Stream*.[60] Judging by the Russian intention to kick Ukraine out of the natural gas pipeline equation and intention of the Western Balkans countries to continue their cooperation with *Gazprom,* the *South Stream* could come back to life in an altered form. This potential development would greatly reinstate Russian political influence over the Western Balkans.

Russianisation of the Balkans as a great myth

At this time it is important to note that there are significant differences in Russian relations with its neighbours, such as Ukraine, Georgia, Poland, the Baltic states, etc. and relations with the Western Balkans. The former represent an immediate sphere of Russian interest, with much stronger political, historical and cultural ties. And for the latter it can be said that Balkans represents an extended sphere of Russian interest in which, although it desires a stronger political and economic presence, Russia is not intent on fully preventing European integrations. According to this interpretation, it pays for Russia to defend its interests in the European Union through an 'internal player', which it currently - other than the nominal support from Cyprus and sporadic support from Greece - does not have.

This can be seen in the statement made by Elmar Brock, German member of the European Parliament, which was cited in the document of the German Foreign Ministry titled *The Effect of Russia on Serbia*: "Putin's goal is to put such strong pressure on the Balkans countries that they either give up on EU membership or commit to strong pro-Russian policy as EU members."[61] Alexander Mirescu agrees with this '*Trojan horse'* in the EU theory, claiming that with a larger Russian presence in Serbia (and other countries of the Western Balkans) within the EU the benefits would be felt by both Russia and the European Union, as it would have a partner with access to and open doors in official Moscow.[62] Therefore, if we assume that the Russian approach to Western Balkans is truly based on the *Trojan horse* strategy, the EU itself could start to create larger obstacles for the region on its path towards Europe, in an effort to fully neutralise Russian influence.

However, it is completely clear that Russia does not have any particular interest in preventing the European perspective for the Balkans, in the same manner that the EU cannot, even if it wished to, fully

56 Pinchuk, 2013.

57 The Oxford Institute for Energy Studies, 2015., p. 2.

58 Gazprom website, 2014.

59 Gotev, 2015.

60 Gotev, 2015.

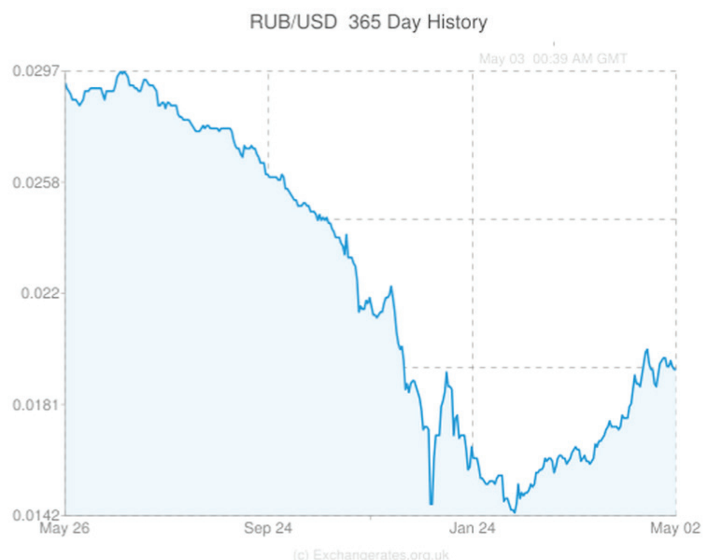
61 Politika, 2014.

62 Mirescu, 2014.

prevent Russian economic interests in the Balkans. Even if these interests grew larger than they are at present, they would still remain far below those held by Russia in Germany, Greece, Slovenia, Hungary, etc. Whether these interests imply a *russianisation of politics* in the Balkans countries is an entirely different matter. And what could the *russianisation of politics* mean? If it means that a country protects some Russian interests while protecting its own, then we should not wait for Balkans to join the EU. This is already so. Did not the Hungarian Government just arrange more favourable terms for Russian natural gas supply without consulting the European Commission? Or, say, the Greek Government which is currently under serious sanctions, which it openly opposes, negotiates financial aid from Russia, even with a mention of suspension of countersanctions on imports of Greek agricultural products into Russia. If on the other hand by *russianisation* we mean playing by Russian rules in the EU, then such a thing is not possible, nor would any Balkans country with clear pro-European objectives be willing to put that much at stake. And the big question remains: what would Russia gain from it? If we move away from this speculative 'what if" domain for a moment and base our conclusions on relevant facts, than it is completely clear that outside of the currently quite limited economic interest Russia would find it difficult to establish an antieuropean sentiment in the Balkans.

4. (In)sufficient to itself – diversifying the crisis

Since mid 2014 up until the moment of drafting of this analysis the Russian economy has been falling into increasingly difficult position. Double negative effects of the sanctions by the West and drop of the oil prices at international markets have resulted in a drop of the value of the Russian ruble, increase in inflation rate, decreased revenues in the Russian budget and created problems for Russian companies with loans in foreign currency. Such context raises several issues: has the combination of sanctions and drop in oil prices really been fatal for the Russian economy or its *Achilles' heel* stems from long-term lack of diversification; what are the chances for recovery of Russian economy and what consequences could current developments have on Russia's position in the Western Balkans?



Graph 3: Drop ruble value against USD– Source: exchangerates.org.uk

Chronology of sanctions by West: [63]

17 March 2014 – Following annexation of Crimea EU member states, US, Canada, Australia and Japan have introduced ban on travel for certain Russian and Kremlin officials.

April 2014 – EU sanctions were joined by Albania, Montenegro, Island and Ukraine; US have banned 17 Russian companies from working on its territory; EU has banned entry for additional 15 Russian officials.

17 July 2014 - US have limited access to long term financing (maturity over 3 months) for Russian companies *Rosnjeft, Novatek* and two banks *Gazprombank* and *Vnesheconombank*.

24 and 25 July 2014 - Canada has extended sanctions to Russian companies in military industry, energy and finance sectors; EU has extended sanctions to additional 18 companies and 15 officials.

29 July 2014 - US have limited access to long term financing to *Bank of Moscow* and *Rosselkhozbank*.

30 and 31 July 2014 - EU has extended sanctions to entire finance sector in Russia, and additional 8 Russian companies; trade sanctions introduced for companies from energy and military sector.

5 August 2014 - Japan freezes assets belonging to certain Russian officials; EBRD and EIB freeze funds for new projects in Russia.

12 and 14 August 2014 – Norway has joined the EU sanctions; Switzerland has expanded its sanctions and introduced a rule whereby *Sberbank, VTB, Vnesheconombank, Gazprombank* and *Rosselkhoz* must obtain approval prior to issuing long-term financial instruments in Switzerland.

12 September 2014 - US have boosted sanctions and expanded them to include *Sberbank, Rostech, Gazprom, Gazpromnjeft, Lukoil, Surgutnjeftegaz* and *Rosnjeft*. In addition, it suspended transfer of technologies required for in-depth exploration of natural gas sites and *shale gas*; limited access for *Sberbank* and *Rostec* to US debt market.

24 September 2014 - Japan banned issuing bonds for *Sberbank, VTB, Gazprombank, Rosselkhozbank* and *Vnesheconombank* and boosts sanctions for Russian exports of military equipment.

18 and 19 December 2014 - EU and US have introduced sanctions on investments and trade with Crimea.

27 January 2015 – New Greek Government does agree after all to extension of EU sanctions.

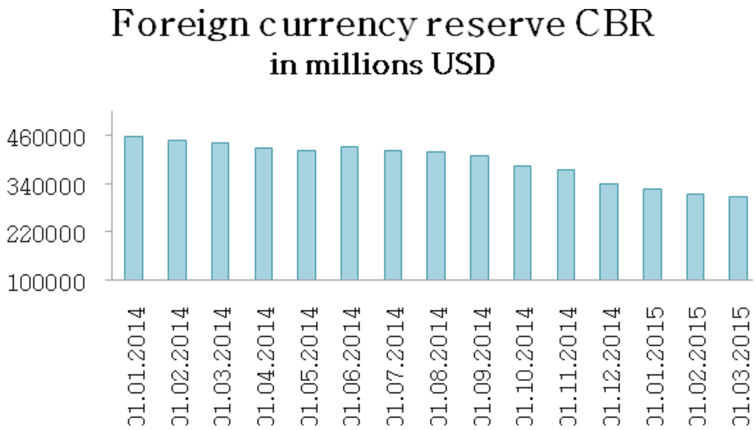
16 and 18 February 2015 - EU and Canada expand list of persons and companies under sanctions.

Sanctions introduced by West have had the largest negative effects on the Russian companies doing business abroad. Namely, due to low interest rates and expansion of the US and EU monetary policy Russian companies have been increasingly borrowing in USD and EUR. Thus corporate borrowing over the last 10 years has increased from USD 100 to 660 billion. According to *Sberbank* analysts, Russian companies have over USD 106 billion debt to pay in 2015. Since US and EU banned long term borrowing of Russian companies at their financial markets, the transfer and payment of debt has become increasingly problematic.

However, Russian foreign currency reserve, which in March 2014 amounted to USD 494 billion, are despite the drop still rather high and in April 2015 amounted to USD 353.5 billion.64 This enabled the Central Bank of Russia (CBR) to extend assistance to those companies affected by the sanctions. Thus, Russian foreign debt (consisting in 90% of corporate debt) in 2014 has dropped from USD 728.2 to 599.5

63 Vercueil, 2014, p. 20.

64 Central Bank of Russia, 2015.



Graph 4: Source – Central Bank of Russia

billion.[65] This means that Russian companies, with assistance of the CBR have been paying instalments of the foreign debt and so far managing to maintain their liquidity. This strategy is supported by analysts' assessments that some 40-50% of the external corporate debt of the Russian companies actually is to other Russian actors engaged in *offshore* business, i.e. "recycling" of Russian capital.[66] However, despite large amount of foreign currency reserve and assistance by CBR, the question emerges for how long such strategy will withstand should enforcement of the sanctions continue. The US and EU have also introduced sanctions to transfer of technologies required for exploration of oil and natural gas, which the Russian companies need to continue long term research and ultimately maintain the required level or production. Based on the provisional effects of the sanctions, one could conclude that Russian economy is doomed, however the companies are currently holding surprisingly well. Despite this, it is very likely that EU member states will not be able to reach consensus regarding extension of the sanctions at the EU Council meeting in mid 2015, because some of the countries, such as Greece, Hungary, Austria and Bulgaria, have already expressed dissatisfaction due to sanctions which they called contra productive.

In second half of 2014, condition of the Russian economy got additionally complicated due to sudden drop in price of oil. Over the period of only half year a price of the barrel of crude oil fell for a record 57.3%, and in January 2015 amounted to USD 47.7.[67] Since export of oil makes up some 70% of overall Russian exports and over 50% of its budget revenues come from that source,[68] the decreasing prices have had two effects: sharp devaluation of the ruble against dollar and euro, as well as the drop in budget revenues.

After foreign capital started leaving Russia due to sanctions and drop in oil prices, 40% decrease of the value of ruble against dollar (see *Graph 4* above) caused serious problems in Russian economy. The above mentioned dollar denominated debts of Russian companies nominally increased, and the inflation rate in March 2015 amounted to 16.7%.[69] Such developments are very dangerous for internal political position of Russian establishment since galloping inflation and increase in price of basic provisions could catalyse dissatisfaction of citizens. According to IMF, Russian GDP in 2015 should decrease by 3%, while in 2016 1% drop is forecasted.[70] However, according to latest public opinion polls, Vladimir Putin popularity has not been decreasing[71] despite bad economic indicators.

65 Kuznetsov, 2015.

66 Reuters, 2015.

67 US Energy Information Administration, 2015.

68 US Energy Information Administration, 2014.

69 Central Bank of Russia, 2015.

70 IMF, 2015.

71 Gallup Polls, 2014.

In an attempt to slow down the drop of ruble, CBR suddenly increased reference interest rate in December 2014 from 10.5% to 17%.[72] This additionally worsened the position of Russian companies because at that time in addition to foreign servicing costs for local loans also increased. However, since the beginning of 2015 ruble managed to partially recover, so that CBR gradually decreased interest rate so that at the end of April 2015 it amounted to 12.5%.[73] The value of ruble at the beginning of 2015 was gradually going back to the level from November 2014. This allowed CBR to decrease spending of foreign currency reserves, while foreign investors again became interested in Russian bonds. Economic situation in Russia at the moment is much worse than before the crisis broke out in Ukraine, but the power of sanctions and low oil prices should not be overestimated. The crisis of even greater proportions hit Russia in 1998 and 2009, but its economy recovered even then, due to the period in which fossil fuels had very high price. However, if the sanctions and low oil prices continue, the effects on Russian economy could become critical, so that situation over the next period will depend greatly on developments in Ukraine. *Table 3* in the Annex shows potential effects of the three scenarios for developments in 2015 – de-escalation, *status quo* and conflict spreading.[74]

In which way the described economic situation reflects on the Russian position and future in the Western Balkans? Economic position of Russia depends on the developments in Ukraine. If the conflict continues with current or increased intensity, one may expect that Russian companies will get into increasingly difficult financial problems and will be forced to limit their investments and operations aboard. This in particular refers to banking and energy sectors. Thus, one might expect an increase in expatriating profit of Russian companies and discontinuing investments into expansion of existing capacities. In short term, CBR might continue injecting liquidity and thus sustain current operations of the Russian companies. However, in the long term this strategy is not sustainable and may undermine Russian political influence and direct Russian capital towards cooperation with Asian countries.

Politically motivated investments of the Russian state companies, in all likelihood will be reduced while the existing ones will most likely be optimised. Russian banks are currently too busy with their own problems in access to international markets, indicating their weaker role in providing loans and financial assistance to other states. However, if the *Trojan horse* theory is accurate, Russian investment in Western Balkans could get strategic assistance from the state to overcome the crisis and maintain Russia's relevance in the region.

For as long as the value of ruble is decreasing, Russia will continue to limit its imports. This should not have greater impact on GDP in the Western Balkans states, due to the smaller volume of the exports to Russia (see *Table 1*). Non-energy exports of Russia (e.g. cars) will become more competitive in foreign markets. Counter sanctions introduced by Russia against agriculture products from EU have to some extent helped Russian domestic production, but also contributed to increased inflation rate. It is also important to stress that despite an increase in military budget, Russian possibilities for new military interventions such as the one in Ukraine are becoming increasingly limited.

In case that in the near future a solution is found for the crisis in Ukraine, Russian companies could quickly go back to the previous level of business. Current financial crisis in Russia did not strike a fatal blow to the Russian economy and signs of recovery are already appearing. In this context it is possible that Russia will choose to have more aggressive economic engagement in Western Balkans, which in future might lead to collision with the EU in this area as well. Although it is obvious that the EU has been trying to use current situation in Russia and its focus on economic problems and crisis in Ukraine to consolidate its influence in the Western Balkans, it is questionable to which extent it has been efficient.

72 Financial Times, 2014.

73 Central Bank of Russia, 2015.

74 Adapted fromVercueil, 2014.

5. Geopolitics based on interests

Based on the presented arguments, in this section certain conclusions will be presented regarding Russian position in the Western Balkans and its current economic situation:

- Russian influence in the region is not monolithic and it differs from one state to the other. In economic and political terms it is stronger in Serbia, while Montenegro for some time already has been distancing itself from Russia. Croatia has had a long standing distancing attitude towards penetration of Russian capital. Although Slovenia in its was not included in this analysis, it is interesting to note that unlike Croatia, Slovenian economy has been in a significant way turned towards Russia, acknowledging of course great asymmetry in their economic potentials.
- There is significant disproportion between the influence of Russia and the EU. For example, the trade ratio among the six Western Balkans countries and Russia is at an average 13 times smaller than trade volume with the EU (4.9% against 66.2% of the overall trade volume).
- Russian investments in BiH are very fragile and still not profitable for the state. As the moment, business operations of Russian companies are not transparent and they are focused on short term gains. It is questionable whether such business operations can project any political influence.
- Russian political influence in BiH is present through Peace Implementation Council (PIC) and UN Security Council (SB), but its wider significance is questionable.
- Russia's relations with Western Balkans states are different from its relations to Ukraine, Georgia and the Baltic states. In that context, it is very likely that Russia will not try to fully prevent EU integration of the Western Balkans states, since long term it is a better option for Russia to have a *Trojan horse* in the EU. To achieve this, Russia needs to strengthen and consolidate its current presence in the region.
- For the Western Balkans this represents both danger and opportunity – on one hand there is the possibility of having benefits from cooperating with both sides, and on the other there is the danger of the Balkans getting the worst of such situation.
- Current economic crisis in Russia has greatly limited Russia's economic reach, primarily due to sanctions by the Wes and decreasing value of ruble. However, the ability of Russia to overcome the crisis should not be underestimated. Over the short term Russia might have fewer investments aboard and limit its current operations. Due to decreased value of ruble, Russia also limited its imports.
- If the solution for crisis in Ukraine is found soon, Russian companies could recover relatively quickly to the previous level of activity. However, even in case that Russian economy recovers, its long standing lack of diversification and dependence on oil exports will have negative effect.
- At the time when Russia is preoccupied with economic crisis and conflict in Ukraine, EU has been trying to consolidate its influence in Western Balkans. The question is how efficient it has been and what are its reasons for doing it? If only to prevent Russian or some other non-EU influence, such policy is equally wrong as any other aimed at geostrategic outsmarting.

6. Annex

Table 3 [75]

	De-escalation	*Status quo*	*Conflict spreading*
Impact of three different scenarios on development of relations between Russia and the West in 2015 (certain economic indicators)	1. **Citizen consumption**: growth +2% to +7% 2. **Budget**: +5%, revenues stagnation 3. **Ruble exchange rate**: recovery +15% 4. **Interest rate**: return to state prior to crisis 5.5% 5. **Investment**: stagnation 0% 6. **Import**: state prior to crisis +4%; **Export**: 0% 7. **Inflation**: level from 2013 cca. +8%	1. **Citizen consumption**: decrease of -2% 2. **Budget**: strong consumption increase +15% to +20%, decrease in revenues -10% 3. **Ruble exchange rate**: 2014 trend continued, drop of -10% to -20% 4. **Interest rate**: continued pressure on CBR 8% to 9% 5. **Investment**: drop -5% 6. **Import**: decrease of -10% to -15% due to drop in ruble value and sanctions; **Export**: decrease of -5% 7. **Inflation**: due to drop in ruble value increase of +8% to +10%	1. **Citizen consumption**: decrease of -10% 2. **Budget**: stimulus of +20 to +30%, drop in revenues of -20% to -30% 3. **Ruble exchange rate**: sudden drop due to capital leaving and drop in FDI -20% to -30% 4. **Interest rate**: 10%-15% increase and convertibility restrictions 5. **Investment**: drop -20% 6. **Import**: decrease of -20% to -30% due to drop in ruble value and sanctions ; **Export**: decrease of -20% 7. **Inflation**: increase despite price control +20% to +25%

75 Adapted fromVercueil, 2014.

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